Tax Management International Forum

Comparative Tax Law for the International Practitioner

Income Tax Consequences for Foreign Service Providers

In this issue of the International Forum, leading experts from 18 countries and the European Union provide their perspectives on the income tax consequences faced by foreign service providers that have no permanent establishment in a country but are providing services to its residents. The issue addresses services that may be provided by an individual (other than in the capacity of an employee) as well as services that may be provided by an enterprise, such as technical support.

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Pascal Faes
NautaDutilh, Brussels

Income Tax Consequences for Foreign Service Providers

Topic

What are the income tax consequences in your country for foreign service providers with no establishment in your country providing services in your country/to your country's residents? (This includes providers of both personal services and other services that might be provided by an enterprise, such as technical support, but does not include services provided in the capacity of an employee.)

Questions

I. Under your country's domestic law what is the threshold of activity (either in terms of length of time, size of project, or otherwise) at which your country considers a nonresident service provider to be fully taxable and requires a tax return to be submitted? Does the threshold, or do other requirements of filing, differ depending on (i) the nature of the services provided; (ii) the nature of the service provider; (iii) length of time the services are provided; or (iv) whether the services are provided in your country or elsewhere?

II. How does your country protect itself to guarantee that a required return or filing would be made, and tax be paid? Does the country require withholding as an advance payment of tax, does it require actual advance payments, or does it have another requirement? What is the rate of withholding if required? Is this a different rate from the rate at which withholding would be required if the nonresident service provider were below the full taxability threshold? If the amount withheld equals the liability, is a return excused? On the other hand, if the withholding either exceeds or is less than the required tax, what is the service provider's obligation (or opportunity) to equalize the amount paid and the amount withheld?

III. Until the threshold that you described above in I. is reached, how are services performed within your country taxed—by way of a final withholding tax or otherwise? What are the rates of tax involved? If tax is imposed by way of final withholding, is this imposed on the gross amount or is the gross amount somehow reduced to take account of expenses incurred by the service provider? In particular, if a service provider is reimbursed for expenses, is that reimbursement considered to be part of the "gross amount" of the services fee?

IV. Please describe any relevant mechanics relating to the procedure or procedures identified in III. (for example, what is the withholding obligation of service recipients; what is the liability of service recipients that do not withhold if they are required to; is there a requirement to appoint a tax agent; if what would be the final liability should be less than amounts withheld, is there a method of claiming a refund; on the other hand, if the amount withheld is deficient, what is the foreign service provider's obligation).

V. Please indicate what would be the position if, instead of providing the services directly, the foreign service provider subcontracts the provision of services in your country. In particular, would the engagement of a subcontractor automatically be

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considered to represent a presence of the foreign service provider in your country? If not what would distinguish the circumstances in which such a presence would be created from those in which it would not?

VI. Are there any exceptions – for example, higher tax, lower tax, exemptions, etc.—to the general system described above, for example, for foreign service providers located in particular jurisdictions (e.g., tax havens, territories like the EU/EEA), or for provision of services in certain locations?

VII. What other, non-tax requirements need to be met by foreign service providers supplying services in your country in these circumstances (e.g., business registration requirements; visas authorizing employment or general work; bank accounts; etc.). Do government agencies responsible for those areas coordinate with your country's tax authority to ensure both proper compliance and proper tax reporting based on those factors?

VIII. How are the positions under I. and III. altered by your country's tax treaties? In particular, if the treaty concerned does not allow source country taxation of the services income concerned, may payments be made without deduction of tax? If not what procedures must be followed to obtain a treaty-based refund? (Provisions dealing with specific services such as directors' services and those performed by artists and athletes/performers can be ignored, as can the circumstances in which a treaty provides a specific formula for determining the taxation threshold —- for example, a monetary threshold).

ARGENTINA

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Under Argentine tax law, a foreign service provider with no permanent establishment ("PE") in Argentina is taxed on the amount of the Argentine-source compensation received for the provision of the services. Argentina imposes income tax on all nonresidents deriving income from Argentine sources, whether or not they have a PE in Argentina. The tax is collected by means of withholding at source by the Argentine person, whether an entity or an individual, paying for the services. The withholding tax is imposed at the rate of 35% on the percentage of the gross payments that the Income Tax Law presumes to be net income, thus resulting in different effective withholding rates depending on the nature of the services provided.

If the services are provided in Argentina, the compensation for the services is considered to be from Argentine sources and is therefore subject to Argentine tax. Conversely, since the general rule is that the source of services income is the place where the services are performed, if the services are provided outside Argentina the compensation for the services will not be subject to Argentine tax. There are, however, some exceptions to the general rule. The main exceptions concern income from services in the form of technical, financial or other types of advice provided from abroad, and fees paid to members of boards of directors of entities organized under Argentine law for services provided abroad, both of which are subject to Argentine tax.

The Argentine Income Tax Law also contains a set of rules dealing with income that is derived partly in and partly outside Argentine. These rules apply to international transportation, international news agencies and producers and distributors of foreign media for the broadcasting, transmission and reproduction of images and sound. In these cases, the law deems a specified percentage of the income to be from Argentine sources and subject to taxation in Argentina.

There is, thus, no specific threshold in terms of length of time, size of project or any other factor at which a foreign service provider becomes taxable in Argentina. If the income from the services is considered to derive from Argentine sources, either because the services are performed in Argentina or because the services, though provided abroad, fall within one of the exceptions outlined above, Argentine tax will be imposed by means of withholding at source. In these circumstances, the service provider will not be subject to any Argentine filing requirements.

A service provider that has a PE in Argentina is required to register for tax purposes, as well as being required to file income tax, value added tax ("VAT") and other federal and local tax returns. The existence of a PE is not necessarily linked to any specific duration or volume of business. The typical PE would be constituted by the Argentine branch of a company that does business in Argentina on a regular and habitual basis.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As explained in I., above, tax on Argentine-source income derived by a nonresident service provider is imposed by way of withholding and no filing requirements apply if the service provider is not carrying on business in Argentina through an Argentine PE.

Where a nonresident company sets up a PE in Argentina, Argentine corporate law requires registration with the Public Registry of Commerce, the appointment of a representative and the establishment of a domicile. In such circumstances, registration with the tax authorities and the filing of tax returns is also required. A PE of a nonresident company is subject to the same requirements as a resident corporate taxpayer regarding registration, filing and the payment of taxes. If a foreign company fails to comply with these requirements, the amount of compensation derived by it will continue to be subject to withholding at source, which is the main method provided by Argentine law for ensuring the payment of tax. In addition, stiff penalties may apply to companies that fail to meet their registration and filing obligations, and to their managers or directors.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Withholding at source applies to that percentage of the gross compensation received by a nonresident beneficiary that Article 93 of the Income Tax Law deems to represent net income. No deduction is there-

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fore allowed for actual expenses incurred. The percentage varies depending on the nature of the income and results in the following effective rates with respect to various kinds of payments for services:

- Payments for technical assistance, and engineering and consulting services, that are not available in the local market: 21%;
- Payments for transfers of rights and licenses for the exploitation of patents, and other royalty payments: 28%;
- Copyright royalties: 12.25%;
- Fees and salaries paid to foreign personnel working in Argentina for a period of no more than six months: 24.5%;
- Lease payments other than real estate lease payments: 14%;
- Real estate lease payments: 21%; and
- Other items of income not specifically provided for: 31.5%.

The effective rate may be higher if the service provider and the service recipient agree to gross up the amount of the withholding tax.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

An Argentine payer of Argentine-source income to a nonresident is required to act as a withholding agent. An Argentine payer that fails to withhold the tax due is personally liable to the tax authorities for payment of the tax. In practice, the tax authorities never seek to recover the withholding tax from the nonresident recipient; instead they invariably resort to the withholding agent. The withholding agent may also be subject to fines of up to four times the amount of the tax not withheld, as well as being liable for late payment interest.

A more serious offense than failure to withhold is failure to remit tax that has been withheld to the tax authorities. Where this occurs, in addition to being liable for payment of the withholding tax and late payment interest, the withholding agent be subject to fines of up to 10 times the amount of the tax due, and possible criminal prosecution carrying a maximum prison sentence of six years.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The engagement of a subcontractor by a nonresident service provider does not create an Argentine PE of the service provider, provided the subcontractor acts in the regular course of its business, is independent of the service provider and acts in its own name. On the other hand, if the subcontractor is considered to be a dependent agent of the service provider, a PE may be deemed to arise.

VI. Exceptions to the General System

There are no exceptions to the general system provided for under Argentine domestic law, but reduced rates may apply to certain kinds of income under Argentina's tax treaties. Also, under the Business Profits Article of Argentina's treaties, income from most services performed outside Argentina by a resident of the other Contracting State will be taxable only in that other State, i.e., the, the country of residence of the service provider. The Permanent Establishment Article of Argentina's treaties may also have an impact in certain cases, for example, where it requires activities to be performed in Argentina over a minimum period of time for a PE to arise in Argentina. (See further at VIII., below.)

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

A foreign business entity doing business in Argentina on a regular basis is required to register its by-laws and articles of incorporation with the Public Registry of Commerce. Such an entity must also appoint a legal representative and specify a domicile within Argentina, where all notices relating to the entity's activities in Argentina will be valid.

Foreign aliens working in Argentina must obtain temporary or permanent working visas.

Since payments in excess of certain specified amounts must be made via the banking system, most individuals and companies working/operating in Argentina will need to have Argentine bank accounts.

VIII. Difference If There Is an Applicable Tax Treaty Between Argentina and the Foreign Service Provider's Country of Residence

Most of Argentina's tax treaties generally do not permit Argentina to tax services income derived by residents of the treaty partner country.

However, none of Argentina's treaties follow the OECD Model Convention with respect to the taxation of royalties, but instead allow both countries to tax royalties, while limiting the maximum tax rate applicable in the source country to between 3% and 18% of the gross amount of the royalties, depending on the applicable treaty. Argentina's treaties also provide that in order for Argentina to grant the benefit of the reduced source country tax rates for royalties, the relevant contracts must comply with the requirements of Argentine law regarding registration, verification and authorization[1] or with the requirement that prior approval[2] must be obtained from the appropriate authorities in the case of services covered by the Transfer of Technology Law. There are some differences between the definitions of royalties in the various treaties. Generally, all Argentina's treaties adopt the definition found in the OECD Model, but also include other items within the definition of royalties. For example, plays recorded for radio and television are considered to give rise to royalties under all Argentina's treaties. On the other hand, only some treaties expressly include consideration for technical assistance, the use of, or the granting of the right to use, news, software and the use of any kind of intangible asset within the definition of royalties.

Argentina's tax treaties also contain special rules regarding the following services:

Professional services: taxable only in the country of residence, unless the individual providing the services

has a fixed base in the source country for purposes of performing the services;

Employment services: taxable in the country in which the employment is performed;

Director's services: taxable in both the director's country of residence and in the country of residence of the entity of which the individual is a director; and

Services of artists and sportspersons: taxable in the country of residence of the artist/sportsperson and in the country in which the performance takes place.

With respect to the definition of a PE, the main respect in which Argentina's tax treaties deviate from Argentine domestic law is that the treaties may specify a period of time for which certain activities must be carried on in order to constitute a PE of a resident of one of the Contracting States in the other Contracting State. Normally, Argentina's treaties specify a period of more than six months in connection with civil works or construction, installation or assembly projects.[3]

It is also usual for Argentina's tax treaties to expand the PE definition to include the provision of consulting or managerial services by a company through its own personnel, provided such activities last for more than 180 days or 12 months, depending on the treaty concerned, and supervisory activities in connection with construction or installation or assembly projects where such activities last for more than six months.[4]

NOTES

[1] See the Argentina-Australia, -Belgium, -Canada, -Denmark, -Finland, -Norway, -Russia, -Sweden and -United Kingdom tax treaties.

[2] See the Argentina-France, -Germany and -Italy tax treaties.

[3] All Argentina's in effect tax treaties, with the exception of the Argentina-Bolivia tax treaty, specify such a period. The period specified in the Argentina-Italy tax treaty is nine months.

[4] See the Argentina-Australia, -Belgium, -Canada, -Denmark, -Finland, -Netherlands, -Norway, -Russia, -Spain and -United Kingdom tax treaties.

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BELGIUM

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

A nonresident service provider providing services in Belgium is, in principle, only taxable in Belgium, and only obliged to file an annual Belgian nonresident income tax return, with respect to income attributable to a Belgian establishment ("BE")[2] through which the service provider provides such services.[3] Belgian domestic tax law, thus, relies on the BE concept for purposes of the taxation in Belgium of foreign companies.

The BE concept only applies if Belgium has the right to tax the nonresident concerned under an applicable tax treaty or if there is no applicable treaty. Although similar to the treaty concept of a permanent establishment ("PE"), the BE concept differs in significant respects from the PE concept.[4] Any presence that qualifies as a PE under the OECD Model Convention will, in principle, constitute a BE, but the converse is not necessarily true. Specifically, the domestic law definition extends the personal BE concept to a representative other than an independent intermediary acting in the ordinary course of business, even if the representative does not have the authority to conclude contracts in the name of a nonresident.[5] The definition of a BE under Belgian tax law also encompasses a service establishment.[6] When a foreign enterprise performs services in Belgium for the same or connected projects through one or more individuals who are present in Belgium and perform services over a period or periods exceeding 30 days within a period of 12 months, the activities carried on in Belgium in performing the services constitute a BE.[7] Thus, Belgium may tax the income of such a service BE if the relevant tax treaty contains a service PE provision[8] or if no tax treaty applies.

A number of commentators[9] and the Belgian tax administration itself[10] are of the opinion that the distinct definitions of BE/PE in, respectively, Belgian domestic tax law and Belgium's tax treaties permit the conclusion that a treaty-exempt establishment or an establishment that does not meet the general conditions for constituting a taxable PE under treaty law, although enjoying treaty protection, may still qualify as a BE and thus be subject to tax obligations in Belgium, such as the obligation to file tax returns[11] or the obligation to respond to a request for information from the tax authorities.[12]

In a limited number of cases, income derived by nonresidents is taxable in Belgium even though the income was not derived with the intervention of a BE. The types of income targeted are as follows:

- Profits derived from activities carried on in Belgium by foreign insurance companies (excluding reinsurance activities);[13]
- Profits derived from the carrying on of the activities of directors or liquidators or from the performance of similar functions in a Belgian company;[14]
- Income from independent professional services performed in Belgium by nonresident individuals ("independent professionals" include lawyers, doctors, architects and auditors);[15]
- Income from services performed by nonresident artists and sportsmen if the services relate to a performance made personally in Belgium in the capacity of an artist or athlete;[16]

Income derived by partners in certain entities not subject to corporate income tax (for example, economic interest groupings and companies not properly incorporated), whether or not connected with an establishment in Belgium;[17] and

Income obtained in Belgium, outside the context of any professional activity, for services rendered to third parties—such income is taxable as miscellaneous income and it is not required that the services concerned be performed in Belgium.[18]

In addition, article 228, § 3 of the ITC,[19] contains a "safety-net" provision[20] that subjects nonresidents to Belgian nonresident tax with respect to profits or income in consideration of independent professional services[21] where the services are provided to: (1) a Belgian tax resident individual acting in the context of his or her professional independent activity; (2) a taxpayer subject to Belgian corporate taxation; (3) a legal entity as defined in article 220 of the ITC; or (4) a BE of a nonresident with which the service provider has a direct or indirect link of interdependence. However, taxation will only apply to the extent that either an applicable tax treaty grants Belgium taxing rights with respect to such income,[22] or, in the absence of a treaty, the service provider does not provide evidence to show that the income is effectively taxed in his/her state of residence.[23]

Nonresident service providers are required to file nonresident tax returns in Belgium, as follows:

- Nonresident individuals must file tax returns on a yearly basis and are subject to global assessment with respect to the following types of income:[24]
  - Profits from an industrial, commercial or agricultural activity realized through a BE;
  - Income derived by partners in certain entities not subject to corporate income tax (for example, economic interest groupings and companies not properly incorporated), whether or connected with an establishment in Belgium;[25]
  - Income from independent professional activities (including the activities of lawyers, doctors, architects and auditors); and
  - Income remunerating the activities of athletes carried on in Belgium for more than 30 days, calculated per period of 12 consecutive months and per debtor.

Nonresident companies must file tax returns on a yearly basis and are subject to global assessment with respect to the following types of income:[27]

- Profits realized through the intervention of a BE; and
- Income derived by partners of certain entities not subject to corporate income tax (for example, economic interest groupings and companies not properly incorporated), whether or not connected with an establishment in Belgium.[28]

Income with respect to which the filing of a tax return is not compulsory is not subject to global assessment for purposes of nonresident income tax; the income tax owed with respect to such income is deemed to correspond to the professional withholding taxes imposed, if any (see III., below).[29]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

If a nonresident individual or company that is required to file a nonresident income tax return fails to file such a return (within the time frame prescribed by law), or files an incomplete or incorrect return, the tax authorities may impose a tax surcharge ranging from 10% to 200% of the non-reported income, depending on the nature and the seriousness of the infringement committed by the taxpayer.[30] Administrative fines ranging in amount from 50 euros to 1,250 euros may be imposed for each violation of the provisions of the ITC or implementing legislation.[31] In addition, late payment interest is imposed at a rate of 7% per annum.[32]

If no tax return is filed (within the time frame prescribed by law), it is possible that an *ex officio* assessment will be made,[33] in which case tax is levied on a presumed amount of income, based on the available information. The burden of proof with respect to the accuracy of the presumed income amount lies with the taxpayer.

The Belgian tax authorities make use of specific means of evidence to determine the existence of a tax liability and the amount of taxes owed. In the absence of conclusive elements supplied by the nonresident, a minimum lump-sum taxation may be imposed.[34]

Self-employed persons[35] (with respect to profits and income from the liberal professions) and corporations[36] must make advance tax payments during the taxable year corresponding to their estimated tax liability for that year. The income tax is increased if no or insufficient advance tax payments are made. Any excess over the tax due may be refunded.

For the situations in which a professional withholding tax is imposed, see III., below.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

The following kinds of income attributed to a nonresident service provider are subject to Belgian withholding tax:

- Profits derived from activities carried on in Belgium by a foreign insurance company (excluding reinsurance activities):[37]subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, professional withholding tax must be withheld at a rate of 3.40% of the gross amount of the insurance premiums collected.
- Profits derived from the carrying on of the activity of a director or liquidator or from the performance of similar functions in a Belgian company:[38] subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, professional withholding tax must be withheld at a rate of 32.29% of the gross amount of the profits.
- Income from the performance of independent professional services in Belgium by a nonresident individual (such as a lawyer, doctor, architect or auditor):[39] subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, professional withholding tax must be withheld by a person that, within the scope of its business activity or of its corporate, statutory or conventional purpose, attributes or pays, occasionally or otherwise, income relating to independent professional services to a nonresident individual. The rate of withholding tax is 27.25% for fees up to 500 euros, 32.30 % for fees of between 500.01 euros and 650 euros and 37.35 % for fees in excess of 650 euros.
- Income from services performed by a nonresident artist or sportsperson relating to performances personally made in Belgium in the capacity of an artist or athlete:[40] subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, the debtor with respect to the income, or the debtor's representative or intermediary or, in default of any of these, the organizer of the event, must withhold the professional withholding tax. The withholding tax rate for income derived by an artist is 18% of the gross amount less a limited lump-sum cost deduction;[41] for income derived by a sportsperson, there are specific rates that vary depending on the age of the sportsperson concerned, the amount of income and the length of the sportsperson's stay in Belgium.[42]
- Income derived in Belgium, outside the context of any professional activity, from services rendered to third parties, which is taxable as miscellaneous income:[43] subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, professional withholding tax must be withheld at the rate of 30.28% of the gross amount of the income.

- Income falling within the "safety-net" provision: subject to exemptions provided for by Belgian domestic law or an applicable tax treaty, professional withholding tax[44] must be withheld at the rate of 33% to be withheld by the debtor from the gross income after allowing a lump sum deduction of 50%. In principle, in these circumstances, the withholding tax constitutes a final tax.

In principle, withholding tax is imposed on a gross amount, reduced in specific cases by a lump sum deduction for expenses. The withholding tax constitutes a final tax[45] unless the beneficiary of the income is required[46] or opts[47] to file a nonresident income tax return, in which case the withholding tax can be credited against the tax owed.[48] Any excess amounting to 2.50 euros or more may be refunded.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

In principle, the professional withholding tax must be withheld by the debtor with respect to the income and must be paid to the tax authorities within 15 days from the end of the month in which the income was paid or attributed.[49] The debtor is liable for any failure to pay the proper amount (within the time frame prescribed by law). In addition, where the debtor is a company, directors of the debtor may be held liable for any non-payment of the professional withholding tax that is due to their fault in relation to the management and administration of the debtor.[50]

In cases of non-compliance with the withholding procedures, the tax authorities may impose a tax surcharge ranging from 10% to 200% of the non-reported income, depending on the nature and seriousness of the infringement committed by the taxpayer.[51] Administrative fines ranging in amount from 50 euros to 1,250 euros may be imposed for each violation of the provisions of the ITC or implementing legislation.[52] Unpaid withholding taxes or late payments are subject to late payment interest at the rate of 7% per annum.

The ITC provides for separate reporting requirements for certain types of payments that constitute expenses of the payer.[53]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

If a foreign service provider subcontracts the provision of the services to an independent Belgian service provider, in principle, no fixed place BE would be deemed to exist in the absence of any intervention on the part of the foreign service provider.

As regards the existence of an agency BE, the Belgian tax authorities are, in principle, of the opinion that an independent intermediary acting on behalf of a nonresident enterprise, i.e., an intermediary that acts in its own name and at its own risk, without interference or intervention on the part of the nonresident enterprise, and in the ordinary course of its business, does not constitute an agency BE of the nonresident enterprise.[54]

VI. Exceptions to the General System

If the service provider is a resident of a tax haven, Belgian income tax provisions may have an impact on the tax deductibility of the service fee payment at the level of the service recipient.

Under article 54 of the ITC, a payment made to an entity that either is not subject to tax or is subject to a tax regime that is significantly more advantageous than the Belgian regime is not tax deductible for the Belgian taxpayer making the payment unless the taxpayer demonstrates that the payment is in consideration for an actual, genuine transaction and the payment is at arm's length (reversal of burden of proof).[55]

Articles 198 (10) and 307 of the ITC[56] provide for a reporting requirement where payments exceeding 100,00 euros per year are made by a Belgian taxpayer to an entity located in a tax haven, or to a PE or a bank account in a tax haven.[57] The reporting must be made on a special form attached to the income tax return. In the event of non-reporting, the payments will be treated as disallowed expenses for income tax purposes. Where the payments have been duly and timely reported, the taxpayer making them must still prove that they were made in consideration for actual, genuine transactions with persons other than wholly artificial arrangements for the payments to be deductible.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

A. Visas

Nationals of EU Member States may enter Belgium with either identity cards or passports. The same rule applies to nationals of various non-EU countries such as Australia, Brazil, Canada and the United-States.[58] Other foreigners intending to stay in Belgium for up to a maximum of three months must hold Schengen[59] short-term visas. Foreigners, other than EU nationals, intending to stay in Belgium for more than three months must obtain long-term visas (visa D). Foreigners staying for more than three months must choose a place of domicile in Belgium and will be registered in the register of foreigners of the municipality of their place of residence.

B. Crossroad Bank for Enterprises

An independent worker staying in Belgium for more than three months must register with the Crossroad Bank (equivalent to the former Commercial Registry). Registration is compulsory for every person who exercises an economic, professional activity in Belgium habitually or as a complementary activity.[60]

C. Professional Card

A foreign service provider who is not an EU/EEA or a Swiss national must obtain a professional card to engage in a professional activity in Belgium.[61] Such a person may benefit from an exemption from this requirement, for instance, if the person is on business travel for a maximum of three consecutive months to visit professional partners, develop contacts, negotiate contracts, or attend exhibitions or corporate meet-

ings. An application for a professional card must be filed with a Belgian Embassy or Consulate.

An application for a residence permit must be made either before or at the same time as the professional card is applied for.

D. Limosa Return

A service provider (whether an EU or a non-EU resident) will also have to file electronically a LIMOSA declaration unless he/she is exempted from this requirement, for instance because he/she: (1) attends meetings in a closed circle in Belgium over a maximum period of 60 days per year and subject to a maximum of 20 consecutive calendar days per meeting; (2) attends a scientific congress in Belgium; (3) stays on Belgian soil for business purposes (attending meetings of a Board of Directors or company general meetings) for no more than five days per month.[62]

E. Registration with the Relevant Municipality

A foreigner is also required, unless he/she lives in a hotel, to register with the relevant municipality. A visa is required for a stay of more than three months, except by a person who lives in, and is a national of, an EU Member State.

F. Social Security

A self-employed person is in principle subject to the social security requirements applying to independent persons.

A foreign service provider who is a national of an EU Member State who is assigned to Belgium will remain subject to the social security regime of his country of residence if the duration of his assignment does not exceed 24 months (with a possible extension for up to five years). An EU service provider who carries on his or her activities both in his/her state of residence and in Belgium (or another EU Member State) will remain subject to the social security regime of his/her country of residence if he/she carries on a substantial part (i.e., 25% or more) of his activities in his/her State of residence.[63] Otherwise he/she will be affiliated with the social security regime of the Member State in which the center of interest of his/her activities is situated.

Belgium's bilateral social security totalization agreements provide that an independent service provider who carries on an activity in one of the country that is party to the agreement is subject to the social security of that country even if he/she is a resident of the other country. If the service provider carries on activities in both countries, each country will apply its social security to the activities exercised therein.

Some social security totalization agreements provide that a nonresident who carries on part of his/her activity in the country in which he/she lives will be subject only to the social security regime of his/her country of residence (for example, the Belgium-Australia agreement). Some agreements provide also that a person who is assigned to a signatory country for no more than five years remains subject to the social security regime of his/her country of origin (for example, the Belgium-India, -Japan and -United States agreements).[64]

G. Value Added Tax

A foreign service provider that provides services whose place of supply is in Belgium must appoint a representative responsible for the value added tax (VAT) due.[65] A provider that is established in the European Union has the option of registering directly for VAT purposes.

In the case of a B2B transaction, the place of supply of a service is in Belgium if the service is supplied to a taxpayer that has its business in Belgium or a PE in Belgium to which the service is rendered.[66] In the case of a B2C transaction, the place of supply is the place where the supplier has its business or a PE rendering the service.[67] There are exceptions to these general place of supply rules, for example, for services concerning immovable property.[68]

In the case of services supplied by a non-EU resident service provider to a Belgian VAT taxpayer, the recipient of the services is liable for the VAT (reserve charge).[69]

H. Coordination

The various Belgian administrations coordinate with each other and may request information in the possession of any administration.

VIII. Difference If There Is an Applicable Tax Treaty Between Belgiumand the Foreign Service Provider's Country of Residence

Most of Belgium's tax treaties provide that income from services derived by a resident of the other Contracting State may not be taxed by Belgium unless the income is attributable to a PE or a fixed base of the service provider in Belgium.[70] A thorough review of the applicable treaty is, however, crucial since some treaties concluded by Belgium follow article 5(3)(b) of the UN Model Convention, some include payments for technical services in the definition of royalties and some grant taxing rights to the state of the payer of fees for services of a technical, managerial or consultancy nature.[71]

Belgium's domestic income tax legislation does not contain a specific procedure for the claiming of treaty relief. The procedures to be followed are embedded within Belgium's ordinary domestic procedures for the processing of tax claims.[72]

With respect to income that is subject to the filing of an income tax return, treaty relief is, as a rule, claimed on a self-assessment basis via the declaration made in the tax return itself. The tax return is subject to the ordinary domestic audit and appeal procedures. A taxpayer can also initiate the specific procedure available under the mutual agreement provision of the relevant tax treaty.[73]

With respect to income attributed or paid to nonresidents, no specific procedure for treaty relief at source is provided for. Based on the principle of the priority of treaty law over domestic legislation,[74] the payer of the income subject to withholding tax in accordance with the Belgian domestic provision may refrain, at his own risk, from withholding the tax if the income is eligible for treaty relief under the relevant tax treaty. A refund of withholding tax imposed in breach of the applicable treaty can be claimed via the

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ordinary domestic tax objection procedure or via the specific procedure available under the mutual agreement provision of the relevant treaty.[75]

NOTES

[1] The collaboration of Pierre Van Achter in providing the social security data is gratefully acknowledged.

[2] *See* P. Cauwenbergh and A. Claes, "Is There a Permanent Establishment?" International Fiscal Association ("IFA") *Cahiers*, 2009, 94a, p. 132.

[3] Income Tax Code ("ITC"), art. 228, § 2, 3°.

[4] *See* L. Denys, "Belgium: The Concept of Permanent Establishment Revisited and Other Reflections Beyond," *Bull. Int. Tax.*, 2008, p. 443.

[5] ITC, art. 229, § 2; L. Denys, "Belgium: The Concept of Permanent Establishment Revisited and Other Reflections Beyond," *Bull. Int. Tax.*, 2008, p. 444. Subject to reciprocity, profits derived from the activities of a representative that collects orders and transmits them without binding the nonresident enterprise are, however, exempt under ITC, art. 231, § 1, 3.

[6] I. Verlinden, K. Abelshausen and T. Geboers, "Substance in International Taxation," *I.T.P.J.*, 2014, vol. 21, n° 5, pp. 357 – 361. The concept of a service PE was introduced into Belgian law as of January 1, 2013. Under ITC, art. 229, para. 2/1, the carrying out of services in Belgium by a foreign enterprise for a period of more than 30 days in any 12-month period for one project (or connected projects) will be considered to constitute a PE of the foreign enterprise under Belgian domestic tax law, i.e., a "Belgian establishment"("BE"). However, this will not always result in an effective Belgian tax liability. If treaty protection is available (i.e., if there is an applicable income tax treaty), it will have to be determined whether the BE is also to be regarded as a PE under the PE Article of that applicable treaty. A BE may be subject to Belgian taxes only if it can also be considered a PE for treaty purposes (thus, the applicable treaty must contain a services PE provision). Belgium has signed a number of income tax treaties that contain a services PE provision, under which the mere provision of services for an extended period of time (typically three, six or nine months, depending on the treaty) is considered to trigger the existence of a PE.

[7] ITC, art. 229, §§ 2/1 and 2/2.

[8] N. Reypens, "Cross-Border Outsourcing—Issues, Strategies and Solutions," IFA, *Cahiers,* 2014, 93a, p. 144. Belgium has, however, only a few tax treaties (based on the UN model) with services PE provisions (e. g., the Belgium-China, -Korea (ROK), -Philippines and -Singapore tax treaties).

[9] Th. Denayer, "Practical issues in the application of tax conventions," IFA, *Cahiers*, 1998, 83b, p. 262. When a foreign enterprise has an establishment in Belgium, as defined by domestic Belgian tax law, it must file an annual income tax return for that establishment regardless of whether the establishment qualifies as PE under an applicable tax treaty. A foreign enterprise claiming that no PE exists under the applicable treaty, must make the claim by filing a nonresident corporate income tax return and reporting no taxable income (the other information requested on the form, such as a detailed list of expenses should, however, be provided). The claim made in the return is subject to the ordinary domestic audit and appeal procedures. N. Reypens, "Cross-Border Outsourcing—Issues, Strategies and Solutions," IFA, *Cahiers*, 2014, 99a, p. 140; for a divergent opinion, see L. Denys, "Belgium: The Concept of Permanent Establishment Revisited and Other Reflections Beyond," *Bull. Int. Tax.*, 2008, pp. 444 *et seq*.

[10] Administrative commentary on tax treaties (Com.DTC), n°5/05; administrative circular n° AAF/96-258 (AAF 17/2003) July 24, 2003.

[11] ITC, art. 305.

[12] ITC, arts. 315 ff.

[13] ITC, art. 228, § 2, 3°, b.

[14] ITC, art. 228, § 2, 3°, d.

[15] ITC, art. 228, § 2, 4°.

[16] ITC, art. 228, § 2, 8°.

[17] ITC, art. 228, § 2, 3°, e.

[18] ITC, art. 228, § 2, 9, a; C. Devillet and X. Van Vlem, "Enterprise services," Belgium, IFA, *Cahiers*, 2012, 97a, p.142. It is important to note that a nonresident can become taxable in Belgium under nonresident taxation outside any professional activity. Indeed, profit derived or income received in return for any kind of performance, action, speculation or services rendered to third parties is taxable as miscellaneous income under nonresident taxation. As noted in the text above, this provision does not apply to profits earned within the framework of a professional activity. Nor does it apply to profit derived or income received in return for the normal management of private assets including immovable property, shares or similar assets and movable assets. This provision is, however, rarely applied.

[19] Initially introduced by the Law of December 13, 2012, but recently modified by the Law of December 18, 2016 (effective as of July 1, 2016). The Belgian tax authorities issued guidance on the application of this provision in a notification that was published in the *Belgian Official Gazette* of July 23, 2014. B. Peeters, "*Quelques nouvelles dispositions marquantes en matière d'INR*," *Fisc. Int.*, 2012, n°347, p. 1. N. Reypens, "Cross-Border Outsourcing —Issues, Strategies and Solutions," IFA, *Cahiers*, 2014, 99a, p. 151.

[20] Covering income not listed under ITC, art. 228, § 1 and 2.

[21] Such as the services of lawyers, doctors and architects.

[22] For example, according to the preparatory works, this would be the case for technical fees under the Belgium-Argentina, -Brazil, -Ghana, -India, -Morocco, -Romania, -Rwanda and -Tunisia, tax treaties.

[23] The note published on July 23, 2014, by the Belgian tax authorities provides for a template that a nonresident service provider can use to obtain certification from its home state tax authority of its tax residence and the fact that it is or will be effectively taxed on the respective income.

[24] ITC, art. 232.

[25] ITC, art. 248, § 1. Foreign partners who have no other Belgian-source income with respect to which a tax return is required need not file Belgian tax returns; in such circumstances, for the sake of administrative simplification, the withholding tax constitutes a final tax.

[26] The filing of tax returns is optional with respect to income from services performed by nonresident artists and sportspersons other than those subject to compulsory filing (ITC, art. 248, § 2) and with respect to income falling within the safety-net provision (ITC, art. 248, § 3).

[27] ITC, art. 233.

[28] The filing of tax returns is optional with respect to income falling within the safety-net provision (ITC, art. 248, § 3).

[29] ITC, art. 248, § 1.

[30] ITC, art. 444.

[31] ITC, art. 445.

[32] ITC, art. 414.

[33] ITC, art. 351.
[34] ITC, art. 342 and Royal Decree executing the Income Tax Code (RD/ITC), art. 182: minimum amounts of taxable income are established for various sectors, based on turnover, persons employed, etc. subject to an absolute minimum of 19,000 euros.
[35] ITC, arts. 243, 243/1 and 244 referring to arts. 157 ff.
[36] ITC, art. 246 referring to art. 218.
[37] ITC, art. 228, § 2, 3°, b); RD/ITC, art. 87, 5°, c) and enclosure III to the RD/ITC.
[38] ITC, art. 228, § 2, 3°, d); RD/ITC, art. 87, 5°, e) and enclosure III to the RD/ITC.
[39] ITC, art. 228, § 2, 4° and art. 271 and RD/ITC, art. 87, 5°, b) and enclosure III to the RD/ITC.
[40] ITC, art. 228, § 2, 8°, art. 270, 3° and art. 271 and RD/ITC, art. 87, 5°, d).
[41] Enclosure III to the RD/ITC.
[42] Enclosure III to the RD/ITC.
[43] ITC, art. 228, § 2, 9, a) and art. 271, and RD/ITC, art. 87, 5°, a).
[44] ITC, art. 270, 7° and RD/ITC, art. 87, 5°, f), Enclosure III to the RD/ITC.
[45] ITC, art. 248, § 1.
[46] ITC, arts. 232 and 233.
[47] ITC, art. 248, §§ 2 and 3.
[48] ITC, art. 276.
[49] ITC, art. 412.
[50] ITC, art. 442 *quater.*
[51] ITC, art. 444.
[52] ITC, art. 445.
[53] G. Cruysmans, *Belgium, Corporate Taxation*, IBFD Amsterdam, section 2.3.2. With effect from December 29, 2014, a 103% (100% increased by the 3% austerity charge) secret commission tax is due on payments that constitute earned income in the hands of an individual recipient and that have not been properly reported and documented on individual statements (before 2014, a secret commission tax rate of 309% applied) (ITC, art. 219). This rate is further decreased to 51.5% (48.5% increased by the 3% austerity charge) if it is demonstrated that the beneficiary of the income is a legal entity, or that the hidden profits are spontaneously (i.e., to the extent the taxpayer has not been informed in writing of the ongoing tax audit) reintegrated in the financial accounts of the taxpayer. The secret commission tax may be avoided if it is demonstrated that the beneficiary has duly reported the income or the beneficiary is identified at the latest within a period of two years and six months following January 1 of the tax year concerned.
For payments made to recipients established in tax havens, see VI.
[54] For a fuller discussion, *see* N. Reypens, "Cross-Border Outsourcing—Issues, Strategies and Solutions," IFA, *Cahiers*, 2014, 99a, pp. 137-144. I. Verlinden, X. van Vlem and B. Markey, "Commissionaire Agency Permanent Establishment Structures and the Impact of the *Zimmer* Case," *I.T.P.J.*, 2010, vol.17, n°5, pp. 347-351.
[55] N. Reypens, "Cross-Border Outsourcing—Issues, Strategies and Solutions," IFA, *Cahiers*, 2014, 99a, p. 137.
[56] As modified by the Program Law of July 1, 2016.
[57] To be considered tax havens, countries must appear either in the list established by the Global Forum on Transparency and Exchange of Information of countries that do not meet the OECD standard on transparency and the exchange of information, or in the Belgian list established by Royal Decree. Such countries include countries outside the European Economic Area ("EEA"): (1) in which companies are not subject to corporate tax on domestic or foreign income; (2) that have a nominal corporate tax rate lower than 10%; or that have a "normal" tax rate for domestic income but an actual tax rate lower than 15% for non-domestic income ("offshore jurisdictions").
[58] Foreigner's Law of December 5, 1980; see Malherbe, Faes, Malherbe and Verstraete, 953-3rd T.M., *Business Operations in Belgium* at pp. 81 ff.
[59] The Schengen area is a passport-free zone established between several European countries by the Schengen agreement.
[60] Code of Economic Law, art. III.16.
[61] Law of February 19, 1965, relating to the exercise by foreigners of independent professional activities; R.D. of February 3, 2003.
[62] Program-law of December 27, 2006, art. 153. The return is valid for 12 months and maybe renewed. The return identifies the independent worker and the user of his/her services in Belgium (R.D. of March 20, 2007).
[63] EU Regulation 883/2004 of April 29, 2004, on the coordination of social security systems, in force since May 1, 2010, art. 12.2.
[64] W. Van Eeckhoutte, *Compendium Sociale-zekerheidsrecht*, 2016-17, vol. 1, pp. 120-123.
[65] VAT Code, art. 55, § 4; R.D. No. 31 of December 29, 1992.
[66] VAT Code, art. 21; EU Directive 2006/112, art. 44.
[67] VAT Code, art. 21 *bis*, § 1; EU Directive 2006/112, art. 45.
[68] Malherbe, Faes, Malherbe and Verstraete, 953-3rd T.M., *Business Operations in Belgium*, at pp. 201-202.
[69] VAT Code, art. 51, § 2.
[70] C. Devillet and X. Van Vlem, "Enterprise Services," Belgium, IFA, *Cahiers*, 2012, p.134. The PE definition in the Belgian Model Tax Convention, which reflects the treaty policy practiced by Belgium, follows the PE definition in OECD Model Convention, Art. 5(1) and (2). The Belgian Model includes neither a specific service PE provision in Art. 5—deeming a PE to exist where one would not otherwise exist under Art. 5(1) and (2)—nor a specific article dealing with independent personal services nor specific provisions dealing with technical or other services. Indeed, Belgium considers that the provision of services should, as a general rule, be treated in the same way as other business activities and that the PE requirement should also apply to the provision of services by an enterprise or by an individual performing independent personal services. The PE requirement avoids increasing the compliance and administrative burden on enterprises and tax administrations, as well as excessive gross taxation.
[71] For a fuller discussion, *see* C. Devillet and X. Van Vlem, "Enterprise Services," Belgium, IFA, *Cahiers*, 2012, 97a, pp.145-153.
[72] ITC, arts. 366 ff.
[73] Th. Denayer, "Practical Issues in the Application of Tax Conventions," IFA, *Cahiers*, 1998, 83b, Belgium report, pp. 245 and 246.
[74] Reflected in RD/ITC, art. 87 where the obligation to retain the withholding tax is subject to domestic exemptions or exemptions provided for under a tax treaty.
[75] Th. Denayer, "Practical Issues in the Application of Tax Conventions," IFA, *Cahiers*, 1998, 83b, Belgium report, p.246, fn. 4. Royal Decree implementing ITC, art. 87; Commentary ITC, No. 275/5 and Comm. TT, No. 15/19. If it is subsequently established that the treaty exemption was not applicable, the debtor with respect to the withholding tax may be assessed for the tax not withheld plus late payment interest.

BRAZIL

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Brazil does not have any specific rules that establish a threshold at which activities carried on by a nonresident entity in Brazil would entail net-basis taxation and the need to file a local income tax return. In this context, a nonresident service provider would only be subject to corporate income taxation in Brazil if it operated in Brazil via an unincorporated entity, such as a branch, an agency or a representative office. Alternatively, if the nonresident were to set up an incorporated entity, such as a subsidiary, in Brazil, the subsidiary itself would be subject to Brazilian income tax on a net basis.

In fact, the operation of foreign companies in Brazil has historically been the subject of strict governmental control. The ability to do business in Brazil through an unincorporated entity is regulated by a set of rules that date back to the 1940s[1] when Decree-Law No. 2,627, of September 26, 1940, was enacted to govern corporations. Although Decree-Law No. 2,627/40 was later repealed by Federal Law No. 6,404, of December 15, 1976, the provisions that require the authorization of the Brazilian Government for foreign and other companies to operate in Brazil were excluded from the repeal and are still in force. Indeed, a foreign company is still only able to operate in Brazil through a branch, etc., after it has obtained a permit from the President. To obtain such a permit, the applicant must submit a number of documents together with its request to the President. The Government of Brazil then has the discretion to grant or refuse a permit.

In view of the bureaucracy associated with obtaining a permit, very few service providers choose to operate in Brazil through branches (and then only in selected industries, such as banking and insurance). Indeed, the vast majority of multinational groups doing business in Brazil prefer to incorporate local legal entities (in the form of corporations or limited liability companies).

Although Brazil's tax treaties recognize the concept of a "permanent establishment" ("PE"), Brazilian net basis taxation of income derived by a foreign entity through a Brazilian PE is seldom imposed, under either Brazilian administrative or judicial tax case law. Indeed the authors are unaware of any administrative or court precedent involving analysis of the nature of a particular place of business based on the main features of the PE concept.[2] Instead, Brazilian income derived by nonresidents is generally taxed in Brazil by means of source taxation on a gross basis, imposed by way of withholding income tax ("WHT"). In addition, Brazil imposes other taxes directly on the service recipient, as will be addressed further in III., below.

The above does not mean, however, that the recognition of a PE in Brazil will not become a relevant issue in the near future. Recent regulations[3] enacted by the Brazilian Federal Revenue Service—for the identification of financial accounts in accordance with the Common Reporting Standards and Country-by-Country Reporting in line with the OECD's Base Erosion and Profit Shifting ("BEPS") Action 13—do contain provisions to enable the use of the PE concept. That being said, the authors are not yet aware of any case law dealing with such regulations.

Be that as it may, if a nonresident service provider were to set up a local branch, the branch itself would have to file tax returns/statements with the Brazilian tax authorities[4] in connection with the business carried on in Brazil, since it would be considered a "separate" taxpayer and, as such, would be subject to corporate income tax in Brazil.[5]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As noted above, it is unusual for the existence of a PE in Brazil to be recognized, since most nonresident service providers will choose to do business in Brazil via a local subsidiary. However, should a nonresident service provider choose to operate in Brazil via a local branch, the branch itself would be considered a "separate" taxpayer and, as such, would be subject to corporate income tax in Brazil and the corresponding filing requirements. Such a branch would need to enroll with the National Corporate Taxpayers' Registry.[6] This registry enables the federal tax administration to ensure that the required filings are properly made and that tax is duly paid.

It should be noted that, once a local branch is properly set up, payments made by a Brazilian resident in consideration for services rendered by the branch are considered to be made to a local resident. In these circumstances, taxation will *not* be levied by way of with-

holding tax on a final, gross basis—instead the branch will pay tax on a net basis in the normal manner.[7]

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

To the extent a nonresident that is not regarded as having a Brazilian PE is considered to provide any kind of services to a Brazilian resident (whether an individual or a legal entity), the Brazilian resident will be deemed to be "importing" the services. In these circumstances, payments made in consideration for the services provided will be subject to final WHT on the corresponding gross amount.

Generally, income paid, employed, remitted, credited or delivered[8] from Brazilian sources to nonresidents is subject to WHT at the rate of 15%.[9] While a higher WHT rate of 25% applies to payments in consideration for "general" services rendered by nonresidents to Brazilian residents,[10] payments in consideration for certain "technical" services are generally subject to WHT at the rate of 15% (increased to 25% in the case of beneficiaries resident in tax haven jurisdictions—see further at VI., below).[11] In the case of payments for such technical services, a special additional contribution on intervention in the economic domain (*Contribuição de Intervenção no Domínio Econômico* —"CIDE") is levied at the rate of 10%,[12] so that, in both situations, the aggregate rate of tax is 25%.

It should be noted that the importation of services will be subject to other taxes in addition to WHT and CIDE. Payments made in compensation for services rendered in Brazil (or the "result" of which is verified as transpiring in Brazil) will also be subject to PIS and COFINS social contributions, at the rates of 1.65% and 7.6%, respectively.[13] Lastly, the importation of services will be subject to a municipal tax on services (*Imposto sobre Serviços*—"ISS"), the rates of which vary depending on the city in which the Brazilian "importer" of the services is located—generally from 2% to 5% (there would, however, be grounds for challenging the constitutionality/legality of this levy).

If a nonresident service provider is reimbursed for expenses, the Brazilian tax authorities would generally maintain that the reimbursement should be considered part of the "gross amount" of the services fee and, as such, should be included in the calculation of the taxable basis for purposes of the WHT.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

With regard to WHT levied on payments to a nonresident service provider, the beneficiary of the services, i.e., the Brazilian payer, is the "withholding agent." As such, the Brazilian payer must either withhold the full amount of the WHT or obtain documentation upon which it may rely to apply a reduced withholding rate.

With respect to the other taxes that may be levied on the "importation of services" (PIS, COFINS, ISS and CIDE), the Brazilian beneficiary of the services is itself the taxpayer, and, therefore, bears the economic burden of these taxes.

If the taxes referred to above are not duly withheld and/or paid over, or if the amount withheld/paid over is insufficient, additional payments may be due as follows:

If the Brazilian service recipient pays over tax in arrears *before* an assessment is issued by the Brazilian tax authorities, the recipient will be subject to interest at a rate based on the monthly variation in the SELIC rate (the interest rate paid by the federal government on its internal debt).[14] Additionally, the Brazilian tax authorities will try to impose a late payment penalty fee of 0.33% a day—up to a total of 20%.[15]

If the Brazilian service recipient pays over tax in arrears *after* an assessment is issued by the Brazilian tax authorities, the tax deficiency would be claimed plus: (1) a penalty fee of 75% (or 150% or even 225% in certain situations) of the tax due;[16] and (2) interest calculated from the date on which tax should originally have been paid, at a rate based on the monthly variation in the SELIC rate.

If a withholding agent withholds and/or pays over more tax than is due, it may seek a refund in cash or set off the overpayment against future tax liabilities.

All that being said, in view of the steep taxation to which the "importation of services" is subject, it is common for service agreements entered into between nonresident providers and Brazilian beneficiaries to include "tax gross-up" clauses, under which the nonresident provider is to receive the amount charged for the provision of services net of any taxes payable in Brazil (i.e., for the Brazilian beneficiary to bear the economic burden of all such taxes).[17]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

In view of the fact that the "importation of services" attracts a significant tax burden, the Brazilian tax authorities would probably not seek to establish that a Brazilian subcontractor creates a taxable presence of a nonresident service provider in Brazil, but rather would continue to be content with imposing gross basis taxation—assuming that the nonresident service provider retained a direct relationship with the Brazilian client, not with the subcontractor.

As a consequence, subcontracting the provision of services in Brazil would not be a tax-efficient strategy, since, in addition to the imposition of the taxes discussed above, the subcontractor itself would be subject to taxes on the income it earned (i.e., the consideration paid to it by the nonresident service provider).

VI. Exceptions to the General System

As noted in III., above, while payments made in consideration for certain "technical" services are subject to WHT at the general rate of 15%, a higher WHT rate of 25% applies to payments in consideration for "general" services rendered by nonresidents to Brazilian residents.

The higher, 25% WHT rate also applies to income derived by residents of countries that do not impose income tax or that impose income tax at a rate lower than 17%[18] ("tax havens").[19] The tax haven definition

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also encompasses jurisdictions whose legislation does not allow access to information relating to companies' shareholding structures or to persons holding shareholder's rights, or to the identity of beneficial owners of income attributable to nonresidents.[20] Thus, payments in consideration for technical services made to a tax haven resident would be subject to WHT at the rate of 25%, in addition to CIDE at the rate of 10%.

It should be noted that the importation of services from service providers resident in tax havens would also be subject to PIS and COFINS social contributions, and ISS.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

There are usually no other specific business requirements that have to be met by nonresidents rendering services for Brazilian beneficiaries, especially where the services are entirely rendered overseas (i.e., where the nonresident service provider has no significant physical presence in Brazil). Evidently, a nonresident service provider that establishes a local subsidiary or operates in Brazil via a branch, etc., will have to abide by the set of regulations applicable to the industry concerned (for example, banking or aerospace).

Local immigration rules may require nonresident employees coming to Brazil on business trips to obtain visas; this is because Brazil adopts a policy of "reciprocity" regarding visas—a citizen of a country that requires Brazilian citizens travelling to that country to obtain visas will need a visa to enter Brazil.

Nonresidents may set up deposit accounts in Brazilian local currency. Such accounts are subject to specific rules and regulations issued by the Brazilian National Monetary Council (*Conselho Monetário Nacional*—"CMN") and the Brazilian Central Bank.[21]

VIII. Difference If There Is an Applicable Tax Treaty Between Brazil and the Foreign Service Provider's Country of Residence

According to Brazilian law, Brazil's tax treaties revoke or amend Brazilian domestic law (to the extent of their scope of application), and domestic law must respect those tax treaties that are already in force and effect at the time such law is enacted.[22] The provision giving precedence to tax treaties over domestic law is usually accepted as valid by the Brazilian tax administration without reservation.[23]

Most of the tax treaties signed by Brazil have a number of features that are relevant to the present discussion. Even though Brazil is not a member of the Organisation for Economic Cooperation and Development ("OECD"), Brazil tax treaties tend,[24] to some extent, to follow the various versions of the OECD Model Convention. While the Business Profits Article (Article (Article 7) and the Other Income Article (usually Article 21) in these treaties are along the lines of those in the OECD Model, the Royalties Article (Article 12) is somewhat unusual.

Specifically, Article 12 of Brazil's tax treaties generally allows source-country taxation as well as residence country taxation of royalty income (the OECD Model Convention provides that only the residence country is entitled to tax royalty income). In addition, Brazil's treaties provide a much broader definition of "royalties" than that found in the OECD Model: accompanying Protocols[25] include within the scope of Article 12 payments made in consideration for the rendering of "technical services" and "technical, scientific, administrative or similar assistance."[26] Accordingly, payments made in consideration for technical services generally fall within the scope of Article 12 of Brazil's treaties, while payments made in consideration for general (non-technical) services generally fall within the scope of Article 7 (or where the services are rendered by an individual in an independent capacity and the applicable treaty contains an Independent Personal Services Article, within the scope of Article 14).

Under Article 12, payments made in consideration for technical services may be subject to WHT in Brazil at a rate of up to 15%. As a consequence, nonresidents that are resident in most of Brazil's treaty partner countries would probably not need to resort to the applicable treaty, as the applicable tax regime established by Brazilian domestic tax law is generally compatible with the position agreed on by Brazil in negotiating its treaties.

On the other hand, under Article 7, payments made in consideration for general (non-technical) services should not be subject to any WHT in Brazil, provided the nonresident service provider does not have a PE in Brazil (or where the services are rendered by an individual in an independent capacity and the applicable treaty contains an Independent Personal Services Article (Article 14), a fixed base in Brazil).

That being said, in a number of rulings,[27] the Brazilian tax authorities have expressed the opinion that payments for general services should fall within the scope of Article 21 (Other Income) rather than Article 7. All Brazil's tax treaties that contain this article deviate from the equivalent article in the OECD Model Convention, in that they allow the source country to tax income not dealt with elsewhere in the relevant treaty without limitation where such income arises in the source country; the OECD Model, by contrast, gives sole taxing rights with respect to such "other income" to the residence country, irrespective of where the income arises.

Taxpayers have challenged this understanding and there are a number of more recent precedents that confirm that general services fall within the scope of Article 7 and, thus, should not be subject to WHT in Brazil.[28] In fact, more recent views expressed by the Brazilian tax authorities seem to indicate that they now acknowledge taxpayer arguments in this respect. For example, in addressing the taxation of payments for technical services, Ordinance (*Ato Declaratório Interpretativo*) No. 5, of June 16, 2014, argued that: (1) when the applicable tax treaty includes payments made in consideration for the rendering of "technical services" and "technical, scientific, administrative or similar assistance" within the scope of Article 12, such payments will be taxed accordingly, whether or not there is an actual transfer of technology; and (2) such payments will only be regarded as covered by the Business Profits Article (Article 7) where the relevant Protocol does *not* include such payments within the scope of Article 12.

It is worth noting that the question of whether taxes are to be withheld and paid over when a Brazilian payer is making payments to a nonresident beneficiary usually becomes an operational issue in Brazil. This is because every Brazilian payer must enter into a foreign exchange agreement with a Brazilian financial institution (that is allowed to carry out transactions on the foreign exchange market) in order to be able to remit funds overseas. Consequently, a financial institution that is to make such a remittance may only agree to carry out the foreign exchange transaction if the payer: (1) presents proof that it has withheld and paid over all applicable taxes in relation to the payment concerned; or (2) if the payer argues that such taxes are not due, is supported by a judicial injunction to the effect that it is not required to withhold and pay them over. In other words, in practical terms, the Brazilian payer is often unable to question the applicability of WHT, especially in cases where the amount to be remitted overseas is not significant when compared to the costs of filing for an injunction and sustaining a lawsuit.

It should also be noted that the above discussion is only relevant for purposes of WHT; other taxes levied on the "importation of services" discussed above (ISS, PIS, COFINS and CIDE) are generally outside the scope of Brazil's income tax treaties and may, therefore, be levied regardless of the existence of an applicable income tax treaty between Brazil and the service provider's country of residence.

NOTES

[1] Decree-Law No. 2,627/40, arts. 59 to 73.

[2] There are, however, a handful of decisions that simply attest to the existence of a Brazilian PE without regard to any of the tests underlying the PE definition such as the "right of use" test, the "place of business" test, the "location" test and the "business activity" test. Decision No. 107-08.998, issued by the 1st Chamber of the Taxpayers' Council characterized a branch of a Portuguese public bank as a PE and, therefore, equated it to a Brazilian resident for tax purposes. Additionally, in Rulings (*Soluções de Consulta*) Nos. 287/98, 19/98 and 247/97, local branches of foreign air carriers have been referred to as PEs.

[3] See Normative Instruction (*Instrução Normativa*) No. 1,681, issued by the Brazilian Federal Revenue Service (*Secretaria da Receita Federal do Brasil* – "RFB") on December 29, 2016.

[4] Beginning in 2015, the Tax Accounting Bookkeeping (*Escrituração Contábil Fiscal* —"ECF") is an electronic replacement for the Corporate Income Tax Return (*Declaração de Informações Econômico-Fiscais da Pessoa Jurídica*— "DIPJ"). The ECF is a comprehensive accounting and tax reporting filing obligation for corporate income tax that integrates accounting, tax and economic information, and must be used by most legal entities.

Companies are required to prepare and submit the ECF electronically via the Public Digital Bookkeeping System (*Sistema Público de Escrituração Digital* — "SPED"); the former DIPJ had to be prepared using tax preparation software provided by tax authorities. The new reporting obligation is more complex than the DIPJ and is expected to give the Brazilian tax authorities the ability to perform faster consistency reviews, thus increasing the efficiency of future tax audits.

[5] Federal Law No. 4,131, of September 3, 1962, art. 42; Decree No. 3,000 of May 26, 1999, the Brazilian Income Tax Regulations (*Regulamento do Imposto de Renda—* "RIR"), arts. 146 and 147.

[6] The *Cadastro Nacional da Pessoa Jurídica* ("CNPJ"). *See* Normative Instruction No. 1,634, of May 6, 2016, arts. 1 to 4.

[7] Nonetheless, if the beneficiary of the services is a legal entity, tax withholding may still apply, in which case tax collected by a withholding agent will represent an advance payment of tax due from the branch. According to RIR, arts. 647 to 649, the rate of WHT will vary from 1% to 1.5%, depending on whether "general" or "professional" services are rendered— "professional" services are those listed in RIR, art. 647, para. 1; "general" services include cleaning, conservation and maintenance services, surveillance, security and staff outsourcing. Payments in consideration for services rendered by a local branch are also subject to the withholding of other taxes such as the social contribution on net profits, and PIS and COFINS social contributions; *see* Federal Law No. 10,833, of December 29, 2003, art. 30.

[8] For the sake of convenience, this paper will refer only to "income paid" or "payments."

[9] In accordance with the Federal rules compiled in the RIR.

[10] Federal Law No. 9,779 of Jan. 19, 1999, art. 7; RIR, art. 685, II, "a".

[11] Decree-Law No. 1,418, of September 3, 1975, art. 6; Federal Law No. 9,249, of Dec. 26, 1995, art. 28; Federal Law No. 9,779/99, art. 7; RIR, art. 708. See also Normative Instruction No. 1,455, of March 6, 2014, art. 17.

[12] Federal Law No. 10,168 of December 29, 2000, art. 2.

[13] Federal Law No. 10,865, of April 30, 2004, art. 1, para. 1, I and II, and art. 3, II.

[14] Federal Law No. 9,430, of December 27, 1996, art. 61, para. 3; Federal Law no. 9,065, of June 20,1995, art. 13.

[15] Although there may be grounds for sustaining that Brazilian National Tax Code (Federal Law no. 5,172, of October 25, 1966), art. 138 prevents such a penalty fee from applying when tax is paid before a tax claim is established.

[16] The penalty fee would be reduced by 50% if the Brazilian beneficiary were not to challenge the assessment and were to pay the amount presumed due in full within 30 days after having been given notice of assessment. See Federal Law No. 9,430/96, art. 44, para. 3; Federal Law No. 9,065/95, art. 13; and Federal Law No. 8,218, of August 29, 1991, art. 6.

[17] The "gross-up" is an adjustment to the taxable basis, which is the full amount of income paid to the payee. The concept behind the gross-up is that, when the payer agrees to bear the burden of the tax, the income paid to the payee is in fact greater than the amount of income specified in the relevant agreement. From the perspective of the Brazilian tax authorities, when a Brazilian payer agrees to pay net, the foreign payee is, in fact, deemed to have been paid an additional constructive income equal to an amount that, when added to the amount specified in the relevant agreement, will result in the net amount the payee is willing to accept, after the relevant taxes are deducted.

[18] The definition of tax haven, as originally provided by Federal Law No. 9,430/96, encompassed countries that do not impose income tax or impose income tax at a rate lower than 20%. However, this threshold was recently reduced to 17%, under Internal Ordinance (*Portaria*) No. 488, issued by the Ministry of Finance on November 28, 2014.

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[19] Tax haven jurisdictions are generally defined in Federal Law No. 9,430/96, art. 24 and expressly listed in Normative Instruction No. 1,037, of June 4, 2010, art. 1.

[20] Federal Law No. 11,727, of June 23, 2008, effective January 1, 2009, amended Federal Law No. 9,430/96 and introduced the concept of a "Privileged Tax Regime," i.e., a tax regime under which: (1) income is not taxed or is taxed at a maximum rate lower than 20%; (2) tax benefits are granted to nonresident entities or individuals: (a) without the exercise of a substantial economic activity in the country or location concerned being required; or (b) contingent on the non-exercise of a substantial economic activity in the country or location concerned; (3) in particular, income earned outside the country or location concerned is not taxed or is taxed at a maximum rate lower than 20%; or (4) access is not allowed to information relating to shareholding composition, the ownership of assets and rights, or economic transactions. The thresholds above in (1) and (3) have also been reduced to 17%, under Internal Ordinance No. 488/14. The concept of a Privileged Tax Regime is only relevant to specific types of transactions, including transactions subject to the transfer pricing rules. Thus, the increased 25% WHT would arguably not apply with regard to payments made to foreign parties that are beneficiaries of Privileged Tax Regimes.

[21] See Resolution No. 4,373, issued by the CMN on Sept. 29, 2014; Ordinance (*Circular*) no. 3,691, issued by the Brazilian Central Bank on Dec. 16, 2013, arts. 168 *et seq.*

[22] *See* Brazilian National Tax Code, art. 98.

[23] *See* Ruling CST No.03, of August 28, 1996, item 5.1.

[24] Brazil currently has tax treaties with the following 32 countries: Argentina, Austria, Belgium, Canada, Chile, China (PRC), Czech Republic, Denmark, Ecuador, Finland, France, Hungary, India, Israel, Italy, Japan, Korea (ROK), Luxembourg, Mexico, the Netherlands, Norway, Peru, the Philippines, Portugal, Slovakia, South Africa, Spain, Sweden, Trinidad and Tobago, Turkey, Ukraine and Venezuela. Brazil had a tax treaty with Germany that was terminated in 2006. Finally, the Brazil-Russia tax treaty has already been signed, but is currently undergoing the internal legislative ratification process.

[25] As is well known, the main objective of a Protocol accompanying a tax treaty is to settle any doubts arising from, and therefore clarify the application of, the articles of the corresponding treaty.

[26] Note, however, that Brazil has signed tax treaties that do *not* include within the scope of Article 12 payments made in consideration for technical services (see the Brazil-Austria, -Finland, -France, -Japan and –Sweden tax treaties). As a consequence, payments made to service providers that are domiciled in such countries should *not* be taxable in Brazil under Article 7 (or where appropriate Article 14) of these treaties.

[27] *See, e.g.,* Ruling No. 12, of April 14, 2003.

[28] *See, e.g.,* Appeal No. 0024461-74.2005.4.03.6100/SP, ruled by the 3rd Federal Court (*Tribunal Regional Federal da 3ª Região*) on January 26, 2012.

CANADA

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Generally, Canada taxes the provision of services by a nonresident service provider when the nonresident service provider is carrying on business in Canada.[1] An income tax return must be filed by every nonresident carrying on business in Canada. There is a common law meaning to the phrase "carrying on business in Canada" and a statutory deeming provision that provides an extended meaning in § 253.

Most of Canada's tax treaties provide an exemption from this general rule if the business is not carried on through a permanent establishment ("PE") in Canada, as discussed in detail in VIII., below. In sections I-VII, it is assumed that the nonresident is providing services in a country with which Canada does not have a tax treaty.

A. Common Law

The concept of carrying on business in Canada may be broken into its component requirements of the existence of *a business*, the business being *carried on*, and the business being carried on *in Canada*.

1. Business

Section 248(1) provides that "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatever and generally also includes an adventure or concern in the nature of trade. At common law, "business" refers to an organized activity undertaken for the purpose of earning a profit.[2] The combined effect is a relatively low threshold for what constitutes business.

The provision of services by a nonresident service provider will in almost all cases constitute business.

2. Carrying on Business

Carrying on business generally requires continuity of time and operations. Both factors are generally involved in the ordinary sense of business.[3] As a result, although § 248(1) deems an adventure in the nature of trade to be business, such business is generally not "carried on."

The provision of services by a nonresident service provider will in almost all cases constitute carrying on business.

3. Carrying on Business in Canada

Whether business is carried on *in Canada* is a question of fact to be determined having regard to all of the facts and circumstances.[4] In making this determination, "one must not consider in isolation the activities carried on in [Canada] by the [taxpayer] but one must consider them in the light of the whole of its business activities and its general operations."[5]

There is no single test or factor that determines where a taxpayer is carrying on business. Courts over the years have applied a variety of criteria to determine where a business is carried on, including the place where the contract was made,[6] the location and power of agents or independent contractors,[7] and whether activities in Canada are simply ancillary to the main business.[8]

The Federal Court of Appeal in *Gurd's Products* concluded, after surveying multiple cases, that the modern principle to apply is that a taxpayer's income from carrying on business arises in the "jurisdiction where the operations take place from which the profits arise."[9] In other words, business is carried on in the jurisdiction where the activity that most significantly determines the profit of the business takes place.

The profit-generating activity will depend on the nature of the business. For a services business, the profit-generating activity generally occurs where the services are performed.[10] However, a nonresident service provider must have a significant presence in Canada to be carrying on business in Canada.[11] For example, a nonresident service provider that completes a single service contract that is insignificant compared to the scale of its overall business likely does not carry on business in Canada. However, a single, significant service contract, or many small service contracts, may cause a nonresident service provider to reach the threshold and carry on business in Canada.

B. Deeming Provisions

A nonresident service provider that is not carrying on business in Canada under common law principles may be deemed to carry on business in Canada under

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the extended definition of carrying on business in Canada contained in § 253.

A nonresident service provider will generally not be deemed to carry on business in Canada unless the service provider solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada.[12]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Generally, the service recipient must withhold 15% on every payment to a nonresident person in respect of services rendered in Canada.[13] The requirement extends to Canadian resident and nonresident service recipients. The withholding amount is determined based on the gross amount of the invoice. If a service provider issues an invoice for some services rendered in Canada and other services rendered outside Canada, the service provider should make an allocation. Withholding is only required on the portion of the invoice attributable to services rendered in Canada.[14]

The withholding is a pre-payment of tax, not an assessment, and does not excuse the nonresident person's tax liability or requirement to file a tax return. The recipient of the services must provide a form T4A-NR to the nonresident service provider summarizing the year's withholdings. When the nonresident files a tax return for the year, the nonresident will receive a refund or have an additional tax liability, as applicable. The corporate tax rate in Canada is approximately 25%, the exact rate depending on the province in which the services are provided. Individual tax rates are graduated, with a top marginal rate of approximately 45%, the exact rate depending on the province in which the services are provided.

If the nonresident service provider is separately reimbursed for expenses, that reimbursement should not be considered part of the "gross amount" of the services fee because it is not a payment in respect of services rendered in Canada.[15]

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

The 15% withholding described in II., above is required on all payments for services rendered in Canada, whether or not the nonresident person providing the services is carrying on business in Canada. See II., above, for details of the withholding regime.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

See II., above.

A service recipient that does not withhold as required is liable to a penalty of 10% of the amount that should have been withheld.[16] The withheld amount must be remitted by the 15th day of the month following the month in which the amount was withheld.[17] For example, if an amount was withheld on a payment made in July, the withholding must be remitted by August 15. There are additional late-filing penalties of up to 10% of the amount due if the service recipient does not remit the amount withheld on time.[18]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The withholding regime described in II., above, applies to every *payment* to a nonresident person in respect of services rendered in Canada. The words "in respect of" are of the widest possible scope.[19] Therefore, if the subcontractor is rendering services in Canada, withholding is required if the *payment* is made to a nonresident.

If the nonresident service provider engages a subcontractor that is resident in Canada, the service recipient's obligation to withhold will generally depend on whether it pays the nonresident service provider or the resident sub-contractor. It should withhold if it pays the nonresident service provider, but not if it pays the resident subcontractor.

Similar rules would apply to payments made between the nonresident service provider and the resident subcontractor: a payment from the subcontractor to the nonresident service provider in respect of services rendered in Canada would be subject to 15% withholding, whereas a payment in the reverse direction would not. It should be noted that these same rules apply generally to payments between nonresidents in respect of services performed in Canada.

In cases of doubt, a well-advised service provider should withhold. There is no liability for the service recipient for intended compliance with the withholding provisions of the ITA.[20] If the 15% withholding is greater than the nonresident service provider's tax liability on its net income from carrying on business in Canada, the nonresident service provider can request a refund when it files its Canadian tax return.

VI. Exceptions to the General System

If the services are provided by a nonresident service provider outside Canada, the nonresident service provider is likely not carrying on business in Canada, and is not rendering services in Canada. As a result, the service provider should not have any Canadian tax liability and no amount should be withheld from the service provider's invoice, regardless of the location from which the invoice is paid.[21]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

In general, a nonresident service provider will have to obtain a business number or an individual tax number from the Canada Revenue Agency ("CRA"). A nonresident service provider may also be required to register and collect federal and provincial sales taxes. The requirement to register generally parallels the liability for income tax discussed in I., above.[22] Work permits are required for most foreign service providers providing services from within Canada. A host of other rules and regulations may also apply, depending on the nature and scope of the underlying business.

It is beyond the scope of this article, but as a general comment, a nonresident service provider that pays remuneration to employees for the performance of employment duties in Canada will be subject to Canadian source deduction rules with respect to the remuneration.[23]

Generally, government agencies do not share private taxpayer information with each other. However, the CRA has broad information gathering powers and actively monitors public sources of information, such as corporate registries.

VIII. Difference If There Is an Applicable Tax Treaty Between Canada and the Foreign Service Provider's Country of Residence

Most of Canada's tax treaties provide that income from carrying on business in Canada is not subject to tax in Canada unless that income is attributable to a PE in Canada.[24] Generally, Canada's tax treaties provide that a PE includes an office or other fixed place of business, and many of the tax treaties include a list of specific types of establishment — such as a place of management, a branch, a factory, a workshop, a mine, an oil or gas well, or a quarry[25] — that are considered to be PEs. In addition, if an agent of a nonresident service provider (other than an independent agent acting in the ordinary course of business) exercises the authority to conclude contracts in the name of the nonresident service provider, then any PE of the agent is attributed to the nonresident service provider.[26]

Furthermore, the Canada-United States tax treaty includes a "services permanent establishment" rule, which will deem an enterprise of the United States to provide services through a Canadian PE when either of the following conditions are met:[27]

The services are performed in Canada by an individual who is present in Canada for more than 183 days in a 12-month period and more than 50% of the gross active business revenues of the enterprise is attributable to services performed in Canada by the individual; or

Services are provided in Canada for more than 183 days in a 12-month period on the "same or connected project" for residents of Canada or nonresidents of Canada with PEs in Canada.

The application of the services PE rules depends on the specific facts that apply in the circumstances.

The withholding requirements discussed in II., above apply even if the nonresident service provider's income is exempt from Canadian tax under a tax treaty. However, a nonresident service provider may apply for relief from withholding by submitting a treaty-based waiver application to the CRA.[28] The waiver application should be submitted 30 days before the services are provided in Canada[29] and its approval is subject to numerous criteria relating to income earned and length of contract engagement in Canada.[30]

As discussed in I., above, a nonresident service provider that carries on business in Canada is required to file a Canadian tax return. The waiver does not affect the nonresident service provider's requirement to file a Canadian tax return. By filing a return, a nonresident service provider entitled to an exemption from Canadian tax under a tax treaty may claim a refund of any withholding tax paid.

NOTES

[1] Canada Income Tax Act § 2(3), § 150(1)(a)(B), § 150(1)(d). All statutory references are to the Income Tax Act as currently proposed to be amended ("ITA") and the regulations thereunder (the "Regulations"), unless otherwise indicated.

[2] *Global Communications Ltd. v. R*, 99 D.T.C. 5337 (F.C.A.); *McKay v. Canada*, [1993] 2 C.T.C. 2740 (T.C.C.); *Stewart v. R*, 2002 S.C.C. 46 at para 38.

[3] *Tara Exploration and Development Company Ltd v. MNR*, 70 D.T.C. 6370 (E.C.C.).

[4] *Erichsen v. Last* (1881), 4 T.C. 22 (CA).

[5] *Capitol Life Insurance Company v. The Queen*, 84 D.T.C. 6087 (F.C.T.D.), *aff'd* 86 D.T.C. 6164 (F.C.A.).

[6] *Cutlers Guild Ltd. v. The Queen*, 81 D.T.C. 5093 (F.C.T.D.).

[7] *Pullman v. the Queen*, 83 D.T.C. 5080 (F.C.T.D.).

[8] *Cutlers Guild Ltd v. The Queen*, 81 D.T.C. 5093 (F.C.T.D.) at 5095.

[9] *The Queen v. Gurd's Products Co. Ltd.*, 85 D.T.C. 5314 (F.C.A.).

[10] See CRA, Income Tax Folio S5-F2-C1, "Foreign Tax Credit" (December 1, 2015) at paras 1.53-1.55.

[11] CRA GST/HST Policy Statement P-051R2, "Carrying on Business in Canada," April 29, 2005. Policy should apply equally to income tax. See in particular examples 18-21, which illustrate situations in which a nonresident service provider may or may not be carrying on business in Canada.

[12] *See* § 253 for a full list of activities subject to the extended meaning of carrying on business in Canada.

[13] § 153(1)(g); Regulation 105.

[14] CRA, IC 75-6R2, "Payments for services other than for an office or employment provided in Canada by nonresidents" (February 23, 2005) at para 32.

[15] *Weyerhaeuser Co.*, 2007 T.C.C. 65; CRA Document #2008-0297161E5 (September 16, 2009).

[16] § 227(8).

[17] Regulation 108(1).

[18] § 227(9).

[19] *Nowegijick v. The Queen et al.*, 83 D.T.C. 5041 (S.C.C.).

[20] § 227(1).

[21] CRA Document #2010-0382921E5 (April 14, 2011).

[22] Excise Tax Act, § 240(1).

[23] § 153(1); Regulation 102.

[24] *See, e.g.*, Canada-United States tax treaty, art. VII(1).

[25] *See, e.g.*, Canada-United States tax treaty, art. V(2).

[26] *See, e.g.*, Canada-United States tax treaty, art. V(5).

[27] Canada-United States tax treaty, art. V(9).

[28] § 153(1.1).

[29] Form R105.

[30] IC 75-6R2, note 14, above, at Appendix A and B.

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CHINA

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Under China's Enterprise Income Tax ("EIT") Law, a nonresident enterprise must pay corporate income tax ("CIT") on its income sourced in China[1] that is derived through an establishment or a place in China and on income sourced outside China that is effectively connected with an establishment or a place in China.

An "establishment or place," as defined in Paragraph 3 of Article 2 of the EIT Law, refers to an establishment or a place in China engaging in production and business operations, including:

- A management organization, business organization or representative office;
- A factory, a farm or a place where natural resources are exploited;
- A place where labor services are provided;
- A place where a contracting project such as construction, installation, assembly, repair or exploration is undertaken; and
- Any other establishment or place where production and operational activities are carried on.

Technically speaking, a nonresident enterprise without any establishment in China providing services to a Chinese entity, so that the services are completely provided outside China, would not be subject to Chinese income tax. However, payments from China for services in the nature of technical or IT services could, in certain circumstances, be considered to have the nature of royalties for Chinese tax purposes under Guoshuihan [2009] No. 507 and subsequently issued relevant circulars, in which case, the nonresident service provider could be subject to Chinese withholding tax even if the services were provided outside China. The tax implications could be different when a tax treaty applies (see VIII., below)

Under Chinese domestic individual income tax ("IIT") law, if contracted services provided by a nonresident individual are performed in China, the payments for such services are subject to Chinese IIT and the individual is required to file a Chinese income tax return regardless of whether the income is paid by a Chinese company/individual.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As discussed in I., above, if the services are provided outside China, and there is no establishment in China or, if there is such an establishment, the income derived outside China is not effectively connected with the establishment, no tax reporting is required. A nonresident company that has some degree of presence in China but believes that, under an applicable tax treaty,[2] it does not have a permanent establishment ("PE") in China to which income from services provided in China is attributable, would be required to file certain forms with the tax bureau and could be asked by the tax authorities to submit supporting documents for record purposes. Such documents include the forms required to be filed for purposes of obtaining treaty benefits, a residence certificate of the service provider issued by the foreign country in which the service provider is resident, relevant service contracts and other supporting documents.

Practically speaking, where no sufficient and valid documentation can be provided to convince the tax authorities that the services are provided outside China, there may be a risk of the nonresident being deemed by the tax authorities to have performed the services through a PE in China. Assuming that the nonresident is deemed have a PE in China, under Guishuifa [2010] No. 19 ("Circular 19"), the nonresident generally would be assessable to CIT based on a deemed profit calculation. The deemed profit rate will range from 15% to 50%,[3] depending on the nature of the services provided. The deemed profit will be subject to CIT at the statutory rate of 25%. In practice, either a PE could file a tax return itself or through an agent, or the tax due could be withheld by the domestic service recipient.

If the remuneration for the services provided is considered to be a royalty payment under Circular 507 and subsequently issued circulars, withholding tax (normally at the rate of 10% under Chinese domestic tax law or at the lower rate provided under the Royalties Article of some of China's tax treaties) will apply on the gross receipt.

Under Chinese domestic IIT law, the payer of service fees is the withholding agent with respect to the IIT payable on the fees. If service fees payable to a nonresident individual are subject to Chinese IIT, the payer of the service fees must withhold the IIT due

from the service fee payment, file an IIT withholding return and remit the IIT withheld to the local tax authority. The IIT withheld is the actual IIT payable and no advance payment of IIT is required in China.

The withholding mechanism described above is underpinned by the Chinese foreign exchange control regulations. Under these regulations, any payment of cross-border service fees in excess of U.S. $50,000 is subject to the tax authorities' record filing requirements, including the submission of contracts, filing forms and relevant supporting documents, with the tax authorities' acknowledgement having to be obtained and the bank's review carried out before remittance. In practice, the bank may require a tax clearance certificate or a copy of the tax authority acknowledgment that the required forms have been filed as a prerequisite for making the outward remittance, thus guaranteeing that either the withholding taxes due have been paid or the service fees are not subject to Chinese taxes.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

The withholding rate and withholding mechanism described in I. and II., above will apply if the nonresident enterprise has an establishment in China or the service fees are classified as royalty payments under the relevant rules.

As regards service fees, the CIT rate could be applied to: (1) the actual profit, where the nonresident enterprise is able to calculate the taxable income accurately; or (2) a deemed profit calculated in accordance with Circular 19, where the nonresident enterprise is not able to calculate and report the actual taxable income because of incomplete books and data, or insufficient supporting documents. Withholding tax will be imposed on the gross amount of the income if the service fees are classified as royalty payments, with no deduction being allowed for expenses.

Under the Chinese EIT law implementation rules, the income subject to withholding tax is the total fees received by a nonresident enterprise from a payer, as well as additional surcharges, if applicable.

Where fees for the provision of services are paid to an individual, a monthly IIT withholding return must be filed and the tax due must be settled on the payment of the service fees to the individual. The tax is calculated by applying progressive tax rates ranging from 20% to 40%. The tax basis is income received: (1) after the deduction of RMB 800 if the monthly income pertaining to the same project does not exceed RMB 4,000; or (2) after the deduction of 20% of the income if the monthly income pertaining to the same project exceeds RMB 4,000.

Generally speaking, if a service provider is reimbursed for expenses, the reimbursement would be considered part of the gross amount of the service fees for withholding tax purposes.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Under Chinese EIT Law and subsequently issued relevant circulars, where any payment is made to a nonresident enterprise as described above, either where the nonresident enterprise has an establishment in China or where the payment constitutes a royalty, as described in I., II. and III., above, the income tax payable on the payment is imposed by way of withholding at source, with the payer acting as the withholding agent. The amount of tax due is to be withheld by the withholding agent at the time it makes the payment or at the time the payable amount is due from, respectively, the payment or the due payable amount.

If the service recipient fails to withhold the tax, the nonresident service provider must report and pay the tax to the tax authority in whose jurisdiction the income is derived.

Under the Law Concerning the Tax Administration and Tax Collection, an entity or individual that is required to withhold and remit tax (which in the circumstances under consideration would usually be the service recipient) is the withholding agent: a taxpayer or withholding agent must pay tax, withhold and remit tax, or collect and remit tax in accordance with the law or administrative regulations. The obligations and legal liability to which a withholding agent is subject will not change even if the withholding agent entrusts any other agent or appoints any other third party to pay the tax due.

Where a withholding agent fails to withhold or collect the amount of tax that should have been withheld or collected, the tax authorities will seek to recover the amount due from the taxpayer, and impose on the withholding agent a fine of not less than 50% of, but no more than three times, the amount of the tax that should have been withheld or collected. The fine imposed on the taxpayer may not be less than 50% of, but may not be more than five times, the amount of the unpaid tax.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

If a nonresident subcontractor provides services in China, the same rules as apply with respect to a nonresident that provides services directly will apply to the subcontractor to determine whether the services create an establishment under Chinese domestic tax law (see I., above) or a PE under a tax treaty (see VIII., below) and whether any withholding tax should be imposed on the service payments.

In the case of a construction project, under Guishuifa [2010] No. 75 ("Circular 75"),[4] if a nonresident enterprise subcontracts any part of the project to another enterprise, the period during which the subcontractor carries out construction activities is to be included in the period during which the principal enterprise carries on such activities for purposes of determining whether the activities give rise to a PE under an applicable tax treaty.

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VI. Exceptions to the General System

Every nonresident corporate service provider is subject to same Chinese CIT rules, including the same withholding tax rate and filing obligations, irrespective of where it is located. The only area in which there might be differences in treatment is with respect to the determination of whether a PE exists in China, which can vary slightly from tax treaty to tax treaty.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

There are no non-tax requirements to be met by a foreign service provider if the services are performed completely outside China or involve only a minimal presence in China that does not rise to the level of a PE under an applicable tax treaty. If a PE is created, the PE must complete a temporary registration procedure for tax purposes and file the relevant returns as required by the tax authorities if the withholding agent fails to fulfill its withholding obligations. There are certain compliance requirements that have to be met on any change, renewal or termination of the service agreement, etc. In practice, certain establishments such as construction projects are required to complete a business registration procedure. The Chinese State Tax Administration is considering new administration measures for withholding on nonresidents' income and new regulations are expected to be issued soon in this regard.

From the perspective of an individual, the proper type of visa must be obtained in order to visit China, based on the length and purpose of the applicant's stay in China. A foreign national who obtains a Chinese work permit must participate in China's social security scheme. In China, different government authorities are in charge of different compliance issues. These government authorities do not coordinate with each other (for example, the tax authorities) for other compliance requirement purposes.

VIII. Difference If There Is an Applicable Tax Treaty Between China and the Foreign Service Provider's Country of Residence

Most of China's tax treaties provide that business income derived by an enterprise of the treaty partner country is not subject to tax in China unless the income is attributable to a PE in China. Generally, China' treaties provide that a PE includes an office or other fixed place of business, and many of its treaties include a list of specific types of establishment—such as a place of management, a branch, a factory, a workshop or a mine, an oil or gas well—that are considered to be PEs. Most of China's tax treaties also provide for a threshold in relation to the constitution of a services PE, typically if the foreign entities perform services in China over a period of time such as six months or 183 days over any 12-month period. In addition, if an agent of a nonresident service provider (other than an independent agent acting in the ordinary course of its business) exercises the authority to conclude contracts in the name of the nonresident service provider, then an agency PE could be created for the nonresident service provider.

If a PE arises under the applicable tax treaty, the same withholding rules and filing obligation apply as would apply in the absence of a treaty. If the entity believes that no PE arises, certain forms required to be filed with the tax authorities together with supporting documents as explained in II, above.

From an IIT perspective, the domestic law position set out at I., above will be changed where the service provider is resident in a country that has a tax treaty with China. Generally speaking, under China's tax treaties, income derived by a resident of the other contracting state with respect to professional services or other activities of an independent character will only be taxable in China if:

- The taxpayer has a fixed base regularly available to him/her in China for the purpose of performing his/her activities; or
- The taxpayer's stay in China exceeds in aggregate 183 days in the tax year/calendar year concerned/rolling 12-month period, as specified in the particular tax treaty.

If the individual concerned is entitled to benefits under the applicable treaty, the withholding agent, i.e., the Chinese service recipient that pays the service fee, should ensure that it retains all the relevant supporting documents (for example, an individual tax resident certificate, travel records, service contract, etc.) on file for future tax audit purposes.

However, if, under the applicable treaty, the income received by the nonresident service provider remains subject to Chinese IIT, neither the tax calculation nor the withholding treatment will change under the terms of the treaty.

Disclaimer

This article represents the author's personal understanding and does not represent Ernst & Young's technical opinion.

The article is based on the Chinese tax law and regulations as well as tax treaties that entered into force as of March 1, 2017, which is subject to development and updates by the Chinese tax authority.

NOTES

[1] In this paper, "China" refers to mainland China in a tax technical context. Such usage is without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, region, city or area.

[2] The term "tax treaty" encompasses both double taxation agreements and double taxation arrangements to which China is a signatory.

[3] The rate is not capped at 50% if the actual profit rate is higher than 50%. In such circumstances, the Chinese tax authorities are empowered to use the actual rate instead.

[4] Circular 75 is an interpretation of the China-Singapore tax treaty. Different tax treaties may be subject to different interpretations, although Circular 75 may, to some extent, represent the Chinese tax authorities' position—at least with respect to those treaties that contain the same provisions as those in the China-Singapore treaty.

DENMARK

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

A. General

There are no circumstances in which a nonresident service provider will be fully taxable in Denmark (in the sense of being taxed on its worldwide income). However, such a service provider may be subject to Danish limited tax liability, i.e., subject to taxation on its Danish-source income.

Generally, a foreign service provider with no establishment in Denmark will not be subject to even limited tax liability and there is no threshold of activity that would give rise to such liability or require a tax return to be submitted. By way of a general comment, it can therefore be observed that, strictly speaking, the considerations that are the subject of this topic would not have any relevance when determining liability to Danish taxation.

That being said, Danish limited tax liability may crystallize for a foreign service provider if the service provider:

- Has a permanent establishment ("PE") in Denmark;
- Receives certain royalty payments; or
- Renders consultancy or other similar services, if the service provider is an individual who used to be a Danish tax resident (or a foreign entity controlled by such an individual) and the Danish entity to which the services are provided is or has been controlled by that individual. This is an anti-abuse measure that applies only to the extent that the income derived from the consultancy services is not taxed in the country in which the individual is resident (for example, if the individual is resident but not domiciled in the United Kingdom, in which case the individual can elect not to be taxed on the income unless it is remitted to the United Kingdom). Given the limited applicability of this anti-abuse measure, it will not be further addressed in the discussion that follows.

B. Foreign Service Provider with a Permanent Establishment in Denmark

The Danish definition of a PE is in accordance with the definition of a PE in the OECD Model Convention. Thus, a PE is created in Denmark pursuant to the general PE rule in Article 5 of the OECD Model if the following three cumulative criteria are satisfied: (1) there is a place of business; (2) the place of business is fixed; and (3) the business of the enterprise concerned is carried on partly or wholly through the fixed place of business. However, under Danish domestic law, unlike under the OECD Model, there is no 12-month threshold that has to be exceeded for a building site or construction or installation project to constitute a PE. The assessment of whether a building site/construction project constitutes a PE is made on a case-by-case basis, taking in to account all the relevant facts and circumstances.

C. Foreign Service Provider in Receipt of Danish-source Royalties

A nonresident may be subject to Danish limited tax liability with respect to royalties paid to it by a Danish resident (though it seems unlikely that such royalties would be paid with respect to services rendered by a foreign service provider). Article 12 of the OECD Model Convention defines "royalties" to mean payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience. However, the Danish domestic royalty definition excludes payments with respect to any copyright of literary, artistic or scientific work. Thus, Danish-source royalty payments for software, music, movies, videos, etc. would not give rise to any Danish tax liability. Nor would payments for the use of, or the right to use, industrial, commercial or scientific equipment. Where Danish-source royalties do give rise to Danish limited tax liability, double taxation may be mitigated or eliminated under the terms of an applicable tax treaty or the Danish domestic law implementation of the EU Interest and Royalties Directive.[1]

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II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

A. Foreign Service Provider with a Permanent Establishment in Denmark

The PE would have to register with the Danish authorities, pay on-account taxes and file an annual tax return (based on self-assessment). The Danish corporate income tax rate is a flat 22%.

B. Foreign Service Provider in Receipt of Danish-source Royalties

If the foreign service provider were to receive a payment falling within the Danish domestic law definition of royalties, the Danish payer would have to withhold tax at the rate of 22% of the gross amount of the payment and report and pay the amount withheld to the Danish tax authorities. In these circumstances, if part of the payment represents consideration for distinct services rendered that do not attract withholding tax, that part of the payment may be excluded from the amount on which the withholding tax liability is calculated. The payer would be liable for any tax not withheld unless the payer were able to demonstrate that it had not acted negligently in this respect.

The withholding tax is a final tax and no tax return is required to be submitted by the foreign recipient of the income concerned (here, the service provider). However, a service provider resident in another EU Member State would presumably be entitled to produce documentation of the relevant costs associated with the Danish-source income received by it and thus be taxed on a net basis. This follows from a number of rulings of the Court of Justice of the European Union (CJEU), including the July 2016 ruling in case C-18/15.[2]

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

This question is not strictly relevant in the context of Danish taxation, but see, respectively, II.A. and II.B., above regarding the taxation of a foreign service provider with a PE or in receipt of Danish-source royalty income.

IV. Mechanical and Procedural IssuesRelating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

This question only has relevance in relation to the position of a foreign service provider in receipt of Danish-source royalty income. The withholding tax rate in these circumstances is 22%, irrespective of whether the foreign service provider is a legal person or an individual. The service recipient (or the person paying the fee) to the foreign service provider must report the amount of tax withheld to the Danish tax authorities on a special form[3] and pay over that tax to the authorities no later than the 10th day of the month following that in which the withholding was made. The payer is liable for any tax not withheld unless the payer can demonstrate that it has not acted negligently in this respect. The obligation to withhold and pay over the tax lies with the relevant Danish taxpayer (or foreign taxpayer with a Danish agent that is paying an amount to a foreign service provider). A refund of tax overwithheld may be available where an applicable tax treaty provides for an exemption from source country taxation or a rate of withholding tax lower than that provided for under Danish domestic law (see VIII. Below).

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

A. Foreign Service Provider with a Permanent Establishment in Denmark

As noted at I.B., above, Denmark uses the OECD definition of a PE, including the agent rule in Article 5(5) of the OECD Model Convention. Thus, only a *dependent* agent could create a Danish PE for a foreign service provider, and only if the criteria laid down in Article 5(5) were satisfied. Denmark applies a substance-over-form approach in this respect, so that the presence of a sales person in Denmark can create a Danish PE even where the relevant sales contracts are always signed outside Denmark, if the contracts are in fact negotiated by the sales person in Denmark and the signing of the contracts by superiors outside Denmark is simply regarded as a formality.

B. Foreign Service Provider in Receipt of Danish-source Royalties

Depending on the particular circumstances, a foreign service provider subcontracting the provision of services may still be taxable on Danish-source royalty payments either because the royalty payments are deemed to be made directly to the foreign service provider or because the subcontractor liable to taxation in Denmark is deemed to make royalty payments to the service provider.

VI. Exceptions to the General System

A. Foreign Service Provider with a Permanent Establishment in Denmark

There are no exceptions to the general rules described above in relation to a foreign service provider with a PE in Denmark.

B. Foreign Service Provider in Receipt of Danish-source Royalties

As noted at I.C. above, service providers resident in other EU Member States may benefit under the EU Interest and Royalties Directive. Also, as noted at II.B., above, EU-resident service providers may be eligible for taxation based on their net rather than their gross income.[4]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

All foreign service providers providing services in Denmark through employees present in Denmark for more than eight days must register with the Register of Foreign Service Providers ("RUT"), the Danish government's official register for reporting the provision of services by foreign service providers. The registration must provide information with respect to the services rendered and the employees who render the services. Depending on their country of origin, the employees may need to acquire Danish visas.

There is no specific coordination between the government agencies responsible for the above matters and the tax authorities, since foreign service providers are not subject to regular Danish taxation except where they are deemed to have Danish PEs.

VIII. Difference If There Is an Applicable Tax Treaty Between Denmark and the Foreign Service Provider's Country of Residence

A. Foreign Service Provider with a Permanent Establishment in Denmark

A tax treaty to which Denmark is a party would normally specify a time threshold, so that a building site or installation or construction project in Denmark lasting for less than the time specified would not give rise to a Danish PE. The 12-month period specified in the OECD Model Convention is often used in Denmark's treaties.[5]

B. Foreign Service Provider in Receipt of Danish-source Royalties

The Danish domestic law withholding tax rate of 22% applying to royalty payments made to a nonresident that fall within the narrow Danish domestic law definition of royalties may be eligible for reduction or elimination under the terms of an applicable Danish tax treaty. The relief is given by way of a refund of the excess withholding tax obtained by submitting an application to the Danish tax authorities. A reduced or zero rate may not be applied upfront except where the EU Interest and Royalties Directive is applicable. The foreign service provider must use a special form[6] to claim a refund and provide documentary evidence of tax residence in the treaty partner country/EU Member State and, if required by the treaty concerned, evidence that the royalty income is taxable in that residence country. A Danish service recipient is required to provide a certificate to the foreign service provider indicating the relevant amount of tax withheld, reported and paid to the Danish tax authorities.

NOTES

[1] 2003/49/EU as amended.

[2] *KBC-Brisal*.

[3] Form 06.013.

[4] The Danish tax authorities have not yet expressed their opinions on the recent CJEU ruling in case C-18/15 (*KBC-Brisal*).

[5] See, e.g., 1995 Denmark-Germany tax treaty, Art. 5(3) and 1996 Nordic convention, Art. 5(3).

[6] Form 06.013.

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FRANCE

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

The comments in this paper relate only to direct taxation. Indirect tax rules, in particular value added tax (VAT) rules, which generally permit a large degree of source-country taxation, are outside the scope of the paper and will not be addressed. The paper focuses mainly on the provision of services by a foreign corporation: only limited attention is given to service providers who are individuals and to income from services that does not constitute business income.

The provision of services by a nonresident service provider can be taxable in France under three sets of rules:

- First, Article 164 B of the French Tax Code ("FTC") defines French-source income to include, in particular, income from commercial activities carried on in France, but also other professional income derived in France, including income from the supply of the services of athletes and artists, and income from patents and other intellectual property paid by a French payer.
- Second, Article 209 of the FTC, which defines the scope of corporate income tax ("CIT"), permits the taxation of a foreign corporation if the corporation can be regarded as "carrying on a business" in France.
- Third, a nonresident provider of services may be subject to withholding tax on its French-source income. The withholding tax provided for by Article 182 B of the FTC applies whether or not the nonresident beneficiary of the income concerned is subject to directly assessed tax in France: the withholding tax is an independent tax, separate from directly assessed tax, and is not therefore, technically, simply a way of guaranteeing the payment of directly assessed tax. The withholding mechanism is discussed in II., below.

As further explained below, France, as the source country, is in principle prohibited from imposing either directly assessed tax or withholding tax on business profits derived by a service provider resident in the treaty partner country where a tax treaty applies, if the service provider is not physically established in France and does not have a dependent agent in France (the relevant treaty rules are discussed in VIII., below).

As regards France's domestic CIT rules with respect to business income, under Article 209-I of the FTC, "the income liable to corporation tax is computed by taking into account only income generated by enterprises carrying on a business in France, as well as French-source income as defined in Article 164 B of the FTC and income the taxation of which is allocated to France in accordance with the provisions of a tax treaty."

It is important to understand that, in accordance with this definition, France's nexus rules are unlike those of most other countries in that France applies a territorial approach to assessing CIT (It should be noted that this "territorial" approach applies only to entities subject to CIT; it does not apply to individuals, who are taxed on their worldwide income).

Because of this territorial approach, the criteria used to determine: (1) whether *a nonresident corporation* is taxable in France; and (2) whether *a French corporation subject to CIT* is taxable in France on its foreign-source income or whether such income is to be excluded from the territorial base, must be applied symmetrically. Thus, for example, the wider the range of circumstances in which foreign corporations are regarded as deriving income from electronic commerce that is subject to French tax, the wider the range of circumstances in which French companies generating profits abroad from the same activities or in the same situations would be regarded as deriving income outside the French territorial nexus (or as incurring losses that are not deductible for French tax purposes).

In its reliance on a combination of the fixed place of business and dependent agent criteria, the concept of "carrying on a business in France," as used in France's domestic CIT law, is quite close to the corresponding tax treaty approach. However, French case law has extended the concept to encompass situations in which the foreign corporation has no such fixed place of business or dependent agent, but carries out a "full commercial cycle" in France.

The "full commercial cycle" concept derives from a 1944 court decision (in which purchase and sale transactions carried out outside France were excluded from the territorial scope of French taxation) and was

subsequently incorporated into administrative guidelines. The concept refers to situations in which a nonresident carries out a significant number of business operations that, taken together, constitute a comprehensive business in France (one transaction or only a few transactions would not be sufficient). The classic example of a full commercial cycle is an operation of buying and selling goods or services in France.[1] Another well-known example is furnished by the case of a radio station located in Monaco but receiving advertising fees for transmitting radio broadcasts received by French listeners, a technical precursor of the "GAFA" model.[2]

There is more recent case law that deals with income from the provision of services related to a building site abroad, which was regarded as outside the French territorial nexus.[3] In a number of cases, the concept was, however, restricted by requiring that the activity at issue be considered in "dissociation" from the corporation's main activity,[4] an approach that, where it entails the requirement that there be no involvement of the head office, in practice significantly undermines the full commercial cycle concept.

What does emerge clearly from all these cases, is that to qualify as a full commercial cycle, the activities concerned must have enough substance, continuity and regularity to constitute a taxable business in France. Thus, "casual" transactions should not qualify, even though there is no clear delineation of the point at which casual transactions become regular.

It is important to note that the scope of the full commercial cycle concept, which technically can produce conclusions that diverge from those resulting from the application of more usual permanent establishment ("PE") criteria, remains largely confined to theoretical realms. As already noted, the concept applies only in a non-tax treaty context, because it is not compatible with the treaty criteria, which require a physical presence in France, whether through a fixed place of business or a dependent agent.

Furthermore, the physical presence of teams on site was a factor that was considered in the above cases concerning building sites, which further limits the autonomy of the concept (though the radio station case referred to above probably has more current relevance). That being said, the full commercial cycle concept would seem to be highly relevant in analyzing the treatment of transactions effected through the internet (though again only in a non-treaty context).

Turning to the more traditional PE criteria used in a tax treaty context, the French administration has indicated in the past that the presence of a server does not by itself constitutes a PE and looks mainly at the presence of staff or other agents.[5]

As in other countries, a hot issue in France is whether a foreign corporation "commercializing" goods or services through the Internet should be subject to French CIT, where the corporation has not registered a taxable PE in France, but carries out activities in France, either through a presence that is represented as being auxiliary and preparatory, or through dependent agents located in France.

In these latter circumstances, the relevant question is whether or not such presence constitutes a PE in substance. As such, it is not really a question relating to territoriality principles described above, but a question of fact regarding the substance of the French activities in terms of the traditional PE criteria. Similar questions can arise in relation to transfer pricing, when services are provided by a foreign corporation and a related entity of the foreign corporation located in France and acting as an agent is involved in the process.

These issues, which are at the center of the BEPS discussions, are highly sensitive, and, since 2009, the French government has been under public pressure to take steps to counter what is widely perceived as aggressive tax optimization and even fraud—albeit that much of this public pressure unfortunately fails to make a clear distinction between legitimate and necessary tax optimization (as accepted by the Court of Justice of the European Union ("CJEU") itself in a landmark case[6]) and the kind of aggressive optimization that relies on artificial structures.

It is interesting to note that, quite independently of the OECD's BEPS initiatives (which will not be discussed here since they are not purely a question of French domestic law), a few weeks ago in the most recent Finance Bill (i.e., the Finance Bill for 2017), the French Parliament tried to introduce a provision (proposed Article 209 C of the FTC) that would in essence have functioned as a kind of reverse controlled foreign corporation ("CFC") mechanism: instead of taxing the foreign income of CFCs or other foreign entities controlled by French resident entities (as provided for by Article 209 B), the proposed measure would have taxed foreign controlling entities on income deemed attributable to their French agents.

In summary, proposed Article 209 C of the ITC was aimed at a foreign corporation, whether or not established in France, carrying on activities consisting of sales of goods or supplies of services on the French market, through a dependent agent or a website, when "there are serious reasons" to consider that the activities of the foreign corporation had the purpose of avoiding or reducing tax due in France. When applicable, Article 209 C would have allowed France to impose the tax on the income arising from such activities that would normally have been due in the absence of an artificial arrangement.

There was, however, no explanation as to what the tax normally due would have been and why, if the tax would normally have been due under other ordinary provisions of the FTC, these existing ordinary provisions were not sufficiently effective to tax the foreign entity, without a provision as ambiguous provision as Article 209 C having to be implemented. The proposal also indicated that the provision could be used in a tax audit based on a decision of the tax authorities to apply the presumption with respect to the taxpayer under audit, thus leaving a great deal of autonomy to the administration in deciding whether or not to implement the provision.

Unsurprisingly, this new provision (originating as it did in an isolated initiative of the Parliament, and voted contrary to the will of the government) was rejected and annulled by the French Constitutional Council before coming into force, based on the principle that Parliament cannot surrender to the tax administration the constitutional prerogative, which is its alone, to define the scope of taxation: apart from

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the fact that it was based on a number of apparently very vague concepts, proposed Article 209 C was worded in such a way as to leave too great a power of interpretation to the tax administration.

Although it was not necessary for the Constitutional Council to express its opinion on all the constitutional principles involved (one constitutional reason to annul the law being sufficient), as worded, proposed Article 209 C appeared also to raise other difficulties in relation to equality principles (equality with respect to taxation and with respect to the law), and the principle of certainty of rights, both provided for by the 1789 Declaration of Human and Citizens Rights, which remains part of the French Constitution (and remains impressively apposite and effective, even after more than two centuries, especially now that it can be resorted to in litigation).

Furthermore, implementing a reverse CFC mechanism only applicable to foreign entities and extending the territorial nexus in the situations in which the mechanism was applicable would have created an asymmetry with the territorial approach applied to French-based corporations and would have created substantial tax discrimination (or reverse discrimination) problems.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

To combat fraud in the form of having a physical presence in France but not recognizing the income attributable to such presence, the French tax administration can have recourse to a special audit procedure (L 16 B of the Tax Procedure Code), which, in a departure from normal practice, allows unannounced, on site audits, after prior authorization has been obtained from a judge, based on suspicion of the existence of fraud with respect to tax. The procedure allows the administration to seize all documentation necessary to establish the nature and substance of the activity on French soil. The number of these L16B procedures has substantially increased over the years and foreign service providers with some form of presence in France are in the focus of attention.

Apart from this audit procedure, withholding tax is imposed on payments made to nonresident service providers that are not established in France under the widely-drawn provisions of Article 182 B of the FTC. An anti-avoidance mechanism targeted at foreign "rent-a-star" entities may also apply to both resident and non-resident service providers.[7]0

Under Article 182 B of the FTC, payments made by a French resident professional or corporation to a nonresident provider of services are subject to withholding tax at the rate of 33.33% (15% in the case of payments to athletes). No withholding tax applies to payments made by individuals acting in a private capacity (i.e., no "B-to-C" services are subject to withholding tax).

The withholding tax is imposed on gross payments made in consideration of services furnished or used in France, which gives the tax a wide scope. Article 182 B of the FTC also applies to income derived from nonbusiness activities, such as income from patents and other intellectual property and income deriving from sporting activities (artistic activities are dealt with in a separate article, Article 182 A *Bis*).

France's tax treaties generally prevent the imposition of this withholding tax, under their articles dealing with business profits (which require an enterprise of the treaty partner country to have a PE in France for the enterprise's business profits to be subject to French source country taxation), or royalties (though some of France's treaties allow withholding tax to be imposed on royalties, at a reduced rate).

Apart from this general withholding tax on income from the provision of services, Article 155 A of the FTC also allows France to tax remuneration paid by a French payer to a foreign entity for services effectively rendered by a French resident, when the foreign entity is controlled, directly or indirectly, by the French resident (for example, in the context of a "rent-a-star" structure), which hires an artist or athlete as an employee and receives the fees for the artist's or athlete's performances. The income received by the foreign entity in these circumstances is taxable in the hands of the French resident, unless the French resident can establish that the entity's activity does not essentially consist in the supply of the French resident's own services, whether in France or abroad, and/or that the service supplied by the foreign entity itself constitutes the main service supply.

Article 155A also applies to a nonresident supplying services in France (even, in principle, where that nonresident is a corporation) that controls a nonresident entity receiving remuneration for services supplied in France by the nonresident service provider (i.e., Article 155 A applies to nonresidents only with respect to their French-source income, but does apply to such income even where the transaction giving rise to it is an isolated transaction).

Under these provisions, the person receiving the remuneration is jointly responsible for the tax due.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Article 182 B withholding tax applies to all gross payments made by a French resident professional or corporation to a foreign beneficiary, whatever the amount of the payment concerned.

The status of the withholding tax with respect to directly assessed tax remains somewhat ambiguous, though it has been clarified to a certain extent by recent case law.[8] When the provisions of Article 182 B of the FTC were voted on in 1976, it was indicated during the parliamentary debate that the intended function of the withholding tax was to guarantee the payment of directly assessed tax, which could have confined the scope of the withholding tax to situations in which directly assessed was due. In these circumstances, business income derived by nonresidents not carrying on a business in France (i.e., having no fixed place of business and no agent in France and not carrying out a full commercial cycle in France in satisfaction of the criteria laid down by French domestic law) would not have been subject to withholding tax.

However, in a July 30, 1997 decision,[9] the High Court held that the withholding tax could be imposed, irrespective of whether directly assessed tax was due.

This left open the question of whether the withholding tax could be credited against directly assessed tax due or whether it constituted an entirely independent tax. It has now been confirmed by the High Court (in a February 17, 2015 decision[10]) that the withholding tax is not a final tax and that, when there is a corresponding directly assessed tax liability, the withholding tax paid can be credited against the directly assessed tax due.

In practice, the above situation would only arise for taxpayers subject to progressive income tax on their French-source non-business income (for example, income from patents and other intellectual property, income from the activities of athletes, and pension income), as defined in Article 164 B of the FTC as discussed in I., above. The minimum progressive rate of directly assessed tax applicable to nonresidents is 20%, but this minimum rate does not apply if the taxpayer is able to establish that the application of the progressive rates to its worldwide income would result in an effective rate lower than 20%. Directly assessed tax amounts of less than 305 euros are not due.

Where the application of the progressive rates to net income (after the deduction of related expenses) results in a tax burden lower than the withholding tax burden, the excess withholding tax will be refunded. The withholding tax is thus neither a minimum nor a maximum tax.

In principle, the position would be different for a nonresident in receipt of business income, since, assuming the nonresident is not established in France, there would be no CIT or directly assessed tax liability against which the withholding tax paid could be credited (in the absence of a business carried on in France). In this context, the withholding tax still operates as a separate tax, not merely as a guarantee of payment. Nonetheless, a nonresident in these circumstances should be able to claim a refund if the withholding tax on gross income is higher than the tax that would be due on net income, taking into account related expenses.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Payments made by a French resident to a nonresident service provider must be reported in the annual return of payments made to service providers (including resident and nonresident service providers) and penalties equal to 50% of payments made can be imposed in cases of failure to report.

The service recipient is considered a "withholding agent" with respect to payments to a nonresident service provider and must pay the withholding tax due before the 15th of the month following that in which the payments are made. In cases of failure to withhold, a 9000 euro penalty can be imposed and the administration can deem the amount paid to be a net amount and compute the withholding tax due on the deemed gross amount (gross-up).

A withholding agent must either withhold the full amount of the applicable withholding tax or obtain documentation upon which it may rely to apply a reduced or zero rate of withholding tax.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Where a nonresident service provider subcontracts with a local agent, the local agent is, of course, taxable on the related income received from French clients with which the agent contracts in his/her own name. If the agent is a dependent agent and contracts in the name of the foreign supplier (albeit this is not actually a subcontracting arrangement) the agent may be regarded as a PE of the contractor where the usual criteria are satisfied.

A more difficult question to answer—and one that currently often arises as a practical matter—is how a contractor and an independent agent should be taxed where the income received by the agent from clients is, even partially, paid back to the contractor, as will generally be the case. The focus will normally be on transfer pricing—the functions effectively performed by the agent and the appropriate consideration for intangibles—but, in some circumstances, the tax administration may argue that the foreign contractor is, in fact, established in France, which would require a requalification of the agent as being dependent. Even in the latter situation, the real question is a transfer pricing question: what income should be allocated to what party for what functions?

VI. Exceptions to the General System

The EU Interest and Royalties Directive prohibits the imposition of withholding tax on royalty payments made between related entities (25% control is required) resident in the European Union.

The rate of withholding tax is increased from 33.33% to 75% for payments made to beneficiaries located in "non-cooperative" countries.[11]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

As noted at I., above, the presence of premises and staff in France point to the existence of a French PE except when the activity is limited to auxiliary and preparatory functions. The use of premises in France must be reported to the tribunal of commerce, and triggers a liability to French local taxes related to premises (even if auxiliary). The presence of staff in France must also be declared for social security purposes. Such physical presence in France does not necessarily constitute a fixed place of business when the activity in France is limited to preparatory and auxiliary functions, but this exception is limited in scope. The French tax administration has undertaken numerous audits to examine the presence of nonresident enterprises in France, often using the on-site L16 B procedure to appropriate evidence regarding a potential taxable presence.

VIII. Difference If There Is an Applicable Tax Treaty Between France and the Foreign Service Provider's Country of Residence

France's tax treaties generally follow OECD guidelines and the definition of a PE in those treaties is normally based on the traditional fixed place of business and

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dependent agent criteria and thus excludes situations in which a nonresident enterprise carries out a "full commercial cycle," which are not relevant in a treaty context. The treaties prohibit the imposition of source country tax (withholding tax) on business profits derived by an enterprise resident in the other country, where the enterprise does not have a PE in the source country. Some of France's treaties permit the imposition of withholding tax on royalties (albeit at a reduced rate), in which case the principles discussed in II. and III., above, may apply. In all cases, a French payer of income to a nonresident must obtain sufficient documentation to establish that the nonresident qualifies for benefits under the applicable treaty.

Since France has an extensive network of tax treaties, treatment in accordance with OECD principles will apply in most circumstances. Non-treaty situations are the exception and generally arise where a tax haven is involved, but it is worth noting also that Denmark has denounced its treaty with France (for reasons related to the treatment of pensions) and is one of the few OECD countries (perhaps the only OECD country) in relation to which French domestic law, rather than treaty rules, will determine the tax treatment.

All that being said, for the reasons explained above, when and how a nonresident service provider should be taxed in France remains a highly sensitive issue, especially when the service provider has some form of presence in France (through an agent, a subcontractor, or a presence that is represented as being preparatory or auxiliary in nature).

By way of a general conclusion, it is worth emphasizing that the French domestic law territoriality concept is wide in scope and the best approach is to examine the wording of the applicable treaty (if any) regarding the definition of a PE and auxiliary activities. Based on current law and treaty principles (and subject to any change in the OECD approach), where a foreign service provider has absolutely no physical presence in France and no agent in France, income derived by the service provider should clearly be outside the scope of French taxation. Other situations will require the carrying out of a functional and transfer pricing analysis based on the relevant facts.

Discussions revolving around source of income issues did not begin with the Internet[12]—they have a long history, dating back to before the creation of the Internet, in the context of the tax treatment of intangibles and the attempts of developing countries to retain a taxing nexus with respect to income generated in their markets, especially in relation to business-to-consumer activities. Doubtless, developing countries will be following the ongoing BEPS discussions with a great deal of interest—in particular, any amendment to the source of income rules that could arise from such discussions.

NOTES

[1] High Court May 22, 1963 n°46870.

[2] GAFA is an acronym coined by the French media for U.S. tech. giants, Google, Apple, Facebook, Amazon.

[3] High Court May 17, 1989 n°34380.

[4] High Court Feb. 5, 1968 n° 62333.

[5] Ministerial answers *De Chazeaux*, 1998 and 2001; note, however, that these answers are no longer commented on or referred to on the French tax administration's web site.

[6] *Cadbury Schweppes* EUCJ Sept. 12, 2006 n°196/04.

[7] FTC, Art. 155 A.

[8] CE Feb. 17, 2015 n° 373230.

[9] High Court July 30, 1997 n°169179.

[10] High Court Feb. 17, 2015 n° 373230.

[11] "Non-cooperative" countries are specified in a list published every year by the tax administration. A non-cooperative country is a non-EU Member State that:

- Has been subject to OECD review;
- Has not concluded a tax treaty with France allowing for the full exchange of information for purposes of applying the Contracting States' tax legislation; and
- Has not concluded such treaties with at least 12 other countries.

The last list published by the Administration includes Botswana, Brunei, Guatemala, Marshall Islands, Nauru, Niue, and Panama.

[12] *See* Report to IFA Congress: *Taxation of Income Derived From Electronic Commerce*, Vol. 86a, San Francisco (2001).

GERMANY

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Nonresident persons are subject to German "limited tax liability,"[1] if they derive "domestic income." Domestic income is defined in the exhaustive catalogue set out in § 49(1) of the EStG. The structure of this catalogue follows the definition of taxable income contained in § 2 of the EStG. Under that provision, taxable income is defined by reference to seven classes of income. Income that does not qualify as income under one of these seven income classes is not taxable at all. Foreign service providers may derive income falling within either § 49(1) class No. 2 or § 49(1) class No. 3. Class No. 2 comprises income from trade or business. Under § 49(1) No.2a), income from trade or business is domestic, if it is derived from a domestic permanent establishment ("PE"). While this is the basic—and most important—rule, there are a number of variations on the rule that apply with respect to particular businesses.[2] For instance, income derived from a business consisting of transportation carried out by sea-going vessels or aircraft, is domestic income if the transportation is carried out between or from domestic harbors or airports.[3] The income of a sportsperson, athlete or artist (if not covered by class No. 3, see below) is domestic income, if the relevant services are either performed or used in Germany, regardless of the person to whom the remuneration for the services is paid.[4] Income from the business of letting real estate or the licensing of rights is domestic, if the real estate or the rights concerned is/are located in Germany.[5] Class No. 3 comprises income from independent professions. Such income is domestic income if the services concerned are performed or used in Germany.

The distinction between a trade or business on the one hand and an independent profession on the other is a peculiarity of German tax law, the importance of which lies in the fact that only income from trade or business derived through a domestic PE is subject to the municipal trade tax (*Gewerbesteuer*). "Trade or business" is defined in § 15 of the EStG, and "independent or liberal profession" is defined in § 18 of the EStG. The activities of a corporation always constitute business or trade.[6] Until 2000, the distinction between a trade/business and an independent profession was also to be found in the OECD Model Convention: Article 7 of the OECD Model dealt with "business profits," Article 14 with income from independent personal services. Since countries—other than Germany—generally do not have any use for the distinction, Article 14 was eliminated from the OECD Model as of 2000, so that income from independent personal services is now also covered by Article 7.[7] Under German domestic tax law, the distinction between a trade or business and an independent profession remains problematic and has given rise to a large number of court decisions.

Since, for current purposes, the nonresident service provider is envisaged as not having a domestic PE, the following discussion will focus on domestic income within the meaning of § 49(1) No. 3 of the EStG, i.e., on income from an independent activity as defined in § 18 of the EStG. (Neither services that consist of the licensing of rights —copyrights, patent rights, know-how and the like —or the letting of real estate, nor services consisting of the lending of money will be discussed here.) Under this complex provision, income from an independent activity is income from self-employment in the field of science, the liberal arts, writing, teaching or education and the like. § 18 also contains a long list of self-employed taxpayers who are regarded as deriving income from independent services. The list will not be reproduced in its entirety here, but includes attorneys, medical doctors, engineers, architects, chemists and journalists.

Income of such self-employed taxpayers is domestic if the activity from which the income is derived is either carried out or used in Germany. Thus, for example, an attorney who works for a German client derives taxable domestic income if the attorney works in Germany or if the results of the attorney's work are used in Germany, for instance, by virtue of the transmission of legal advice to a client of the attorney in Germany. Remuneration paid to a nonresident opera singer for singing in Germany is domestic income. Services performed by foreign artists/performers may constitute either independent personal services or trade or business. However, since the criteria for classifying income from the activities of artists/performers as domestic income under § 49(1) No. 2 and under § 49(1) No. 3 of the EStG are the same, it does not matter, for practical purposes, whether the

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activities of a foreign artist/performer qualify as trade or business or as independent professional activities.

As noted above, the income of corporations always constitutes income from trade or business. Under § 49(1) No. 2a of the EStG, where derived by a nonresident corporation, such income would be domestic income only if it were derived through a domestic PE. It would, therefore, seem that, if a nonresident corporation of attorneys were to give legal advice to a German client, the remuneration for that advice would not be domestic income if the corporation had no office in Germany. However, in such circumstances, § 49(2) of the EStG applies. Under § 49(2), the facts pertaining in the relevant foreign country are to be ignored where domestic income *cannot* be assumed if the foreign facts *are* taken into account. If the foreign elements of the case envisaged above are ignored— i.e., the fact that the service provider is a corporation—then § 49(1) No. 3 of the EStG applies, under which the remuneration for the advice would be domestic income because the independent personal services concerned are used in Germany.[8]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Sportsmen, artists, athletes and models are subject to a 15% withholding tax on their gross income.[9] No withholding tax is due if the remuneration for a single service does not exceed 250 euros.[10] Foreign members of a supervisory board of a German corporation are subject to a 30% withholding tax. Nonresident taxpayers that are nationals of, or corporations established in, an EU Member State may choose to deduct expenses from their income. If this choice is exercised, the withholding tax rate is 30% for a taxpayer who is an individual and 15% for a corporation. Moreover, nationals/corporations of EU Member States may ask to be assessed, in which case the withholding tax is credited against the assessment tax liability and any excess tax withheld is refunded. The assessment is made by the Federal Central Tax Office ("BZSt").[11] In all other cases, the withholding tax is a final tax.[12]

All other self-employed service providers and freelancers are required to file tax declarations[13] on the basis of which they are assessed. There is little guarantee that a nonresident taxpayer will file a tax declaration or pay the tax due. To take a couple of examples, if a nonresident medical doctor regularly attends to German patients, or a nonresident attorney regularly renders legal services to his/her German clients, it is hoped that they will register with the Finance Office in whose jurisdiction they work and that they will file the required tax declarations. Assessments made with respect to such taxpayers are normally accompanied by requests for quarterly advance tax payments for subsequent years, calculated on the basis of the assessed tax.

Exceptionally, the competent Finance Office may order the withholding of income tax at the rate of 25%, if this seems to be a desirable way of securing the tax claim.[14] If the taxpayer is a corporation, the withholding tax rate is 15%. The Finance Office may modify the withholding tax rate for individual taxpayers, if this seems appropriate. The withholding tax in these circumstances is not a final tax, but will be credited against the assessed income or corporation tax.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Where the withholding of tax is provided for, as in the case of sportspersons, artists, models, athletes, etc., whose services are rendered or used in Germany, and nonresident members of the supervisory board of a German corporation, the base for the withholding tax is the gross income (including a proportion of refunds of travel expenses). As noted in II., above, the withholding tax is final. As a result of a number of decisions of the European Court of Justice ("ECJ"),[15] which held that this kind of taxation was incompatible with European law, nationals of other EU Member States providing services in Germany may choose either to reduce the withholding tax base by deducting expenses directly linked to the services they provide or to request an assessment.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Detailed rules regarding the withholding obligations of service recipients are set out in §§ 73a – 73g of the EStDV.[16] As withholding agent, a service recipient must file a withholding tax declaration with the Federal Central Tax Office for each quarter and pay the withholding tax due on or before the tenth day of month following the end of the quarter concerned.[17] A tax audit may be carried out at the premises of the withholding agent to ensure the withholding tax has been correctly declared and paid.[18] If the tax is not declared and paid correctly, the BZSt will request the tax due either from the withholding agent or from the nonresident taxpayer by issuing, respectively, a notice of liability or a notice of tax assessment.[19]

Nonresident service providers that are not subject to withholding tax, must declare their annual income to the competent Finance Office.[20] The competent Finance Office is the Finance Office in whose jurisdiction the services are rendered or used, or if the services are rendered or used in more than one jurisdiction, the Finance Office in whose jurisdiction the services are mainly rendered or used.[21] The declaration must be filed on a paper form (ESt 1A) or by electronic device by May 31 of the year following that in which the services are rendered. On request, an extension of this date may be obtained.

In calculating their taxable income nonresident taxpayers may deduct expenses directly related to such income, with the exception of the amounts referred to in § 50(1) of the EStG, i.e., personal expenses, special expenses (*Sonderausgaben*), such as insurance fees, and extraordinary charges (*Auszergewöhnliche Belastungen*), such as losses attributable to flood or fire damage. Nonresident taxpayers are not entitled to the benefit of the option to split income between spouses or to child allowances. The tax base by reference to which the income tax rate applicable to nonresident taxpayers is determined consists of domestic taxable

income increased by the general tax free amount (*Grundfreibetrag*), which is currently 8, 652 euros.[22]

> *Example:* In 2016, a nonresident medical doctor has been asked to participate in a number of complicated operations to be performed in Germany. The taxable income derived from this activity is 12,384 euros. The base for determining the income tax rate is 12,348 euros + 8,652 euros = 20,000 euros. According to the tax table for single individuals, the corresponding tax would be 2,567 euros, which corresponds to a tax rate of 12.8%. The doctor's tax liability would be 12.8% × 12,348 euros = 1,580 euros.

While the tax burden on nonresident taxpayers may be much heavier than that on resident taxpayers, subject to certain conditions, nonresident taxpayers may opt to be taxed like resident taxpayers.[23]

The assessment notice is normally delivered through the postal service.[24] If this is not possible, the Finance Office may ask the taxpayer to appoint a domestic authorized recipient.[25]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The particular manner in which services are rendered does not affect the German tax consequences for the service provider: if a nonresident service provider who is contracted to provide services to a German service recipient renders those services through an employee or through a subcontractor, the nonresident service provider is still regarded as providing the services. The income derived from services rendered in this manner is domestic income because the services are rendered or, in any event, used in Germany. For example, if a nonresident attorney gives legal advice to a German client through an employed associate or with the help of another law firm, the advice still constitutes a service provided by the attorney that is rendered or used in Germany.

It should also be noted that, if the service provider is an athlete or an artist who performs his/her activities in Germany, the remuneration for the activities represents domestic income even if it is paid to a corporation that contracted to provide the services of the athlete/artist.

VI. Exceptions to the General System

Under § 2 of the AStG,[26] a nonresident taxpayer may be subject to extended limited income tax liability. This provision applies when a formerly German resident taxpayer who has moved to a tax haven country continues to be economically engaged in Germany. The taxable income of such a taxpayer will include not only his/her German domestic income within the meaning of § 49(1) of the EStG, but also all his/her income that is not foreign income according to the catalogue in § 34d of the EStG. For example, while interest paid by a German debtor to a nonresident taxpayer does not qualify as domestic income under § 49(1), neither does it qualify as foreign income within the meaning of § 34d.

It should also be noted that, if the service provider is a corporation with mainly German shareholders, the service provider may be a controlled foreign corporation ("CFC") if it resides in a tax haven country. If such a service provider renders services to its shareholders or—in certain circumstances—to other German residents, or if its German shareholders cooperate in the rendering of services, the German shareholders of the service provider may be subject to Germany's CFC legislation.[27]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

There are no non-tax provisions that specifically apply with respect to services rendered or used within Germany, though of course, the relevant general legal provisions will apply in this context. A service provider resident in a country whose nationals require visas to be able to enter Germany who wishes to be physically present in Germany when rendering his/her services will need to obtain a visa and behave in accordance with German law.

VIII. Difference If There Is an Applicable Tax Treaty Between Germany and the Foreign Service Provider's Country of Residence

Under Germany's older tax treaties remuneration for services rendered by a nonresident service provider is taxable in Germany only if the services are rendered through a German "fixed base regularly available to" the service provider.[28] Under recent treaties, which do not make the distinction between business profits and income from independent personal services, the Business Profits Article applies to income from personal independent services.[29] Consequently, under such treaties, the term "permanent establishment" applies instead of the term "fixed base" to determine whether Germany has taxing rights with respect to income derived by a nonresident service provider. Under all Germany's tax treaties, Germany has no taxing rights with respect to remuneration paid to a nonresident service provider for services used, but not rendered, in Germany.

NOTES

[1] § 1(4) EStG (*Einkommensteuergesetz*—Income Tax Act) for individuals; § 2 KStG (*Körperschaftsteuergesetz*—Corporation Tax Act) for corporations.

[2] § 49(1) No.2 b) – g) EStG.

[3] § 49(1) No. 2 b) EStG.

[4] § 49(1) No.2 d) EStG.

[5] § 49(1) No.2 f) EStG.

[6] § 8(2) KStG.

[7] This results from the fact that "business" is defined in OECD Model Convention, Art. 3(1)(h) to include "the performance of professional services and of other activities of an independent character."

[8] See BFH (*Bundesfinanzhof*— Federal Finance Court), decision of December 18, 1974, I R 161/73, BStBl.II 1975, 464.

[9] § 50a (1) and (2) EStG.

[10] § 50a(3) last sentence EStG.

[11] *Bundeszentralamt für Steuern* —BZSt, cf. §§ 50(2) sentence 8 EStG.

[12] § 50(2) sentence 1 EStG.

[13] § 25(3) EStG.

[14] § 50a(7) EStG.

[15] The first case was that of the Dutch drummer, who successfully contended that he was unlawfully discriminated against as compared with a resident German drummer, because he was not able to deduct his expenses and because the basic income tax exemption available to a German resident was not available to him. This was held not to be compatible with the freedom of movement of services provided for by Art. 49 of the EGV (European Community Convention), now Art. 56 of the AEUV (Convention on the Functioning of the Organs of the European Union): see EuGH, decision of June 12, 2003, Rs.C-234/01 *Arnoud Gerridse*, IStR 2003, 458.

[16] *Einkommensteuer-Durchführungsverordnung*—Income Tax Ordinance.

[17] § 73e EStDV.

[18] § 73d EStDV.

[19] § 73g EStDV.

[20] § 25 EStG.

[21] § 19(2) AO (*Abgabenordnung* — Fiscal Code).

[22] § 32a(1) EStG.

[23] *See* § 1(3) EStG.

[24] § 122 AO.

[25] § 123 AO.

[26] *Auszensteuergesetz*— Foreign Relations Tax Act.

[27] §§ 7 ff. ASt.

[28] 1998 OECD Model Convention, Art.14.

[29] 2000 OECD Model Convention, Art.7.

INDIA

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

A. Scope of Taxation of a Nonresident

Broadly, under the Indian Income-Tax Act, 1961 ("ITA"), a nonresident is taxable in India with respect to its income, from whatever source derived, that is received or deemed to be received in India, that accrues or arises to it in India, or that is deemed to accrue or arise to it in India. Below are some instances in which income would be taxable in India in the hands of a service provider.

B. Business Connection

Under the ITA, there is no objective threshold of activity in terms of length of time, size of project, etc. at which a nonresident becomes subject to Indian taxation. Generally, a nonresident service provider will be taxable in India if it has a "business connection" in India.[1] The ITA does not provide an exhaustive definition of the term "business connection." Indian Courts have interpreted the term "business connection" on a number of occasions with reference to the various facts, circumstances and prevailing conditions. Based on the broad principles that have emerged from these cases, "business connection" means something more than a business; it presupposes an element of continuity of business relationship. A stray or isolated transaction is not normally regarded as a business connection.[2] The essence of a "business connection" is the existence of a close, real, intimate relationship and a commonality of interest between the nonresident concerned and the Indian person concerned.[3] Once it is established that a business connection of the nonresident exists in India, only profits attributable to operations carried out by the nonresident in India by way of a business connection are taxable in India.

C. Fees for Technical Services

Apart from taxability based on the test of a business connection, the ITA provides for the taxability of a foreign service provider if the income from the services qualifies as fees for technical services ("FTS"). FTS are taxable only when the *payer* is one of the following:

- The Government of India;
- A resident of India, except where the FTS are paid with respect to services utilized:
  - In a business or profession carried on by the resident outside India; or
  - For purposes of making or earning any income from any source outside India.

A nonresident, where the FTS are paid with respect to services utilized:

  - In a business or profession carried on by the nonresident in India; or
  - For purposes of making or earning any income from any source in India.

FTS have been defined[4] as consideration for the provision of services in the nature of managerial, technical or consultancy services. FTS do not include consideration for any construction, assembly, mining or similar project undertaken by the recipient. Nor do they include income in the nature of "salary." FTS are taxable in India when the relevant services are used in India, irrespective of wherever they are rendered.

Since no definition of the terms "managerial," "technical" or "consultancy" is provided in the ITA, there is a series of judicial decisions dealing with what constitute FTS. An element of human intervention is considered necessary for the provision of managerial, technical and consultancy services and the consequent taxability of payments for such services as FTS.[5]

The following are examples of services, payments for which have been treated by the courts/the Appellate Tribunal, based on the facts and circumstances, as having the nature of FTS:

- The furnishing of a project report covering a detailed design for rehabilitating/strengthening existing carriageways and designing new carriageways and structures;
- Consultancy services rendered by experts for the preparation of a scheme for raising finance and tie-up loans for a power project;
- Consultancy services including the supply of architectural diagrams and designs for the construction of a complex; and
- The provision of information/data on various subjects such as financial products, foreign exchange

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and commodities markets, where the payments received for the services provided were made on a subscription basis.

The following are examples of payments for services that have been treated by the courts/the Appellate Tribunal, based on the facts and circumstances, as *not* having the nature of FTS:

- Commission payments made to lead managers of a global depositary receipt ("GDR") issue;
- Payments for the provision of a "standard facility" by a telephone company by means of the use of sophisticated equipment in the exchange;
- Payments under a comprehensive contract for the provision of design, manufacture, supply, erection and commissioning services; and
- Payments for the provision of hosting space in servers located abroad.

Payments for services that are inextricably linked to income in the nature of royalties are taxed as royalties.

The taxability of a service provider will have a bearing on whether the service provider is required to file an income tax return. This is discussed in detail in II., below. However, in and of itself, neither the nature of the services provided, nor the nature of the service provider, nor length of time over which the services are provided, nor the place where the services are rendered has any bearing on the income tax return filing requirements.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

A. Rates of Tax

The rates of tax applicable to a service provider under the ITA are as follows:[6]

- Where the payer is the Government of India or an Indian concern, the service provider has a PE in India and the FTS are effectively connected to the PE,[7] the rate is 40% of net profits included in FTS;
- Where the payer is the Government of India or an Indian concern but the FTS are not effectively connected to a PE of the service provider in India,[8] the rate is 10% of gross FTS; and
- Where the payer is a nonresident, the rate is 40% of net profits included in FTS.

However, if the service provider is entitled to benefits under an applicable tax treaty between India and the service provider's country of residence and the rate of tax provided for in the treaty with respect to FTS is lower than the rate provided for in the ITA, the treaty rate would prevail, as discussed in VIII., below.

B. Withholding of Tax

Payments made to a nonresident that are chargeable to tax under the ITA are subject to tax withholding by the payer (whether a resident or a nonresident). Tax is normally required to be withheld on the gross amount at the time the payment is made to the nonresident or at the time of credit to the account of the payee in the payer's books, whichever is earlier. In the case of payments that comprise both a taxable and a nontaxable portion, the payer has the option of approaching a tax officer to obtain a determination of the portion of the payment that is taxable.[9] Based on the order passed by the tax officer, the withholding tax rate would be applied to the portion determined by the tax officer to be taxable. A payer must provide certain prescribed information to the authorities when making a payment to a nonresident. A nonresident service provider can also approach a tax officer with a view to obtaining a certificate of lower or zero rate of withholding tax.[10]

In the case of a service provider that holds a Permanent Account Number ("PAN"), a unique number that is mandatory for a taxpayer in India, tax is required to be withheld at the lower of the following rates:

- The rate provided for in the ITA;
- The rate specified in Part II of the first schedule to the Finance Act[11] relevant to the financial year concerned; or
- The rate specified in the applicable tax treaty, if any.

Where tax is to be withheld but the payee does not provide a valid PAN to the payer at the time of payment, the payer is required to deduct tax at the rate of 20% if the withholding tax rate determined as set out above is less than 20%. However, where the payee does not have a valid PAN but provides certain basic information such as its contact details, its address in its country of residence, a residence certificate from its country of residence and a Tax Identification Number of its country of residence, the higher rate of 20% does not apply.

Regarding withholding tax in the case of "net of tax" agreements, the amount to be withheld needs to be computed by reference to the income grossed up by the tax borne by the payer.

C. Filing of Return of Income by Service Provider

Ordinarily, a nonresident service provider, other than a company or a firm is required to file a return of income if his/her taxable income in India exceeds the maximum exemption limit.[12] Technically, every foreign company is required to file a return of income under the ITA. However, in practical terms, only those foreign companies that have income that is taxable in India under the ITA make it their practice to file returns of income in India. It is advisable for a foreign company to file a return of income even where its income, though taxable under the ITA, is not taxable in India under the provisions of an applicable tax treaty.[13]

D. Difference Between Actual Tax and Tax Withheld

An income tax return is required to be filed even where the withholding tax amount is the same as the actual tax payable. Where the tax withheld is more than the actual tax payable, the excess tax can be claimed as a refund in the return of income. On the other hand, if the tax withheld is less than the actual tax payable, ordinarily the taxpayer is required to pay the balance as advance tax in quarterly instalments during the financial year in which the income arises or as self-assessment tax after the end of the financial year. A taxpayer that does not fulfil its obligation to pay advance tax and/or self-assessment tax is liable for interest on the shortfall in the amount of tax paid.

However, in accordance with a number of judicial precedents, where the entire taxable income is subject to withholding, there is no liability to interest for non-payment of advance tax.[14]

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

As noted at I.B., above, there is no specified objective threshold at which a nonresident becomes subject to Indian taxation. Gross and net basis withholding tax is discussed, along with the applicable rates of tax, at II., above.

Ordinarily, a reimbursement of expenses that have been incurred by the service provider in the course of rendering services is treated as part of FTS, i.e., as part of the "gross amount." Fees for consultancy services in the form of tax advice, legal advice and advice relating to information technology constitute FTS and, thus, are taxable irrespective of whether there is an element of profit for the nonresident service provider in rendering such services.[15] In *Cochin Refineries Ltd. v. CIT*,[16] payments reimbursed by an Indian company to the personnel of a foreign company were treated as FTS along with the payments for services rendered, as the reimbursed payments were part and parcel of the consideration for the technical advice provided. However, in cases where it can be established that the expenses are incurred on account of or on behalf of the payer, such reimbursements may not be taxable.[17]

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

A. Consequence of Failure by Service Recipients to Withhold Tax

The Indian tax laws impose a binding obligation on a payer of FTS to deduct tax at the time of payment or the crediting of the FTS to the account of the payee, whichever is earlier. Any failure to deduct tax entails the following adverse consequences for the payer:

Interest liability: If the payer fails to deduct the requisite tax or does deduct the tax but does not pay it over to the government Treasury, the payer will be liable for interest, the rate of which will depend on the nature of the default, from the date on which the tax should have been deducted until the date of actual payment of the tax to the government;

Penalty: The payer may also be subject to a maximum penalty equal to the amount of the tax not withheld or not paid to the government;

Prosecution: In certain cases of wilful offense, prosecution may be initiated, possibly leading to a prison term of a minimum of three months and a maximum of seven years, along with a fine; and

Disallowance of expenses: Where the payer fails to fulfill its withholding obligations with respect to payments of FTS, no deduction is allowed for such payments made by the payer in computing its taxable income.

There is no requirement to appoint a tax agent under the ITA.

The implications where there is a difference between the tax withheld and the actual tax payable are discussed in II., above.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Ordinarily, the engagement of a subcontractor in India by a foreign service provider would be considered to represent a presence of the foreign service provider in India. Thus, ordinarily, the activities of the subcontractor would be treated as activities of the principal service provider and the tax implications would follow accordingly.

VI. Exceptions to the General System

Under section 94A of the ITA, there are strict compliance implications for any taxpayer dealing with persons in a territory that is designated by notification in the Official Gazette as a specified territory for purposes of that section, including transfer pricing compliance requirements, the denial of a deduction (if the taxpayer is unable to provide the required information) for payments made to such persons and a higher withholding tax rate. Cyprus was designated a specified territory in 2013 but delisted in December 2016.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

Since the focus of this paper is on direct tax implications, the information on this subject provided below is in broad terms.

In general, a foreign service provider setting up operations in India can either operate as an Indian entity creating a separate legal entity in the country or as a foreign entity with an office in India. A foreign service provider that has such an office or a place of business in India may be required to obtain registration under the Company Law. Deputation for expatriates and foreign nationals gives rise to a number of issues under the Indian legal system. Any person entering India is required to have formal authorization, such as an employment visa. A foreign national, including his/her family members who intend to stay in India for more than 180 days, must register with the Foreign Regional Registration Office ("FRRO"). In October 2008, the government made it mandatory for a foreign national who qualifies as an "international worker" ("IW") to comply with social security norms. A foreign national qualifies as an IW if he/she comes to India to work for an establishment in the country to which the Indian social security regulations apply.

Apart from the above, a host of other rules and regulations may also apply, including the foreign exchange law, depending on the nature and scope of the underlying business and activities of the service provider.

VIII. Difference If There Is an Applicable Tax Treaty Between India and the Foreign Service Provider's Country of Residence

Where the applicable treaty does not contain an Article specifically dealing with FTS, the services income

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is taxable as business income only if the service provider has a PE in India.

India's tax treaties ordinarily cover the taxation of service providers in the following articles:

- Permanent Establishment ("PE") Article: a "services PE" provision (included in the definition of a PE) would specify a threshold number of days of activity in India for constituting a PE.[18] Ordinarily the threshold is 90 days or 180 days. The non-resident who forms a Service PE in India would be ordinarily subject to tax on the profits attributable to the PE.
- Independent Personal Services Article: this provides for the taxation of professionals (ordinarily, individuals and firms) only if they have a fixed base in India. Ordinarily, FTS that are effectively connected with a PE or fixed base of the service provider in India are taxable under, respectively, Article 7 (Business Profits) or the Independent Personal Services Article (usually Article 14).
- Fees for Technical Services Article: if present in the treaty concerned, this will specifically deal with services in the nature of FTS each treaty containing such a clause will define FTS for purposes of the treaty. Ordinarily, the scope of the services PE clause in the PE definition/Independent Personal Services Article and the Fees for Technical Services Article are mutually exclusive.

India's tax treaties that contain an Article specifically dealing with FTS provide for source-based taxation with respect to FTS. Some treaties have a narrower definition of FTS. For example, the India-United States treaty provides that services qualify as FTS only if they "*make available* technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design." Ordinarily, when the applicable tax treaty provides for a narrower definition of FTS or a lower tax rate for FTS than the ITA, the treaty provisions will prevail. However, where the services provided qualify as FTS under the applicable treaty but are effectively connected with a PE in India, the FTS are taxable as business profits.

As already noted, the tax treaty rates can be used for tax withholding purposes subject to the conditions discussed in III., above.

NOTES

[1] ITA, Sec. 9(1)(i).

[2] *CIT v. Aggarwal & Co.* (RD) [1965] 56 ITR 20 (SC).

[3] *GVK Industries Ltd. v. ITO* [1997] 228 ITR 564 (AP HC).

[4] ITA, Sec. 9(1)(vii).

[5] *CIT v. Bharti Cellular Ltd.* [2011] 330 ITR 239 (SC).

[6] All rates described in this paragraph are excluding the applicable surcharge and cess. The actual rate of tax would be higher by somewhere in the range of 0.5 – 3% because of the surcharge and cess.

[7] Where the payment of FTS is made under an agreement entered into after March 31, 2003.

[8] Where the payment of FTS is made under an agreement entered into on or after June 1, 2005. Further, the agreement must either be approved by the central government or relate to a matter included in the industrial policy.

[9] ITA, Sec. 195.

[10] ITA, Sec. 197.

[11] The Finance Act for each year is passed after the Union Budget in that year.

[12] The maximum exemption limit applies only with respect to individuals. Individuals are taxed based on slab rates under the ITA.

[13] In *VNU International B.V., In re* (2011) 334 ITR 56 (AAR), where a foreign company that transferred shares in an Indian company, was not liable to tax under the provisions of the India-Netherlands tax treaty, the Authority for Advance Rulings (AAR) held that the foreign company was nonetheless required to file a return of income in India.

[14] *DIT, International Taxation v. GE Packaged Power Inc.* [2015] 56 taxmann.com 190 (Delhi HC).

[15] *Shell India Markets Pvt. Ltd.* [2012] 342 ITR 223 (AAR).

[16] *Cochin Refineries Ltd. v. CIT* [1996] 222 ITR 354 (Kerala HC).

[17] *CIT v. Industrial Engineering Projects P. Ltd.* [1993] 202 ITR 1014 (Delhi HC).

[18] E.g., the India-United States and India-United Kingdom tax treaties.

IRELAND

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Under Irish domestic law, in order to come within the charge to Irish corporate income tax (in the case of a company) or Irish income tax (in the case of an individual) with respect to the relevant services, it is necessary for the non-Irish tax resident foreign service provider to be carrying on a trade, in the case of a company, or to be exercising a trade, in the case of an individual, "in" Ireland. The test to be applied under Irish domestic law, therefore, is somewhat different from a test dependent on a particular level of activity being carried on in Ireland.

Where the foreign service provider is a company that is not tax resident in Ireland, with respect to income from the provision of services in Ireland or to Irish residents, the provider is liable for Irish corporate income tax if it carries on a trade in Ireland through a branch or agency. In such a case, in relation to income from the relevant services, the non-Irish resident foreign service provider company is liable for Irish corporate income tax on trading income arising through the Irish branch or agency, and on income from property or rights used by, or held by or for, the branch or agency.

Where the foreign service provider is an individual who is not tax resident in Ireland, with respect to income from the provision of services in Ireland or to Irish residents, the provider will be liable for Irish income tax on the profits from any trade or profession exercised in Ireland. There is little difference in the Irish tax treatment of a profession and a trade and, for the sake of convenience, the discussion in this paper refers to a trade and should generally be taken as relating to a profession also.

In order to determine whether a foreign service provider is within the charge to Irish income tax or corporate income tax with respect to the provision of the relevant services, it is necessary to determine whether the foreign service provider is carrying on (or exercising) a trade in Ireland. Concerning the first limb of the test, while there is no precise statutory definition of "trading" or a "trade," the concept of carrying on a trade is narrower than the concept of being engaged in business, in that carrying on a trade requires a degree of activity. The provision of a service should be considered to be the carrying on of a trade and the nature of the particular service should not of itself be relevant in that regard.

The second limb of the test for determining whether a foreign service provider is within the charge to Irish tax requires that, to be so, the foreign service provider must be trading "in" Ireland, rather than merely trading "with" Ireland. Guidance on this can be found in case law, principally U.K. case law, which is of persuasive authority in Ireland. Generally, following the modern line of relevant case law, a trade is considered to be carried on in Ireland if the operations from which the profits in substance arise take place in Ireland. The place where the relevant contracts giving rise to the income were concluded is also a very important factor. An earlier line of case law, generally 19th century cases dealing with the sale of goods, rather than the provision of services, emphasized the importance of the place of the conclusion of contracts, but that test is likely to be more conclusive in the case of the sale of goods than in the case of the provision of services. In a modern U.K. case, *IRC v. Brackett*,[1] it was held that even though the contract for the provision of the services was concluded outside the United Kingdom, as the service activities were carried out in the United Kingdom and those activities represented the essential operations of the company's trade, the company was trading in the United Kingdom. Similarly in another U.K. case, *Yates v. GCA*,[2] it was held on the facts that the profits from the contract for services arose in substance where the services were performed.

It is a question of fact as to whether the Irish-based activities of a foreign service provider constitute profit-making activities so that the nonresident is regarding as carrying on a trade in Ireland. It is possible that Irish-based activities of a foreign service provider or its employees or agents could be functions that do not result in the earning of profits or that are peripheral to the trade of the foreign service provider. In that case, it is possible that the foreign service provider may not be regarded as trading in Ireland, despite having some sort of Irish presence. Factors such as the length of time over which the relevant activities are carried on, or the size of the project should not, of themselves, be determinative but may be of relevance.

Where a foreign service provider comes within the charge to Irish corporate income tax or income tax, it

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is required to make returns and payments of tax to the Irish tax authorities on a self-assessed basis.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

A non-Irish tax resident foreign service provider that comes within the charge to Irish income tax or corporate income tax is obliged under Irish tax law to make the appropriate tax returns and payments of tax to the Irish tax authorities on a self-assessed basis. In addition, Irish tax law seeks to facilitate the assessment and collection of tax due from a foreign service provider that comes within the charge to Irish corporate income tax or income tax, by providing that the service provider may be assessed and charged to tax in the name of any "factor, agent, receiver, branch, or manager." The Irish tax authorities may therefore assess a nonresident foreign service provider in the name an Irish agent or an Irish branch if and to the extent that profits arise from a trade exercised in Ireland by, or on behalf of, the foreign service provider. An Irish-based employee may be considered to be a branch or agency of a nonresident foreign service provider.

Irish withholding tax generally does not apply with respect to payments of service fees. However, a service provider (regardless of its tax residence) providing certain defined professional services (which include legal services and consultancy services) to an Irish government department, Irish state body or Irish local authority is subject to professional services withholding tax, currently at the rate of 20%, on the payment of fees for such services. Whether or not the service provider is within the charge to Irish income tax or corporate income tax is irrelevant to the operation of this professional services withholding tax. A foreign service provider that suffers this withholding tax may either seek a refund from the Irish tax authorities where the amount withheld exceeds its Irish tax liability, for example, where the foreign service provider does not come within the charge to Irish income tax or corporate income tax, or may have the withholding credited against its Irish income tax liability or corporate income tax liability when self-assessing its Irish tax liability and making the relevant tax return and payments to the Irish tax authorities.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

The charge to Irish tax is not dependent on a particular threshold being reached but rather on whether the foreign service provider is carrying on a trade in Ireland through a branch or agency.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

These issues are not relevant in the context of Irish taxation.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

A foreign service provider comes within the charge to Irish tax if it is carrying on a trade in Ireland through an agent. The engagement of an Irish subcontractor should not of itself automatically be considered to represent a presence of the foreign service provider in Ireland giving rise to an Irish taxable presence. The particular activities carried out by the Irish subcontractor need to be considered in light of the tests set out in I., above, and it would need to be determined whether the activities of the agent are such that it can be said that the profits in substance arise in Ireland.

VI. Exceptions to the General System

There are no exceptions to the general system.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

Irish law requirements that do not relate to Irish tax law should depend on the nature and scope of the particular services provided by the foreign service provider. Where the provider is a company having an Irish branch under Irish company law, it would be required to register with the Irish Companies Registration Office, and be obliged to make certain filings with that office and to meet certain other requirements under Irish company law. Where a foreign service provider has employees performing duties in Ireland, Irish employment law obligations or requirements may arise, and social insurance matters may be required to be attended to. The Irish tax authorities have particular obligations regarding confidentiality and the disclosure of taxpayer information, and the matter of co-ordination and engagement between the Irish tax authorities and other Irish authorities would depend on the particular authority concerned and the context in which co-ordination or engagement is sought.

VIII. Difference If There Is an Applicable Tax Treaty Between Ireland and the Foreign Service Provider's Country of Residence

Ireland has signed 72 tax treaties, 70 of which are in effect. Ireland's tax treaties each contain an article dealing with business profits, generally following Article 7 of the OECD Model Convention. Where the foreign service provider, be it an individual or a company, is tax resident in a country with which Ireland has a tax treaty in effect, generally it must carry on business in Ireland through a permanent establishment ("PE") in Ireland if it is to be subject to Irish income tax or corporate income tax on its income from the provision of services. Ireland's treaties commonly include an article with respect to income derived from professional services or other independent activities of a similar character. This Independent Personal Services Article generally provides that the foreign resident is to be taxable only in his/her country of residence unless he/she has a fixed base regularly available to him/her in Ireland for the purpose of performing his/her activities. If he/she has such a fixed base in Ire-

land, income that is attributable to the fixed base may be taxed in Ireland. Certain of Ireland's treaties, such as the Ireland-Czech Republic and Ireland-New Zealand tax treaty, provide that even if the foreign resident providing the independent personal services does not have a fixed base in Ireland, if the foreign resident is present in Ireland in aggregate for 183 days or more within any 12-month period, Ireland may tax income derived from his/her activities performed in Ireland.

The definition of a PE in Ireland's tax treaties generally follows the definition in Article 5 of the OECD Model Convention. While there are certain similarities between the concept of "branch" or "agency," relevant to the Irish domestic tax charge for a foreign service provider, and the concept of a PE for purposes of an Irish tax treaty, the concepts differ in certain respects. For example, the concept of a PE generally requires a fixed place of business whereas the concept of branch or agency does not necessary require such, and it is possible for a foreign service provider to be trading in Ireland through a branch or agency but not to a be carrying on business in Ireland through an Irish PE. Certain of Ireland's tax treaties do not require a fixed place of business in order for there to be an Irish PE in the case of a service business, as the definition of PE is broadened to include also the furnishing of services by personnel in Ireland where such activities continue for at least six months in aggregate within any 12-month period. For example, the Ireland-Moldova tax treaty includes such a definition, which makes reference to consultancy services, as does the Ireland-Slovak Republic tax treaty, which also makes reference to managerial services.

NOTES

[1] [1986] STC 521.

[2] [1991] STC 157.

ITALY

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Under Article 3 of the Income Tax Code ("ITC"), the taxable income of nonresident individuals comprises only income that is sourced in Italy. The same principle applies, under Article 151 of the ITC, with reference to the income of nonresident companies and other entities. To determine the Italian tax treatment of a given item of income it is, therefore, necessary to classify the item of income, to establish whether income of that kind can be considered to be sourced in Italy, and then to identify the actual taxing rules applicable to income of that kind.

For individual income tax purposes, the classification is to be made in light of the definitions provided by the ITC corresponding to the rules in Chapter I of the ITC concerning each of the six possible income categories. For corporate income tax purposes, the starting point is Article 152, Paragraph 2 of the ITC, under which income of a nonresident company without a permanent establishment ("PE") in Italy (or, where the nonresident company does have an Italian PE, income not attributable to the PE) is to be classified in accordance with Chapter I of the ITC, i.e., based on the rules for individual income tax. As a result, income earned by a nonresident company is not inherently considered to be business income, but is classified based on its intrinsic nature ("*trattamento isolato*" or "isolated treatment"), in the same way as income derived by a taxpayer who is an individual.

The provision of services would likely give rise to either business income or income from independent personal services. Classification as one or the other of these two categories of income is crucial in the case of income from the provision of services derived by a nonresident. Under Article 23, Paragraph 1, of the ITC, business income of nonresidents is taxable in Italy only to the extent that it derives from activities carried on in Italy through a PE (Article 23, Paragraph 1, Letter e), while independent personal service income is taxable in Italy simply where it derives from activities carried on in Italy (Article 23, Paragraph 1, Letter d). Further, under Article 23, Paragraph 2, any consideration received by a nonresident business, company or entity for artistic or professional services performed in Italy on its behalf is considered to be Italian-source income.

Article 53 of the ITC defines independent personal services income as income deriving from any independent activities other than business activities. Business activities are defined in Article 55 of the ITC—by reference to Article 2195 of the Italian Civil Code—to include manufacturing, trading, transportation, banking, insurance and related, auxiliary activities. In addition, under Article 55, the provision of services not covered by the Civil Code provision nonetheless qualifies as a business activity if the services are provided by a business organization.

Determining the application of the Italian taxing rules to services provided by nonresidents thus requires an assessment of both the nature of the services and the organizational structure that supports the provision of those services.

Resolutions issued by the Italian authorities over the years have classified the following as independent personal services: (1) the delivery of lectures by academics or experts;[1] (2) the performances of professional sportspersons[2] or artists[3] (no special treatment being provided for these under domestic rules); and (3) the activities of individual engineers.[4] These resolutions have focused primarily on the intrinsic nature of the service, and some uncertainties remain as to the evaluation of the organizational structure supporting the provision of services. In one resolution dating to 1979, in which the assembly, repair and maintenance of plant and machinery was examined, the tax authorities remarked that while mere assembly is a business service, maintenance and repair may constitute professional services for Italian tax purposes.[5] In a more recent resolution, technical advisory and validation services rendered by a foreign company have been classified as giving rise to business income.[6]

The Central Tax Court took considerable account of the organizational element in a decision handed down in a 1995 case concerning technical and scientific advisory and assistance services rendered by a Swiss company to an Italian company in the context of a wide-ranging service agreement.[7] In its decision, the Court classified the consideration received for such services as business income, based on the nature of the agreement and the argument that independent personal services are services that can be performed

by individual persons, not services rendered by businesses, where capital investments prevail.

It should be noted that examination of the organizational features of the foreign enterprise concerned is also considered to be crucial for purposes of classifying income derived by influential authors.[8]

A service that qualifies as an independent personal service under the above rule and is performed in Italy is subject to taxation in Italy.

Where the remuneration is paid by an Italian withholding agent,[9] the remuneration is subject to withholding tax. In these circumstances, in accordance with Articles 3 and 152 of the ITC, the remuneration would no longer be subject to mainstream income taxes or any tax return filing obligation. Otherwise, a foreign recipient of such taxable income is required to file an Italian tax return and is subject to tax at the applicable ordinary rates.[10]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As noted in I., above, services that are taxable in Italy are subject to withholding tax where the remuneration is paid by an Italian withholding agent (see further at III., below).[11] Where income from services is taxable in Italy but the remuneration is not paid by an Italian withholding agent, the nonresident recipient of the income is required to file a personal income tax return (if the recipient is an individual) or a corporate income tax return (if the recipient is an entity of any kind, including a partnership), and pay the corresponding tax at the applicable ordinary rates. There are no measures in place that would ensure that this tax obligation is complied with.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

For Italian tax purposes, whether services income derived by a nonresident is taxed by way of assessment or by way of withholding depends not on any particular taxability threshold, but on whether or not the income is paid by an Italian withholding agent. The situation in which there is no Italian withholding agent is discussed in II., above. This section deals with the situation where remuneration for services that is taxable in Italy is paid by an Italian withholding agent. In these circumstances, the remuneration is subject to withholding tax. The withholding tax is imposed at the rate of 30% on the taxable portion of the remuneration, which corresponds to the gross amount paid, including refunds of expenses,[12] and with the sole exclusion of social security contributions where due.[13] The withholding tax is a final tax, so that the recipient has no further Italian tax or reporting obligations and no refund or equalization facility is provided.

The final withholding tax regime described above, however, appears to be in potential conflict with EU internal market principles, as interpreted by the Court of Justice of the European Union ("CJEU"), to the extent the resulting taxation is higher than that applicable in comparable circumstances to Italian resident recipients.[14] However, in practice, the issue is unlikely to arise where the recipient of the income is a resident of an EU Member State, since (except in the case of performing artists and sportspersons), Italy would be prevented from imposing withholding taxes on services income by the tax treaties that it has signed with all EU Member States.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Where the service recipient is a withholding agent, it is required to deduct the withholding tax provided for by Article 25, Paragraph 2 of Presidential Decree No. 600/1973 at the time of payment and to pay the corresponding amount to the Italian tax authorities by the 16th day of the following month. Failure to withhold the withholding tax or to pay over the amount withheld makes the withholding agent liable both for the omitted tax and for penalties. Penalties apply with respect to each of the obligations of the withholding agent, so that failure to withhold the withholding tax constitutes an undue shifting of the tax burden and entails penalties even where the withholding tax is actually paid over to the tax authorities (i.e., at the withholding agent's own cost).

The withholding agent is also required to report information about the recipient of the income and the amount paid in an annual withholding tax return. Where the withholding tax is applicable, no refund or equalization facility is available, since the withholding tax is a final tax imposed on the gross amount paid.

Where services are classified as independent personal service but are not taxable because they are rendered outside Italy by a nonresident person, there is no nexus with the Italian jurisdiction to tax, so that the withholding tax does not apply. In these circumstances, the withholding agent may be asked to provide evidence that the criteria for taxability set down in Article 25 of Presidential Decree No. 600/1973 are not satisfied. To this end, a rather old instruction indicates that the service provider is to furnish the withholding agent with a certificate of residence showing that it is resident in a foreign country and a statement to the effect that the services concerned were rendered outside Italy.[15]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The question of whether the activities of a subcontractor can trigger the imposition of Italian income taxes on the remuneration paid to a nonresident service provider is addressed neither in the legislation nor in the official interpretation of the nexus rules involved. It could be argued that, since Article 23, Paragraph 1, letter (d) of the ITC refers objectively to the place where services are rendered, a liability to Italian tax arises even where the recipient of the remuneration is not the person that renders the service. Also, the withholding tax rule (i.e., Article 25, Paragraph 2 of Presidential Decree No. 600/1973) clearly applies to situations where services are rendered in Italy *on behalf of* a nonresident person.

VI. Exceptions to the General System

The source rules and the withholding tax regime do not provide for any differences in income tax treatment based on the location of the service provider. The only possible exception to the general system, though it is unlikely to occur in practice, concerns the situation referred to in III., above, in which the recipient of the income is resident in the European Union but has no access to the exemption from source country taxation provided by all the tax treaties that Italy has entered into with EU Member States. In such circumstances, based on principles deriving from CJEU case law, the recipient should be able to claim that the withholding tax should be applied at a lower rate in recognition of potential expenses relating to the rendering of the services, such expenses being deductible for comparable service providers resident in Italy and therefore potentially resulting in the application of a lower income tax rate to such service providers than the withholding rate that would apply to the recipient because of the withholding tax being imposed on the gross amount.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

In general, service providers that are not established in Italy are not subject to any registration requirement. Special rules may apply for environmental or work safety purposes, or with respect to specific industries.

Under Legislative Decree. n. 136/2016 issued in implementation of Directive 2014/67/EU of May 15, 2014, foreign companies wishing to second workers to Italy in the context of the cross-border provision of services are required to give prior notification of such secondment.

VIII. Difference If There Is an Applicable Tax Treaty Between Italy and the Foreign Service Provider's Country of Residence

Italy's tax treaties generally provide that income derived from business services or independent personal services by a resident of the treaty partner country is taxable in Italy only where there the service provider has, respectively, a PE in Italy or a fixed base in Italy.

The provisions in Italy's tax treaties concerning business income quite closely follow Article 7(1) of the OECD Model Convention, and the definition of a PE in Italy's treaties quite closely follows that provided in Article 5 of the OECD Model.[16]

By contrast, Italy has chosen to retain a treaty article dealing with income from independent personal services—even in its treaties signed after 2000, the year in which Article 14 (i.e., the Independent Personal Services Article) was deleted from the OECD Model. This position does not reflect any intended difference between the definition of PE and fixed base,[17] but rather aims to safeguard the peculiarities in Italy's domestic rules regarding the computation of the taxable base for independent personal services income.[18] In some of Italy's treaties, the Independent Personal Services Article deviates from the corresponding article in the pre-2000 versions of the OECD Model, in that it contains an alternative condition under which Italy, as the source country, retains taxing rights where a service provider resident in the treaty partner country, though not having a fixed base in Italy, stays in Italy for at least a specified number of days.

The tax treaty source exemption for service providers without a PE/fixed base in Italy can be directly applied at the time of payment at the request of the recipient of the payment (avoiding the need to file a refund application at a later stage). The direct application of the treaty exemption is not explicitly provided for in Italy's treaties, but is unilaterally granted by the Italian tax authorities via official instructions, provided that the requested documentary evidence is made available by the recipient before the payment is made.[19] It is the responsibility of the withholding agent to obtain the requested documentary evidence before making the payment.

Forms for the application of benefits under Italy's tax treaties have been issued by the Italian tax authorities under a Decree dated July 10, 2013. The exemption or refund of Italian source taxation on independent personal services income may be requested in Section D (which concerns all income categories other than dividends, interest and royalties), which includes a statement of the recipient that all requirements for the availability of treaty benefits are met and a statement of the tax authorities of the state of residence of the recipient.[20]

NOTES

[1] Resolution No. 12/1247 of December 30, 1977; Circular Letter No. 118/8/460 of April 27, 1978.

[2] Resolution No. 73/E of May 21, 2001.

[3] Resolution No. 118/E of July 12, 2001.

[4] Resolution No. 12/1591 of July 18, 1984.

[5] Note No. 12/832 of October 1, 1979. In the same year, the issue of technical assistance and consulting services was examined in Resolution No. 12/134 of March 3, 1979, but the conclusions of the tax authorities are not helpful as regards income classification, since they were ultimately based on the effects of the applicable tax treaty rather than on the domestic classification rules.

[6] Resolution No. 99/E of April 30, 1997. This classification, although made for purposes of the Italy-United States tax treaty, does not make explicit reference to the treaty definitions and may thus be considered broader in scope.

[7] Central Tax Court, Decision No. 1598 of November 18, 1996, filed on April 5, 1996.

[8] S. MAYR, *Compensi corrisposti a soggetti non residenti*, in *Bollettino tributario d'informazioni*, 1976, p. 185 *et seq.*; A. BENAZZI, *Il regime convenzionale dei redditi di natura professionale conseguiti nell'esercizio d'impresa*, in *Rivista di diritto tributario*, 1998, IV, p. 380 *et seq*. The latter submits—based on the explanatory notes to the legislation—that the provisions concerned have an anti-avoidance purpose and should thus apply only where a business entity is artificially attributed income deriving from the performance of individuals.

[9] Under Presidential Decree No. 600 of 1973, Art. 23, withholding agents include independent professionals and entrepreneurs, and most legal entities. A nonresident can also be a withholding agents, if it has a PE in Italy, is otherwise obliged to file a tax return in Italy or has a representative office in Italy. *See* on this point M. PIAZZA, *Guida alla fiscalità internazionale*, Milan, 2004, p. 300.

[10] See, in support of this view, G. PUOTI, *Redditi di lavoro nel modello OECD*, in (a cura di V. Uckmar) *Diritto tributario internazionale*, 3rd ed., Padova, 2005, p. 691; a different view is taken by S. MAYR, *Lavoro autonomo prestato in Italia da non residenti mediante una base fissa*, in *Corriere tributario*, 1991, p. 2891.

[11] Presidential Decree No. 600/1973, Art. 25, Para. 2.

[12] Resolution No. 69/E of March 21, 2003.

[13] Resolution No. 118/E of July 12, 2001.

[14] *See* the ECJ decisions in *Gerritse*, June 12, 2003, case C-234/01, points 29 and 55; *FKP Scorpio Konzertproduktionen*, October 3, 2006, case C-290/04, point 42; Centro *Equestre de Leziria Grande*, Feb. 15, 2007, case C-345/04, point 23.

[15] Resolution No. 12/762 of February 3, 1977.

[16] Italy also has a number of treaties under which the provision of services over a specified time period of time, ranging from six to 12 months (e.g., the Italy-Chile, -China (PRC), -Kazakhstan, -Lebanon, -Malta, -Pakistan, -Saudi Arabia, -Sri Lanka, -Turkey and -Uganda tax treaties), itself creates a PE for the enterprise. These treaty provisions, however, do not have any effect when Italy is the source country, since there are no corresponding provisions in Italian domestic legislation and, in general, a tax treaty cannot create a tax liability that is not provided for under domestic law. Also, ITC, art. 169, provides that domestic rules prevail over treaty rules if they are more favorable to the taxpayer.

[17] In most instructions provided by the Italian tax authorities, the terms "fixed base" and "permanent establishment" are used together in a way that does not imply any difference in meaning between them. A recent instruction attempts a definition of a fixed base as follows: "an autonomous centre of attribution of interest for the purpose of carrying on independent personal services" (Resolution N0. 154/E of June 11, 2009). Nor does case law, which has not generally examined the definition of a fixed base, indicate that there is any difference in the meanings of the two terms. An exception is represented by a famous Supreme Court case (Decision No. 3375 of May 23, 1981) concerning a French painter. Scholars have also emphasized the similarity between the notion of a PE and that of a fixed base and have opined that a fixed base consists of space and premises suitable for the exercise of an independent activity. See G. PUOTI, *Redditi di lavoro nel modello OECD*, in (a cura di V. Uckmar) *Diritto tributario internazionale*, 3rd ed., Padova, 2005, p. 691; C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2005, p. 560.

[18] *See* the Observation on the Commentary on OECD Model Convention, Art. 7, at point 78 in the 2010 version. The Observation: "Italy and Portugal deem as essential to take into consideration that—irrespective of the meaning given to the fourth sentence of paragraph 77—as far as the method for computing taxes is concerned, national systems are not affected by the new wording of the model, i.e. by the elimination of Article 14."

[19] The direct application of tax treaties is addressed in many official interpretations with similar content (see, e.g., Resolution No. 12 of June 10, 1989, Circular Letter No. 7 of March 25, 1981; Circular Letter No. 4 of February 4, 1980; Circular letters No. 86/12/793 of September 13, 1977, No 115/1978 and No. 147/1978; Resolution No. 95/E of June 10 1999 and No. 68 of May 24, 2000). With specific reference to independent personal service income, see Resolution No. 12/1247 of December 30, 1977 and Resolution No. 12/1591 of July 18, 1984.

[20] For some countries, specific forms have been bilaterally agreed. However, such forms concern only dividends, interest and royalties. The forms approved by the 2013 Decree should therefore be used with reference to all other income categories.

JAPAN

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Generally, under Japanese domestic income tax laws,[1] even if it does not have a permanent establishment ("PE") in Japan, if a nonresident service provider engages in business in Japan that primarily involves the provision of such categories of services as are specified in the relevant Cabinet Orders[2] ("Specified Services"), remuneration or compensation for any Specified Services received by the service provider is treated as Japanese-source income fully taxable in Japan on a net basis. The applicable rate is 23.2% if the service provider is a corporation (subject to a certain reduced rate for small corporations). Progressive rates apply where the service provider is an individual (the highest marginal rate is 45.945%). Such a nonresident service provider is generally required to file a tax return.

Under the Cabinet Orders referred to above, the following categories of business are designated as Specified Services:

- A business providing the services of entertainers such as movie/theater performers, musicians and professional sportspersons;
- A business providing the services of lawyers, certified public accountants, architects and other professionals; and
- A business providing services requiring the expert knowledge or special technical skills of persons equipped with such expert knowledge or special technical skills in areas such as science/technology and business management, except where: (1) the services provided are incidental to the provider's primary business of selling machinery/hardware;[3] or (2) the services provided are the direction and supervision of construction, installation or assembly work, as provided for in Article 141, item 2 of the CTA.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Generally, under Japanese domestic tax law, any person that pays, in Japan, remuneration for Japanese-source Specified Services to a nonresident service provider is required to withhold Japanese withholding tax from such remuneration at the rate of 20.42%.[4] The withholding tax is applied to the gross amount of the remuneration. For this purpose, the amount of any travel expenses (such as air fare and hotel accommodation expenses) incurred by the service provider and reimbursed by the recipient of the services in question is, in general, included in the gross amount of remuneration. However, if such travel expenses are paid by the recipient of the services not to the service provider, but to the airline company or hotel directly and the amount of such expenses is within a reasonable range ordinarily charged, it is the official position of the tax authorities that such expenses are not required to be included in the remuneration subject to Japanese withholding tax.[5]

It should be noted that, even if the payor of such remuneration pays the remuneration outside of Japan, if the payor has an office in Japan, the payment of the remuneration is legally deemed to have occurred in Japan, so that the Japanese withholding obligation is triggered. A nonresident service provider that is subject to Japanese withholding tax and whose income tax liability calculated on a net basis (see I., above) is less than the amount withheld is entitled to claim a tax credit to set off its income tax liability upon filing a Japanese tax return, and any excess withholding amount is refunded following such filing.

Apart from the foregoing, it should be noted that Japanese tax law contains a special withholding and refund regime for compensation for services performed in Japan by nonresident entertainers and sportspersons, as explained in VIII., below.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

If a nonresident service provider has no PE in Japan and if the services provided by the nonresident service provider do not fall within any of the categories of Specified Services, income derived by the nonresident service provider will not be subject to Japanese income taxation, either by way of withholding or otherwise.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

These issues are not relevant in the context of Japanese taxation. Generally, if a payor of remuneration to a nonresident service provider erroneously withholds Japanese withholding tax (i.e., withholding tax that should not have been withheld because the services provided are not among the Specified Services) and remits the erroneously withheld amount to the Japanese tax authorities, it is, in principle, the payor who is entitled to request a refund of the erroneously withheld withholding tax from the tax authorities. The nonresident service provider should insist that the payor pay the full amount of the remuneration regardless of whether the erroneously withheld amount has been returned to the payor by the Japanese tax authorities.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Generally, given the nature of the Specified Services, a nonresident service provider's engagement of a subcontractor in Japan, in and of itself, would not automatically represent a presence of the nonresident service provider in Japan. There does not seem to be any clear-cut guidance on how and in what circumstances the use of a subcontractor in Japan may give rise to a presence of the nonresident service provide in Japan, and these circumstances may vary depending on the category of Specified Services concerned. See VIII., below, regarding promoters of entertainers and sportspersons.

VI. Exceptions to the General System

Other than the special withholding regime referred to in VIII., below, the author is not aware of any exceptions to the general system.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

Generally, the Companies Act (Law No. 86 of 2005, as amended) requires that any foreign company (which may possibly include a foreign partnership) wishing to engage in business in Japan on a continuous basis must appoint at least one representative in Japan. However, where a nonresident service provider has no PE in Japan but provides any of the Specified Services in Japan without a PE on an *ad hoc* basis, business registration requirements such as the foregoing are unlikely to apply. Visa requirements may apply depending on the nationality of the service provider's personnel coming to Japan. In addition, if the service provider employs any persons in Japan, such employee(s), if residing in Japan and working for the nonresident service provider, would most likely give rise to a PE in Japan, either as a dependent agent(s) or as having an office in Japan, if there is any physical fixed place of the nonresident service provider where such employee works (employees work) in Japan. Further, in such circumstances, various other requirements of a legal and practical nature would apply. Also, depending on the nature and scope of the business activities involved, a host of additional regulations may apply.

VIII. Difference If There Is an Applicable Tax Treaty Between Japan and the Foreign Service Provider's Country of Residence

Generally, under Japan's tax treaties, business income derived by a nonresident service provider is not subject to Japanese income taxation unless the service provider has a PE in Japan.[6] Thus, generally, a nonresident service provider having no Japanese PE may be able to claim an exemption from Japanese income tax, imposed either by way of withholding or otherwise, even if it provides Specified Services in Japan, subject to its filing the required treaty application documents in a timely manner. One exception is where the nonresident service provider concerned is an entertainer or sportsperson. This is because an Entertainers and Sportspersons clause, similar to Article 17 of the OECD Model Convention, which allows the source country to impose income tax on personal services income derived by entertainers and sportspersons, is included in many of Japan's tax treaties.

Further, when an entertainer's or a sportsperson's income from Japan is earned through a foreign entity acting as a promoter and the promoter is entitled to tax treaty benefits, it is possible that the promoter's income may be exempt from Japanese income taxation under the applicable treaty on the grounds that the promoter does not have a PE in Japan. In order to ensure that, even in such cases, it can collect income tax from nonresident entertainers or sportspersons, Japan has introduced a special withholding and refund regime in its domestic tax law, under which certain special Japanese withholding obligations are imposed on persons who make payments to such foreign promoters (out of which compensation is to be paid to the nonresident entertainers or sportspersons) or foreign promoters paying compensation to nonresident entertainers or sportspersons. As noted above, the special regime is provided for in Japan's domestic tax law, but its application is triggered when the relevant foreign promoter is exempt from Japanese income taxation under an applicable tax treaty.[7]

NOTES

[1] The Income Tax Act (Law No. 33 of 1965, as amended; "ITA") with respect to personal income tax imposed on individuals and withholding tax, and the Corporation Tax Act (Law No. 34 of 1965, as amended; "CTA") with respect to corporate income tax imposed on corporations.

[2] If the nonresident service provider is an individual, the Income Tax Act Enforcement Order (Cabinet order No. 96 of 1965, as amended; "ITAEO"); if the nonresident service provider is a corporation, the Corporation Tax Act Enforcement Order (Cabinet Order No. 97 of 1965, as amended; "CTAEO").

[3] The Corporation Tax Basic Circular issued by the National Tax Administration makes it clear that the following cases are included in the exception under item (1) above: (1) where an enterprise whose business is to sell machinery or other hardware dispatches engineer(s) to its customers purchasing such machinery or other hardware for purposes of installation, assembly or trial opera-

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tion; and (2) where a licensor that provides a license to use industrial property or know-how dispatches engineer(s) to its licensee(s) for purposes of enabling the licensee(s) to implement the licensed right (see Sec. 20-2-12).

[4] *See* ITA, Arts. 212 and 213. *See also* Special Measures Law to Secure Rehabilitation Funds for the Great East Japan Earthquake (Law No. 117 of 2011, as amended), Arts. 13 and 27.

[5] *See* Income Tax Basic Circular issued by the National Tax Administration, Secs. 161-9 and 212-4.

[6] It should be noted that some Japanese tax treaties provide a special threshold period requirement for an enterprise providing certain specific categories of services (*see, e.g.,* Japan-India tax treaty, Art. 5(5).

[7] For more details, *see* Special Taxation Measures Law (Law No. 26 of 1957, as amended), art. 41-22 and its subordinated regulations. *See also* Law Concerning Special Rules for Income Tax Act, Corporation Tax Act and Local Tax Act (Law No. 46 of 1969, as amended), Art. 3-2 and its subordinated regulations.

MEXICO

Terri Grosselin and Isabel Rodriquez
EY Mexico

I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

A nonresident may be taxed in Mexico either because it has a permanent establishment ("PE") in Mexico or because it obtains income deriving from a source of wealth located in Mexico.[1] To the extent the taxpayer is not a Mexican resident and does not have a PE in Mexico, as described in more detail below, the Mexican tax is payable on a gross basis.

As a general rule, service fees and income from the provision of independent personal services are considered to be sourced in Mexico when the relevant services are rendered in Mexico. In addition, in the case of services that are deemed to constitute technical assistance, the income from such services is considered to be Mexican-source income if it is paid by a Mexican resident or if the underlying rights or assets are used in Mexico. Thus, the threshold for taxability in Mexico differs depending on the nature of the services, as well as on whether the services are provided in Mexico or elsewhere.

Services are presumed to be rendered entirely in Mexico when a portion of the services is rendered in Mexico, unless the service provider is able to demonstrate that a portion of the services is rendered abroad, in which case, the service provider's Mexican tax liability will be calculated based on the portion of the consideration corresponding to the portion of the services rendered in Mexico.[2]

Unless demonstrated otherwise, services are also presumed to be rendered in Mexico when the remuneration for the services is paid by a Mexican resident or a nonresident with a PE in Mexico to a nonresident related party.[3]

In the case of a nonresident service provider, the mechanics of the payment of tax depend on whether or not the payer of the remuneration for the services is a Mexican resident/a nonresident with a PE in Mexico. If the payer is a Mexican resident or a PE of a nonresident, the tax is calculated by applying a 25% tax rate to the total gross income, with no deductions. This withholding tax is withheld by the person making the payment. Otherwise, a nonresident service provider must pay the corresponding 25% gross income tax by filing a tax return within 15 days following the day on which the income was obtained.

It is worth noting in passing that the definition of a PE under Mexican domestic law includes any place of business in which business activities, including independent personal services, are wholly or partially carried out. As such, to the extent a nonresident has a place of business in Mexico, this may give rise to a Mexican PE of the nonresident. The existence of a PE does not depend on any minimum time period threshold being met. Since, for purposes of the Forum questions, the nonresident service provider is assumed not to have an establishment in Mexico, the discussion below addresses only the situation in which the nonresident does not have a Mexican PE.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Mexico's method of ensuring the payment of tax due from a nonresident with respect to Mexican-source services income relies primarily on the Mexican payer of the income. The tax is paid via a withholding mechanism and must be documented as properly paid in order for a Mexican taxpayer to be able to deduct the corresponding payment as an expense.

Generally, where payments are made to a nonresident by a Mexican resident or a nonresident with a PE in Mexico, the payer is required to withhold income tax from such payments made.[4] Withholding tax generally becomes due and payable at the earlier of the following:

- The time at which the payment obligation becomes due; or
- The time at which the payment is effected.

Tax withheld by a Mexican resident or a PE of a nonresident must generally be paid over to the tax authorities along with the monthly tax return, which is due on the 17th day of the month following the month to which the return relates. In the case of payments not made by a Mexican resident or a PE of a nonresident, the gross tax must be paid by the nonresident recipient no later than 15 days after the day on which the payments are received.

In the case of payments for services, including technical assistance, the tax is calculated by applying a 25% rate (the only withholding tax rate) to the total income earned, without any deductions.[5] The tax must be withheld by the person making the payments if that person is a Mexican resident or a nonresident

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with a PE in Mexico to which the services are related. In these circumstances, in which the tax is paid by way of withholding, the nonresident is not otherwise required to file a tax return in Mexico. Instead, the withholding tax is deemed to constitute a final tax.

Under the Federal Fiscal Code ("FFC"),[6] a withholding agent is jointly and severally liable for taxes that are required to be withheld by it under the law. Moreover, with respect to withholding tax, the general rule is that a withholding agent (whether a Mexican resident or a nonresident with a PE in Mexico) is required to pay over an amount equivalent to the withholding tax due, even if payment has not been made or the tax was not withheld.[7] Furthermore, a Mexican resident that receives services from a nonresident is jointly liable for the tax due from the nonresident service provider, even when the services are paid for by a nonresident.

In general, a nonresident will only be required to file a tax return, if the tax due from it is not withheld upon payment. If the tax paid via withholding exceeds the nonresident's overall liability, the nonresident is able to request a refund. However, since the tax payable is 25% of the gross amount, there should not be any circumstances in which withholding should result in an overpayment. If the amount paid by way of withholding is less than the nonresident's overall liability, the withholding agent (whether a Mexican resident or a nonresident with a PE in Mexico) will be jointly liable with the nonresident for the difference.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

As discussed in II., above, remuneration for services performed in Mexico is taxed by way of final withholding where the payer of the remuneration is a Mexican tax resident or a nonresident with a PE in Mexico. The remuneration is taxed to the nonresident service provider directly where the payer of the remuneration is a nonresident without a PE in Mexico.

The withholding tax is imposed at a single rate of 25% on the gross amount of the remuneration. If the service provider is reimbursed for expenses, it may be possible to avoid withholding tax on such reimbursement.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

As discussed in II., above, a Mexican resident or PE making payments to a nonresident service provider is required to withhold tax from those payments. The payer is jointly liable for the tax with the nonresident recipient and in practice would be the primary source for the tax authorities should they be attempting to collect any unpaid tax. Furthermore, no deduction would be allowed to a Mexican resident or PE for the amount of service fees paid to a nonresident if the proper withholding tax was not paid.

There is no requirement to appoint a tax agent in Mexico, though one might be appointed to assist with the payment of tax if necessary. A tax agent would be necessary from a practical perspective in order to be able to request a refund. Such a refund could be requested where the foreign service provider determined that the tax paid was inappropriate. The tax authorities would review the request and would generally be required to respond within 40 days.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Mexico's tax rules do not specifically address the use of a subcontractor to provide services in Mexico, except as it relates to the creation of a PE, as described below. To the extent a foreign resident is earning income for services that do not give rise to a PE in Mexico, the income would be taxed in Mexico if the services are performed in Mexico, as discussed in I., above. A Mexican resident or PE of a nonresident paying remuneration to a nonresident service provider would generally be required to withhold tax from the remuneration relating to services performed in Mexico, even if the nonresident subcontracts the provision of the services to a Mexican resident. If the Mexican resident payer is aware that the services are provided in Mexico, even if not directly provided by the nonresident, the withholding obligation would apply.

The engagement of a subcontractor would not automatically be considered to represent a presence of the foreign service provider in Mexico. The circumstances in which such a presence would be created can be distinguished from those in which it would not by reference to the criteria for the creation of a PE in Mexico through the subcontractor, which generally, both under domestic law and under Mexico's tax treaties, are to the effect that a PE may be created by: (1) the carrying on of a business through a fixed place of business; (2) a dependent agent (if the subcontractor has the power to execute agreements in Mexico on behalf of the foreign service provider); or (3) an independent agent *not* acting in the ordinary course of its business.[8] In addition, there are specific rules that apply to construction-related activities.

VI. Exceptions to the General System

A. Higher Tax Rate

As a general rule, income earned by a resident of a tax haven or a country where it enjoys a preferential tax regime would be subject to tax on Mexican-source income derived by it at a rate of a 40% rather than the 25% otherwise applicable. However, under current regulations, if such a person is a resident of a country with a broad exchange of information agreement with Mexico, the 25% general rate would still apply. For this purpose, a resident of a tax haven under Mexico's income tax rules includes a person subject to a preferential regime and a fiscally transparent entity located in a tax haven.[9]

B. Exemption

A nonresident service provider who is present in Mexico for less than 183 days in a 12-month period, would not be subject to Mexican tax on payments of

Mexican-source income, except where such payments are made by a Mexican resident or a PE of a nonresident in Mexico. As such, services fees and income from the provision independent personal service that are paid to a nonresident service provider by a non-Mexican resident that does not have a PE in Mexico, or that does have such a PE but the services are not related to the PE, are exempt from Mexican tax, subject to the condition that the service provider remains in Mexico for less than 183 calendar days, whether or not consecutive, in a 12-month period.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

An employer is generally required to be registered with the Federal, State and local government so that it may withhold and pay the corresponding employment taxes. While this requirement may not apply to a foreign entity sending individuals to Mexico, if Mexican employees are hired, employment-related tax would likely be due.

If the individuals employed by a foreign entity are not Mexican nationals, they will have to obtain visas and permits from the Immigration Institute. The nature of the visa or permit required would depend on the nationality of the individual. Currently, under NAFTA, a U.S. citizen would not need more than a tourist visa to work in Mexico for less than 183 days in a 12-month period.

More rules may be applicable depending on the nature and scope of the underlying business.

VIII. Difference If There Is an Applicable Tax Treaty Between Mexico and the Foreign Service Provider's Country of Residence

Mexico's tax treaties provide that business profits—including fees for services—earned in Mexico by a foreign entity are taxable only to the extent they can be attributed to a Mexican PE of the foreign entity. All of Mexico's treaties provide that, among other things, a PE includes an office or other fixed place of business, and all include a list of specific types of establishment—such as a place of management, a branch, a factory, a workshop and a mine, an oil or gas well, and a quarry—that are considered to be PEs. The treaties also explain the conditions required to create a PE in a country. In addition, Mexico has a number of treaties under which the provision of services in Mexico by a nonresident enterprise over a specified time period of itself creates a Mexican PE for the enterprise.[10] (This, combined with Mexico's domestic rules would require an additional review of the activities being performed in Mexico.) Many of Mexico's treaties[11] also still contain an Independent Personal Services Article, so that Mexico's ability to tax independent personal services income would depend on the nonresident service provider having a fixed base in Mexico (or in some cases staying in Mexico for a specified time period). Since Mexico's domestic rules do not include require the existence of a fixed base for Mexico to tax such income, these treaties afford some degree of protection.

Thus, where a nonresident service provider that is resident in a treaty partner country derives fees for services rendered in Mexico but does not have a PE in Mexico (or, in certain cases, a fixed base in the case of independent personal services income), the income it earns may be taxed only in the service provider's country of residence. Payments for such services in Mexico may, therefore, be made without deduction of tax. According to the MITL,[12] in all cases where a tax treaty provides for a lower withholding rate than that provided for in the MITL, the withholding agent may apply the lower treaty rate if certain requirements are met.[13] If the withholding agent instead applies the higher domestic rate, the nonresident will be able to request a refund of the excess amount paid, as explained in II. and IV., above.

NOTES

[1] Mexican Income Tax Law (MITL), Art. 1.

[2] MITL, Art. 156, para. 1.

[3] MITL, Art. 156, para. 2.

[4] MITL, Art. 153.

[5] MITL, Art. 156, para. 3.

[6] FFC, Art. 26, sec. I.

[7] FFC, Art. 6, para. 5.

[8] MITL, Arts. 2 and 3.

[9] MITL, Art. 171.

[10] E.g., the Mexico-Canada, -Hungary, -Iceland and –Lithuania tax treaties.

[11] E.g., the Mexico-Belgium, -Denmark and -Finland tax treaties.

[12] MITL, Art. 4, para. 3.

[13] MITL, Art. 4, paras. 1 and 2. The nonresident must: prove that it is resident in the country to which the tax treaty is intended to apply; (2) fulfill the conditions established by the treaty; and (3) present, if so requested by the Mexican tax authorities in the case of a transaction between related parties, a sworn declaration stating that the income derived in Mexico is also taxed in its country of residence.

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THE NETHERLANDS

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Dutch tax law includes specific rules on the taxation of nonresidents.[1] For individuals, these rules are laid down in Chapter 7 of the Personal Income Tax Act 2001 ("PITA"). Chapter III of the Corporate Income Tax Act 1969 ("CITA") contains the rules for nonresident companies.

Nonresidents are subject to Dutch income tax only on their "Dutch-source income," which is defined in Chapter 7 of the PITA and Chapter III of the CITA (the "Dutch nonresident taxation rules"). Dutch-source income includes taxable profit from a business carried on in the Netherlands through a permanent establishment ("PE") or permanent representative in the Netherlands.[2]

The terms "permanent establishment" and "permanent representative" are not defined in the Dutch nonresident taxation rules. A definition of PE can be found, though, in other Dutch regulations: Article 15f of the CITA and Article 2 of the Unilateral Decree for the Avoidance of Double Taxation 2001 (the "Unilateral Decree").[3] The definitions used there are broadly in line with the definitions used in the OECD Model Convention. Moreover, a definition of PE is included in the many tax treaties that the Netherlands has concluded with other countries, which are generally based on the OECD Model (specifically the version of the OECD Model existing at the time the relevant tax treaty was signed). The term "permanent representative" is, in substance, similar to the term "dependent agent," which is defined in the Dutch regulations and tax treaties referred to above as part of the PE concept.

In the absence of definitions of the terms "permanent establishment" and "permanent representative" in the Dutch nonresident taxation rules, it is necessary to rely on Dutch jurisprudence for the interpretation of these terms. According to Dutch jurisprudence, guidance with respect to the interpretation of these terms may be obtained from the Unilateral Decree, the Netherlands' tax treaties, the OECD Model Convention and the OECD Commentary.[4] These sources of information are, however, not decisive,[5] and may not expand the scope of the Dutch tax rules.[6] In principle, therefore, the fictions and limitations included in Article 5(3) (deemed PE in the case of a construction site and construction and installation activities that last for more than 12 months[7]) and Article 5(4) (PE exclusions in the case of preparatory and auxiliary activities) of the OECD Model do not apply under the Dutch domestic tax rules.[8] This also applies with respect to the deemed services PE, which is described in paragraphs 42.11 up to and including 42.48 in the Commentary on the OECD Model and which can be found in a few of the Netherlands' tax treaties.[9] The non-application of the Article 5(4) PE exclusions has also been confirmed by the Dutch Ministry of Finance with respect to the services PE fiction, as included in the Netherlands-Portugal tax treaty.[10]

According to Dutch jurisprudence, the following cumulative criteria must be satisfied for a PE to exist:

- There must be a physical construction;[11]
- The physical construction must be equipped to carry out the business activities;[12] and
- The physical construction must be *at the disposal* of the foreign enterprise for an *enduring period* of time.[13]

Also according to Dutch jurisprudence, a person or company qualifies as a "permanent representative" of a foreign enterprise if he, she, or it:

- Is not entirely independent of the foreign enterprise that he, she, or it represents;[14]
- Has the authority to conclude contracts on behalf of the foreign enterprise;[15]
- Makes use of that authority on a regular basis;[16] and
- Carries on activities that are in line with the activities of the foreign enterprise.[17]

The jurisprudence does not provide clear thresholds for the existence of a PE or permanent representative. Whether a PE or permanent representative exists is to be determined based on all the facts and circumstances of the case at hand. The nature of the activities

carried on (for example, the provision of services or production activities) is relevant in this respect but not decisive.

Even in the absence of a fixed place of business or permanent representative, a PE of a foreign enterprise may be deemed to exist based on certain fictions contained in Dutch tax law. For instance, Article 7.2.3 of the PITA contains a PE fiction with respect to business activities performed in the Netherlands by a nonresident artist or athlete that is a resident of a non-treaty partner country. Also, under Article 7.4 of the PITA, certain offshore business activities performed by an individual for a period of 30 days or more constitute a deemed PE. The latter fiction is also contained in Article 17a of the CITA with application to nonresident companies. Article 17a also deems a PE to exist where certain other activities are carried on or certain investments are made—for example, where a nonresident carries on activities in the capacity of a director or supervisory board member of a Dutch company or invests in real estate located in the Netherlands.

Where a foreign enterprise conducts business activities in the Netherlands through a (deemed) PE or permanent representative for Dutch tax (and, if applicable, tax treaty) purposes, generally only the profit allocable to those activities—i.e., to the PE/permanent representative—will be subject to Dutch tax.[18] Such profit will be taxed at the general statutory tax rates, at a CIT rate of up to 25% for corporates and at a PIT rate of up to 52% for individuals. There is no special rate for nonresident taxpayers.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Dutch tax law does not provide for the levying of withholding tax on service fee payments.

A foreign service provider that is subject to Dutch income tax (on the basis that it carries on business activities through a (deemed) PE or permanent representative in the Netherlands) may receive a request from the Dutch tax authorities to submit an income tax return.[19] A foreign service provider that does not receive such a request within the six months following the date on which the relevant income tax liability arose (generally as of the end of the financial year) must request a tax return form.[20]

The tax return must be filed within the legal deadline, which is generally five months following the end of the relevant financial year. Filing extensions are available upon request.[21]

Income tax must be paid on a tax assessment. Advance tax payments can be made on provisional tax assessments, which are issued by the Dutch tax authorities automatically (based on previous years' taxable profits) or at the request of the taxpayer.[22] The final income tax liability is determined by a final income tax assessment, which, as a general rule, is issued after the income tax return is filed. If the income tax return is not filed on a timely basis, the Dutch tax authorities may issue an *ex officio* income tax assessment[23] based on a realistic estimate of taxable profit and may impose penalties for late filing.[24]

The Dutch tax authorities have instruments available to them that allow them to collect taxes due, in the event that a taxpayer does not pay its taxes. If a taxpayer does not respond to reminders and formal notifications,[25] the tax authorities may seize and sell the taxpayer's assets. It may be difficult for the Dutch tax authorities to collect taxes due from a foreign taxpayer that does not own assets in the Netherlands. In these circumstances, the collection of the taxes due will only be possible with the help of the foreign country in which the taxpayer resides and/or owns assets, if that country is a Member State of the European Union[26] or has concluded an agreement with the Netherlands providing for mutual assistance in the collection of taxes.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

This issue has no relevance in the context of Dutch taxation.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

This issue has no relevance in the context of Dutch taxation.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The use of a Dutch subcontractor in and of itself should not create a taxable presence in the Netherlands for a foreign service provider provided the subcontractor is independent and performs its activities for the foreign service provider in the regular course of its business, i.e., it is not a permanent representative.

The existence of a PE in the Netherlands requires a fixed place of business in the Netherlands through which a foreign enterprise conducts business activities (as further explained in I., above). Engaging a subcontractor to provide services would not therefore typically result in the contractor having a PE.

VI. Exceptions to the General System

There are no exceptions to the general system.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

A foreign company with an establishment in the Netherlands is required to register with the Dutch Chamber of Commerce. A foreign company without an establishment in the Netherlands is generally not required, but is allowed, to register if it conducts business activities in the Netherlands. This also applies to private entrepreneurs. A foreign employment agency that provides workers in the Netherlands is required to register, regardless of whether it has an establishment in the Netherlands.

The Dutch Chamber of Commerce exchanges information with the Dutch tax authorities. Generally, a foreign entrepreneur that registers with the Chamber of Commerce will either automatically be registered

for Dutch taxes or receive a questionnaire from the Dutch tax authorities.

Specific rules apply to a foreign entrepreneur or foreign employee who wishes to stay and work in the Netherlands. The requirements for residence and working permits depend on the length of the stay in the Netherlands and the country of residence of the individual (for example, less strict requirements apply if the individual is resident in the European Economic Area ("EEA") or Switzerland).

VIII. Difference If There Is an Applicable Tax Treaty Between the Netherlands and the Foreign Service Provider's Country of Residence

Under the Dutch Constitution, a tax treaty may limit the Dutch tax authorities' rights to levy tax on certain elements of income. However, a tax treaty cannot create a taxation right.[27]

If the activities of a foreign service provider do not constitute a PE under Dutch national law and thus do not result in a Dutch tax liability, the existence of an applicable tax treaty will not create a Dutch tax liability: PE fictions under an applicable tax treaty, for instance, a services PE, should not impact the Dutch tax position. On the other hand, if the activities of the service provider do result in a Dutch tax liability under Dutch tax rules, an applicable tax treaty may provide for an exemption from Dutch taxation.

The Dutch concepts of "permanent establishment" and "permanent representative" under the nonresident taxation rules are broadly interpreted in line with these concepts under the OECD Model Convention. Also, the Netherlands' tax treaties generally are based on the OECD Model. Therefore, if the activities of a foreign service provider result in a "genuine" (i.e., not deemed) PE or a PE under Dutch domestic tax rules, the activities in general will likely also constitute a PE under an applicable tax treaty. Exceptions apply, for instance, where the activities of the service provider performed through a PE in the Netherlands are of a preparatory or auxiliary nature, or the activities carried out by the service provider constitute a PE that qualifies as a project PE under an applicable tax treaty but do not meet the duration threshold specified in that tax treaty (for example, because the activities last for less than 12 months).[28] As discussed in I., above, the PE limitations and exclusions in the case of a construction PE and preparatory and auxiliary activities under Article 5(3) and (4) of the OECD Model do not apply under the Dutch domestic tax rules.

As noted in II., above, Dutch tax law does not provide for the levying of withholding taxes on service fees. An applicable tax treaty will not alter this position.

NOTES

[1] Individuals and companies that are tax-resident outside the Netherlands.

[2] *See* PITA, art. 7.2.2.a and CITA, Art. 17.3.a, respectively.

[3] These provisions are part of regulations that aim to prevent the double taxation of income from certain foreign investments and activities of Dutch resident taxpayers and, thus, do not apply to foreign individuals or companies conducting activities in the Netherlands.

[4] *See, e.g.,* Supreme Court June 15, 1988, BNB 1988/258.

[5] *See* Supreme Court April 3, 1974, BNB 1974/172.

[6] *See, e.g.,* High Court's-Hertogenbosch October 17, 1980, BNB 1982/60.

[7] Some of the Netherlands' tax treaties, in particular those with developing countries, provide for a shorter period (e.g., six or nine months).

[8] *See* Cursus Belastingrecht, IB 7.2.1.A.c and P.G.H. Albert, *Vaste Inrichting*, FED fiscale brochures, Deventer 1994. There are commentators who have a different opinion and argue that, if a tax treaty applies, the definition of a PE in that treaty will apply under the Dutch tax rules. *See* H. Pijl, *Het wettelijke vi-facettenbegrip en de verhouding tussen art. 5, eerste en derde lid, OESO-modelverdrag*, WFR 2004/92.

[9] Primarily tax treaties with Asian (e.g., China, Indonesia) and African (e.g., Nigeria) countries.

[10] Decree dated November 16, 2004, nr. IFZ2004/828M.

[11] *See, e.g.,* Supreme Court December 17, 1975, BNB 1976/33.

[12] *See, e.g.,* Supreme Court, June 15, 1955, BNB 1955/277.

[13] *See, e.g.,* Supreme Court June 15, 1955, BNB 1955/277 and Supreme Court Oct. 13, 1954, BNB 1954/336.

[14] *See, e.g.,* Supreme Court June 28, 1995, BNB 1996/108.

[15] *See, e.g.,* Supreme Court March 10, 1982, BNB 1982/127.

[16] *See, e.g.,* Supreme Court March 10, 1982, BNB 1982/127.

[17] *See* High Court's Gravenhage March 26, 1973, BNB 1974/127.

[18] The Dutch rules for allocating profit to a PE are explained in Decree of January 15, 2011, nr. IFZ2010/457M. According to the Dutch Ministry of Finance, the rules are in line with the Commentary on OECD Model Convention, art. 7 and the OECD's "Report on the Attribution of Profits to Permanent Establishments."

[19] *See* General Tax Act, Art. 6.1.

[20] *See* General Tax Act, Art. 6.3 in conjunction with Execution Regulation General Tax Act, Art. 2.1.

[21] *See* General Tax Act, Art. 9.2.

[22] *See* General Tax Act, Art. 13.

[23] *See* General Tax Act, Art. 11.2.

[24] *See* General Tax Act, Arts. 67a and 67d.

[25] *See* Tax Collection Act, Arts. 11 and 12.

[26] Under Council Directive 2010/24/EU of March 16, 2010, concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures.

[27] Dutch Constitution, Art. 94 in conjunction with Art. 104.

[28] This may be a hypothetical situation since, in the case of activities that are carried on for only a short period of time, the duration criterion for the existence of a PE may not be satisfied.

SPAIN

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Generally, non-Spanish resident individuals or entities acting without permanent establishments ("PEs") in Spain are subject to Spanish nonresident income tax ("NRIT") only on their Spanish-source income. Under Article 13.1.b) of the Spanish Nonresident Income Tax Act[1] ("NRITA"), Spanish-source income includes, among other items:

- Business income derived from economic activities carried on in Spain. This includes income derived from the installation or assembly of imported machinery or equipment when the activity is carried out directly by the supplier itself, if the payment for the activity exceeds 20% of the acquisition price of the imported items.
- Services income including income from services or goods (for example, income derived from consulting activities, project design, technical assistance, management services or any kind of professional activity), if the services are used in Spain. Services are considered to be used in Spain when they are rendered for the benefit of business or professional activities carried on in Spain or when they relate to assets located in Spain. If the services rendered are used partly within and partly outside Spain, Spanish taxation is imposed only on the income derived from the part of the services that serve the economic activity carried on in Spain.
- Income arising, directly or indirectly, from the activities of artists or sportspersons personally performed in Spain, or any other activity related to such activities, even when the income is paid to a person or an entity other than the artist or sportsperson him/herself.

In summary, Article 13 of the NRITA provides that income arising from services rendered by nonresident service providers is taxable in Spain if the services are: (1) effectively performed in Spain; or (2) used in Spain. Services "used in Spain" include services related to business activities carried on in Spain or related to goods located in Spain.

The Spanish General Directorate for Taxes ("GDT") has issued a number of binding rulings[2] in which it provides guidance on the meaning of the expression "used in Spain" in relation to a number of different cases, based on the use criteria laid down in Article 13 of the NRITA.

However, Spanish legislation does not specify any threshold of activity (either in terms of length of time, size of project or otherwise) at which Spain will consider a nonresident service provider to be fully taxable.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As a general rule, Spanish resident individual entrepreneurs and Spanish resident entities paying Spanish-source income to a nonresident are required to withhold NRIT at source on account of the nonresident. Tax must be withheld at the general rates provided for in the NRITA, unless a lower rate is provided under an applicable tax treaty.

Services income derived by a nonresident acting without a PE in Spain is subject to tax at the rate of 24%, except services income derived by an EU resident or a resident of a European Economic Area ("EEA") country with an effective exchange of information agreement with Spain, to which 19% rate applies. Additionally, both the income payments and the amounts withheld must be reported by the payer of the income to the Spanish Tax Authorities on Tax Form 216 and Annual Report Form 296.

A nonresident in receipt of such Spanish-source income is not obliged to file a tax return when the payer of the income has applied the relevant withholding tax.[3] Thus, a nonresident is released from any tax liability with respect to taxable Spanish-source income that was subject to withholding tax. The payer of such income is directly responsible for any nonpayment or underpayment of withholding tax to the Spanish tax administration.

In cases where the withholding tax applied exceeds the NRIT payable by the nonresident, the nonresident will be entitled to request a refund of the tax paid in excess, as further explained in IV., below.

A nonresident deriving income from Spanish sources is generally taxed on the gross amount received, except in the case of certain services income, with respect to which some expenses can be deducted. However, a non-Spanish resident without a Spanish PE that is resident in a tax treaty partner country generally would not be subject to NRIT on business and

services income derived from Spanish sources, unless the income were to qualify as a royalty (which is usually subject to NRIT at a reduced tax rate).

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

As noted in I., above, there is no threshold of activity (either in terms of length of time, size of project or otherwise) at which Spain would consider a nonresident service provider to be fully taxable and required to submit a tax return.

Spanish-source taxable income derived by a nonresident acting without a PE in Spain is taxed by way of a final withholding at the rate of 24% or 19%, as explained in II., above. As also noted in II., tax must be withheld by the payer from Spanish-source taxable income paid to a nonresident at the time of payment. The withholding is normally made based on the gross income.

However, in determining the taxable base with respect to business income[4] derived from professional services, technical assistance, and the installation and assembly of machinery and equipment under registered engineering contracts, nonresidents are allowed to deduct payroll expenses (salaries and social security payments corresponding to employees working or hired in Spain) and the cost of materials incorporated in the activity performed in Spain.

Furthermore, a nonresident that is a resident of another EU Member State [5] is entitled to deduct the same expenses as a Spanish resident taxpayer, provided that: (1) the EU resident taxpayer provides evidence to show that the expenses are directly related to the income derived from Spain; and (2) the expenses have a direct economic link with the activity performed by the EU resident in Spain.

If a nonresident service provider is reimbursed for expenses, the reimbursement is considered to be part of the "gross amount" of the services fee.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

A Spanish resident service recipient[6] is required to withhold the relevant amount from all payments made to a nonresident acting without a PE in Spain relating to the services received, and is responsible both for submitting the relevant tax forms on a timely basis and making the corresponding deposits with the Spanish tax authorities. The service recipient is therefore considered a withholding agent for these purposes.

If the amount withheld by the withholding agent exceeds the effective amount corresponding to the payments made, the nonresident will be able to request a refund of the amount exceeding the correct amount of NRIT by filing Tax Form 210. This form must be filed on or after February 1 of the year following that in which the income in question accrues and within four years following the end of the period for the filing and payment of the relevant withholding tax.

A service recipient that fails to withhold when it is required to do so is fully liable for the payment of the relevant NRIT.

The appointment of a tax representative in Spain[7] is required:

- When a nonresident entity carries on activities in Spain through a PE;
- In certain cases in which a nonresident entity rendering services or technical assistance in Spain, or engaged in certain kinds of construction projects in Spain, if the entity intends to deduct certain expenses from its gross income;
- In the case of an entity subject to the income attribution regime that is incorporated in a foreign country and carrying on activities in Spain;
- If the Spanish tax authorities explicitly require the appointment of such representative; and
- In the case of an individual or entity that holds immovable or movable property or rights that are respectively located or exercisable in Spain (excluding securities traded on the Spanish stock exchange) and that is resident in a jurisdiction that does have not an effective tax information exchange agreement with Spain.

Failure to comply with the requirement to appoint a tax representative is considered a major infringement and is sanctioned with a fixed penalty of 2,000 euros (6,000 euros where the individual or entity is resident in a jurisdiction that does not have an effective tax information exchange agreement with Spain).

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

A subcontractor engaged by a nonresident to provide services in Spain would not automatically be considered to represent a presence of the foreign service provider in Spain.

The presence of the nonresident in Spain is relevant to the extent that it gives rise to a Spanish PE. Spanish-source income derived by a nonresident will always be considered subject to NRIT, but may be exempt under an applicable tax treaty or domestic legislation. If the nonresident has a Spanish PE, it will be subject to NRIT in a manner similar to that in which a Spanish resident entity is subject to Spanish corporate income tax, with regard to the income allocated to the PE.

The Spanish tax authorities may consider a subcontractor engaged by a nonresident to be a dependent agent, and therefore a PE of the nonresident (see VIII., below) if the nonresident manages and controls the activities of the subcontractor,[8] so that it is insulated from all the risks inherent to the economic activity taking place in Spain and the human and material resources of the subcontractor serve the activities of the nonresident.[9] They may also take the view that such a subcontractor constitutes a PE of the nonresident if the premises of the subcontractor are at the disposal of the nonresident and all the activities carried out by the subcontractor are carried out for its nonresident principal.[10]

VI. Exceptions to the General System

As noted in II. and III., above, the exceptions to the general system apply to income derived by:

- EU residents or residents of an EEA country with an effective exchange of information agreement with Spain, which are subject to NRIT at the reduced rate of 19%;
- EU residents, which are entitled to deduct the expenses directly linked to the income derived in Spain; and
- EU residents, which may be exempt from NRIT with regards to royalty payments made to them by a Spanish resident company (or by a Spanish PE of a company resident in another EU Member State), subject to certain conditions.

Nonresidents are allowed to deduct payroll expenses and the cost of materials incorporated in the activity performed in Spain, from the business income derived from professional services, technical assistance and the installation and assembly of machinery and equipment under registered engineering contracts.

There are no exceptions for income derived from services provided in particular locations.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

Any nonresident performing business activities with tax consequences in Spain must obtain the relevant Spanish tax identification number and must also be registered for business activities tax purposes.

A nonresident operating in Spain without a PE is also required to withhold taxes when paying income from labor and any other income subject to withholding tax and treated as a deductible expense in determining its taxable income. Thus, such a nonresident that hires employees will have to register with the Spanish social security and tax authorities in order to be able to withhold and deposit social security contributions and taxes. Furthermore, if the employees are foreign employees, they may have to obtain working visas depending on the nature of the activities and their citizenship (EU citizens do not require visas).

VIII. Difference If There Is an Applicable Tax Treaty Between Spain and the Foreign Service Provider's Country of Residence

Under most of Spain's in force tax treaties, business income (including services income that is not characterized as a royalty) derived by a resident of the other Contacting State is not subject to Spanish NRIT unless the nonresident carries on business in Spain through a PE in the Spain and the income is attributable to that PE.[11]

The definition of a PE in Spain's tax treaties includes:

- A fixed place of business through which the business of an enterprise is wholly or partly carried on. Most of Spain's treaties include specific examples of PEs, such as an office, a factory, a branch, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, or a building site or construction or installation lasting more than a specified period of time.[12]
- A dependent agent of a nonresident service provider (excluding an independent agent acting in the ordinary course of business) that habitually acts and exercises an authority to conclude contracts on behalf of the nonresident service provider. In this case, the nonresident will be deemed to have a PE in Spain with respect to any activities that the agent undertakes for it in Spain.[13]

Spanish domestic legislation does not provide for a services PE, so that where such a PE is provided for in one of Spain's tax treaties, it will have no application since the nonresident will be able to rely on the more beneficial domestic legislation.

In practice, these rules mean that, generally, income arising from services provided by a nonresident acting without a PE in Spain will be tax-exempt in a treaty context. In this respect, to avoid the imposition of Spanish withholding tax, a nonresident service provider must provide the service recipient with a certificate of tax residence, within the meaning of the tax treaty signed between Spain and the country of residence of the service provider. Such a certificate issued by the respective competent authority will generally be valid for one year after the date of issue.

If the certificate is not provided on time and the service recipient has, therefore, withheld tax, a request for a refund can be made. To obtain the refund, the nonresident service provider must submit Tax Form 210, accompanied by a copy of the certificate of tax residence within the meaning of the relevant tax treaty.

NOTES

[1] Royal Decree Law 5/2004, of March 5.

[2] For example: Binding rulings number V0468/2016 dated February 8, 2016; number V0196/2016, dated January 20, 2016; number V2982/2015 dated October 8, 2015.

[3] Under NRITA, art. 28.

[4] Under NRITA, art. 24.2.

[5] Under NRITA, art. 24.6.

[6] As set out in NRITA, art. 3.

[7] NRITA, art. 10.

[8] S.T.S., January 12, 2012 (Rec. No. 1626/2008) (*Roche* Spain).

[9] Adolfo J. Martín Jiménez, "The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, Beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?" *Bulletin for International Taxation*, August 2016.

[10] S.A.N., June 8, 2015 (Rec. No. 182/2012) (*Dell* Spain) and S.T.S., June 20, 2016.

[11] *See, e.g.*, Spain-United Kingdom tax treaty, art. 7(1).

[12] *See, e.g.*, Spain-United Kingdom tax treaty, art. 5(2) and (3).

[13] *See, e.g.*, Spain-United Kingdom tax treaty, art. 5(5).

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SWITZERLAND

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Taxable and Required to Submit a Tax Return

A. Income Tax Liability of Nonresident Service Providers without a Permanent Establishment

A service provider that has neither its registered office, nor its place of effective management, nor a permanent establishment ("PE") in Switzerland, is subject to income taxation in Switzerland only to the extent that:

- The service provider performs an activity in its role as a member and/or beneficiary of a partnership that has its registered office or a PE in Switzerland;[1]
- The service provider holds Swiss real estate and/or earns income derived from Swiss real estate;[2]
- The service provider earns income derived from claims secured by Swiss real estate;[3]
- The service provider earns income from trading in, and/or from intermediation involving, Swiss real estate;[4]
- The services are performed in Switzerland by an individual who qualifies as an employee;[5]

The services are performed by an individual who receives income from a Swiss tax resident company or a Swiss PE in his or her role as a director or managing officer;[6] or

The services are performed in Switzerland by an individual who qualifies as an entertainer, a sportsperson or a speaker/contributor.[7]

In other cases, a nonresident service provider without a PE in Switzerland is outside the scope of Swiss income tax. For the above-listed activities giving rise to Swiss income tax liability without a Swiss PE, the duration of the activities concerned is not decisive.

The term "permanent establishment" as defined in Swiss domestic tax law is very similar to the term as defined in Article 5 of the OECD Model Convention (i.e., a fixed place of business through which the business of an enterprise is wholly or partly carried on).[8] The main differences are that: (1) a dependent agent within the meaning of Article 5(5) of the OECD Model does not give rise to a PE in Switzerland under Swiss domestic law where there is no fixed place of business in Switzerland; and (2) auxiliary activities within the meaning of Article 5(4) of the OECD Model may still give rise to a PE in Switzerland under Swiss domestic law if such auxiliary activities have a certain level of significance. A construction site can give rise to a PE in Switzerland only if it lasts for more than 12 months.[9] For other activities, there is no clear duration threshold below which a PE will not be considered to exist. However, activities that last for less than six months usually do not give rise to a PE.

B. Value Added Tax Liability of Nonresident Service Provider Without a Permanent Establishment

It is worth noting that, for Swiss value added tax ("VAT") purposes, a company that is not a Swiss tax resident and does not have a PE in Switzerland is generally not subject to Swiss VAT. VAT registration is mandatory for such a nonresident company, however, if its turnover from the supply of services and/or the supply of goods taxable in Switzerland exceeds CHF 100,000 to the extent that:

- The service provider supplies goods within Swiss territory; and/or
- The service provider supplies telecommunication or electronic services within Swiss territory to recipients who are not liable for VAT (for example, via the online sale and licensing of software to Swiss resident private customers, or the provision of services of online platforms to Swiss resident private customers).[10]

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

As regards the Swiss tax liability of a nonresident without a PE in Switzerland, there are categories of income with respect to which there is an obligation to file a tax return and pay ordinary income tax (see below at (1)) and other categories of income that are subject to a final withholding tax (see below at (2)).

(1) A nonresident service provider must file an annual tax return in Switzerland to the extent it becomes liable to taxation in Switzerland as a result of: (a) its function as a member and/or beneficiary of a partnership that has its registered office or a PE in Switzerland; (b) its investment in Swiss real estate; and/or (c) its trading in or intermediation involving Swiss real estate. In these cases, there are no withholding requirements. The Swiss tax claim can be enforced via the assets of the Swiss partnership, via the blocking of a change of ownership in the land regis-

ter,[11] via the sequestration of a part of the purchase price in the case of intermediation involving real estate,[12] and/or via a legal mortgage on the affected real estate.[13]

Further, the tax authorities may ask for security for taxes anticipated to be due from a nonresident before such taxes become due. If the nonresident does not provide security in the amount of the anticipated taxes (for example, by way of a guarantee or by way of a deposit of cash or marketable securities), the tax authorities may sequester the nonresident's assets located in Switzerland and/or the nonresident's claims against its Swiss debtors in the amount of the anticipated taxes.[14]

(2) If a nonresident service provider is liable to taxation in Switzerland as a result of: (a) activities carried on by an employee in Switzerland; (b) activities performed by an entertainer, a sportsperson or a speaker in Switzerland; (c) his/her function as a member of the board of directors or a managing officer of a Swiss company, and/or (d) the fact that it receives interest on a claim secured by Swiss real estate, a withholding tax generally applies.[15] The withholding tax generally replaces the ordinary tax on such income that would apply if the income were derived by a Swiss resident.[16] Consequently, such a nonresident is not required to file a Swiss tax return. The withholding on interest secured by Swiss real estate can generally be enforced via the Swiss real estate and/or vis-à-vis the Swiss debtor. The withholding on directors' fees can generally be enforced vis-à-vis the Swiss company paying the fee. However, where a nonresident service provider without a Swiss PE engages a nonresident employee, entertainer, sportsperson, or speaker, there is no way of requiring the nonresident service provider to pay withholding taxes in Switzerland. For that reason, the Swiss tax authorities do not require such a nonresident to withhold taxes from consideration paid from outside Switzerland, but instead require the recipient of the payment to declare the respective income in a tax return and settle his/her Swiss income tax liability directly under the ordinary procedure that applies to resident taxpayers.[17] A nonresident service provider will, however, often offer to report and pay withholding taxes (and social security contributions) in Switzerland on a voluntary basis on behalf of the respective agent or employee in order to release the agent/employee from his or her tax reporting obligations.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

There is no quantitative threshold of any kind at which a nonresident becomes subject to Swiss income tax. A nonresident service provider without a Swiss PE will be liable for Swiss income tax only to the extent it derives income that falls into one of the categories listed in I.A., above:

- Where the nonresident service provider has to file a tax return in Switzerland (i.e., with respect to items of income listed in II., above at (1)), the ordinary income tax rates apply (i.e., the same rates as those that apply to Swiss residents). While the income tax rate applying to legal entities is generally a flat rate (approximately 11.5%-24.4% for corporations, the exact rate depending on the canton and the municipality concerned), the income tax rates applying to individuals are usually progressive (the rates depending on the income bracket as well as on the canton and the municipality concerned, all worldwide items of income being taken into account in determining the applicable income brackets). Because the ordinary income tax rates apply, only the net income after deduction of expenses and the *pro rata* deduction of applicable tax allowances is taxed.
- Where the nonresident service provider is taxed by way of Swiss withholding tax (i.e., with respect to items of income listed in II., above at (2)), special tax rates apply for each category of income. These withholding tax rates are different from the tax rates applying to residents. Depending on the canton and the category of income concerned, the applicable rates are either flat or progressive. Unlike the ordinary income tax described above in (1), the withholding taxes are generally levied on gross income (with the exclusion of expenses that are separately reimbursed).[18] By way of exception, in the case of entertainers, sportspersons, and speakers, gross income for withholding tax purposes *does* include reimbursed expenses; on the other hand, in the case of such individuals, a lump sum (usually 20%), or actual expenses where these are higher, can be deducted in computing the withholding tax base.[19]

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

For Swiss income tax purposes, a Swiss service recipient is not required to withhold any taxes from a payment it makes to a nonresident service provider, unless such payment qualifies as a payment to an employee, a sportsperson/entertainer/speaker, or a member of the service recipient's board of directors or managing officer, or as interest secured by Swiss real estate (i.e., the categories enumerated in II., above at (2)). If the service relates to the sale of or intermediation involving Swiss real estate, the Swiss service recipient may find its property subject to a legal mortgage to the Swiss tax authorities (see II., above at (1)). For this reason such a service recipient should ask for evidence of the payment of the Swiss taxes due by the nonresident service provider before paying the full service fee. Except in such circumstances, there is no Swiss income tax exposure as a result of receiving services from a nonresident service provider.

A Swiss recipient of services from a nonresident service provider that does not have to charge and pay Swiss VAT on the services provided (see I.B., above) must report and pay Swiss VAT under a reverse-charge mechanism: (1) if the service recipient is engaged in entrepreneurial activities in Switzerland and therefore subject to Swiss VAT; or (2) at the request of the tax administration, if the service recipient pays service fees to nonresident service providers in the amount of more than CHF 10,000 per calendar year.[20]

For both Swiss income tax and Swiss VAT purposes, a nonresident service provider that is subject to Swiss tax is required to appoint a Swiss resident tax representative at the request of the tax administration.[21] If

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the service provider fails to appoint a tax representative, the tax authorities may deliver their decision by way of publication in the official Swiss (federal and/or cantonal) gazette.[22]

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Where a nonresident service provider subcontracts an independent contractor or agent to provide its services in Switzerland, this generally does not create any Swiss income tax exposure for the nonresident principal. Swiss income taxation applies at the level of the Swiss contractor or agent, rather than at the level of the nonresident principal.

However, if a legally independent contractor or agent is, in fact, dependent on the principal in the manner of an employee, the relationship between the principal and the contractor or agent may be reclassified as an employment relationship for Swiss tax purposes. The main criteria used to determine whether a contractor or an agent is independent or an employee are:

- whether and to what extent the contractor/agent is bound to follow the principal's work instructions;
- whether the contractor/agent is free to decide on the work organization or is integrated into the principal's organizational structure and is in a position of subordination to the principal; and
- whether the contractor/agent performs the activities for his/her own profit at his/her own risk.[23]

The risk of a relationship being reclassified as an employment relationship can be mitigated by engaging a subcontractor or agent that is organized in the legal form of a stock corporation or a limited liability company.

If the contractual arrangement with the Swiss service provider is reclassified as an employment relationship for Swiss tax purposes, the nonresident service provider will still have no immediate Swiss income tax exposure if neither the employment nor any other circumstances give rise to a PE in Switzerland. In the absence of a Swiss PE, liability to pay taxes and social security contributions lies with the employee and not with the nonresident employer (see II., above at (2)).

If the contractor or agent qualifies as a service provider independent of the nonresident principal, any place of management and/or fixed workplace that the contractor/agent might have in Switzerland is not attributed to his/her nonresident principal. That is, an independent agent cannot give rise to a PE of his/her principal in Switzerland (as outlined in I.A., above). However, if the contractual arrangement is reclassified as an employment relationship, a PE resulting from that employment *is* attributed to the nonresident principal. While there are circumstances in which engaging an employee in Switzerland does not give rise to a Swiss PE (for example, where the employee only *travels* in Switzerland and does not maintain any office or other fixed workplace in Switzerland for more than a few months), an employee usually performs at least some of his/her work from a fixed place of business, which generally gives rise to a PE of the principal in Switzerland (assuming the fixed place of business is in Switzerland).

VI. Exceptions to the General System

Based on the non-discrimination clause contained in the Treaty between the European Communities and Switzerland regarding the Free Movement of Persons, nationals of EU Member States/European Free Trade Association (EFTA) countries staying in Switzerland may not be treated less favorably than Swiss nationals.[24] However, since the Swiss tax rules for nonresidents are the same for both Swiss and non-Swiss nationals, there is no discrimination against foreign nationals as compared to Swiss nationals. Nevertheless, the Swiss Federal Supreme Court has come to the conclusion that nonresident EU/EFTA nationals who derive more than 90% of their income from Swiss sources should be taxed in the same manner as Swiss residents. Nonresident EU/EFTA (including Swiss) nationals may therefore claim to be subject to ordinary taxation instead of withholding taxation (ordinary income taxation is usually more favorable in the case of individuals with a low level of income).[25] While doctrine states that final withholding taxes may also violate the non-discrimination clause contained in the tax treaties reflecting article 24(1) of the OECD Model, there has been no Swiss court decision in this regard.[26]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

A. Regulatory requirements for Nonresident Service Providers

In general, foreign service providers may provide services in Switzerland without any advance permission. A foreign service provider will have to obtain a license before commencing its activities in Switzerland only if Swiss law indicates that those particular business activities require permission to be obtained. This applies particularly to financial and insurance services.

B. Tax and Social Security Reporting

A foreign service provider that does not have a PE in Switzerland does not have to report for Swiss tax and social security purposes for its employees. Instead, tax and social security reporting is the responsibility of an employee who does not have a Swiss employer (see II., above at (2)).

C. Permit for Foreign Employees

A non-Swiss national who works in Switzerland must generally apply for a work and/or residence permit. EU/EFTA nationals need only file notifications if they work in Switzerland for less than three months and only have to file requests for residence permits if they work in Switzerland for three months or more. EU/EFTA nationals are generally entitled to obtain residence permits if they are employed in Switzerland. However, discussions are going on in the Swiss Federal Parliament with a view to restricting the issuing of resident permits to EU/EFTA nationals.[27]

Persons other than EU/EFTA nationals must either apply for advance visas in order to enter Switzerland or apply for residence permits if their stay in Switzerland exceeds a certain period of time (depending on their nationality). In addition, they must apply for advance work permits in order to be able to carry on professional activities in Switzerland.[28] Such permits are generally subject to a quota and whether a permit will be issued will mainly depend on the employee's professional qualifications.[29]

Although employers often assist their employees in obtaining Swiss residence and work permits, the arranging of the required permits is the responsibility of the employee rather than the employer.

D. Registration with the Swiss Commercial Register

A foreign service provider must register with the Swiss Commercial Register if it has a branch in Switzerland. A foreign service provider has a branch in Switzerland if it carries on a business activity in Switzerland with premises and personnel in Switzerland that acts in its own name and on its own account.[30] While a PE for tax purposes will not necessarily qualify as a branch under Swiss civil law, the existence of a branch will generally give rise to a PE.

E. Coordination between Swiss Authorities

While the Swiss authorities are generally entitled to exchange information and give notice of punishable acts or omissions, there is no coordination of reporting requirements and generally no automatic or institutionalized exchange of information. The tax authorities, however, generally notify the social security authorities of facts relevant to the assessment of social security contributions.

F. Swiss Bank Account

A foreign service provider does generally not have to maintain a Swiss bank account. Depending on the facts and circumstances, a nonresident service provider might even find it difficult to open a Swiss bank account.

VIII. Difference If There Is an Applicable Tax Treaty Between Switzerland and the Foreign Service Provider's Country of Residence

Most of Switzerland's tax treaties broadly follow the OECD Model Convention. Given the limited scope of the taxation of foreign service providers in Switzerland, the relevant Swiss domestic tax rules are broadly in line with treaty law. Generally, the following are the only circumstances in which a tax treaty may limit Switzerland's right to impose income tax on a nonresident service provider, namely where the service provider:

- Carries on activities via a fixed place of business in Switzerland that qualifies as a PE under Swiss domestic tax law, but the activities only qualify as auxiliary activities under the applicable tax treaty, which results in Switzerland not being allowed to tax the relevant income.
- Receives interest income on a claim secured by Swiss real estate. Since Switzerland's tax treaties generally limit or eliminate the source state's right to levy interest withholding tax, Switzerland's right to levy interest withholding tax in these circumstances is either limited (usually to 10%) or entirely eliminated.
- Derives income via intermediation involving Swiss real estate, unless such income is allocated to a Swiss PE. Under its tax treaties, Switzerland may generally not levy income taxes on such income.
- Is a speaker/contributor tax resident in a treaty partner country and performs his/her activities in Switzerland without having a PE in Switzerland. While Switzerland's tax treaties generally allow Switzerland to levy withholding taxes on entertainers and sportspersons performing their activities in Switzerland, they generally do not provide for such taxation rights with regard to income derived by speakers/contributors.

Is an employee assigned to Switzerland who stays in Switzerland 183 or less days per calendar year (older treaties) or 183 days or less within any 12-month period (newer treaties). Switzerland's tax treaties restrict Switzerland's right to impose withholding taxes on such an employee. Switzerland's treaties with neighboring countries also limit Switzerland's right to tax international commuters.

To the extent a taxpayer would have to pay ordinary income taxes in Switzerland assessed based on a tax return, the taxpayer may directly claim tax treaty relief and the tax authorities will only levy income taxes in accordance with the applicable treaty.

Where a tax treaty limits Switzerland's source country taxation rights, Swiss domestic income tax law does not generally specify whether withholding taxes may still levied with a subsequent request having to be made for the reimbursement of the overcharged tax, or whether tax relief at source applies. Based on the current practice of the tax authorities, relief at source generally applies and the debtor with respect to the taxable payment concerned need only withhold taxes in accordance with the applicable treaty.[31] If the debtor with respect to the payment nonetheless withholds tax, the nonresident recipient may request a reimbursement by claiming treaty relief.[32]

NOTES

[1] Swiss Federal Act on the Swiss Federal Income Tax, dated December 14, 1990 ("DBG"), arts. 4 (1) (b), 51 (1) (a); Swiss Federal Act on the Harmonization of Direct Taxes of the Cantons and Municipalities, dated Dec. 14, 1990 ("StHG"), arts. 4 (1), 21 (1) (a).

[2] DBG, arts. 4 (1) (c), 51 (1) (c); StHG, arts. 4 (1), 21 (1) (c).

[3] DBG, arts. 5 (1) (c), 51 (1) (d); StHG, arts. 4 (2) (c), 21 (2) (a).

[4] DBG, arts. 4 (1) (d), 51 (1) (e); StHG, arts. 4 (1), 21 (2) (b).

[5] DBG, art. 5 (1) (a); StHG, art. 4 (2) (a).

[6] DBG, art. 5 (1) (b); StHG, art. 4 (2) (b).

[7] DBG, art. 92; StHG, art. 35 (1) (b).

[8] DBG, art. 4 (2), first sentence.

[9] DBG, art. 4 (2), second sentence.

[10] Swiss Federal Act on Value Added Taxes, dated June 12, 2009 ("MWSTG"), arts. 10 (2) (b), 45 (1); Swiss Federal

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Ordinance on Value Added Taxes, dated November 27, 2009 ("MWSTV"), arts. 9a *et seq.*

[11] DBG, art. 172.

[12] DBG, art. 173.

[13] Swiss Civil Code dated December 10, 1907 ("CC"), art. 836.

[14] DBG, arts. 169 *et seq.*; StHG, art. 78.

[15] DBG, arts. 91 *et seqq.*; StHG, arts. 35 *et seqq*. Withholding taxes also apply to nonresidents in other cases but these are not relevant to service providers.

[16] DBG, art. 99.

[17] Guido Jud/Adrian Rufener, in: Martin Zweifel/Michael Beusch (ed.), Kommentar zum Schweizerischen Steuerrecht I/2b, 3th ed., Basel 2017, art. 100 DBG no. 2.

[18] DBG, arts. 91 *et seqq.*; StHG, art. 36 (3).

[19] DBG, art. 92 (3); StHG 36 (2); Federal Withholding Tax Ordinance dated Oct. 19, 1993 ("QStV"), art. 7 (3).

[20] MWSTG, art. 45 (2).

[21] DBG, 118; MWSTG, 67 (1).

[22] Federal Act on Administrative Procedure dated December 20, 1968, art. 36 lit. b.

[23] Markus Reich, Steuerrecht, 2nd ed., Zürich 2012, § 13 no. 6.

[24] Treaty between the European Communities and Switzerland regarding the Free Movement of Persons dated June 21, 1999, art. 2.

[25] Decision of the Swiss Federal Supreme Court 136 II 241 dated January 26, 2010.

[26] Stefan Oesterhelt, in: Martin Zweifel/Michael Beusch/René Matteotti (ed.), Internationales Steuerrecht, Basel 2015, art. 24 nos. 39 *et seqq.*; 199 *et seqq*.

[27] Cf. https://www.sem.admin.ch/sem/en/home/themen/fza_schweiz-eu-efta/umsetzung_vb_zuwanderung.html, visited on Jan. 27, 2017.

[28] Federal Act on Foreign Nationals dated December 16, 2005 ("AuG"), art. 11.

[29] AuG, arts. 20 *et seqq*.

[30] Martin Eckert, in: Heinrich Honsell/Peter Nedim Vogt/Rolf Watter (ed.), Basler Kommentar Obligationenrecht II, 5th ed., Basel 2016, OR 735, nos. 2, 7.

[31] The only exception—where the full withholding tax applies and the recipient must subsequently request a tax reimbursement—relates to capital payments of pensions to nonresidents (QStV, art. 11), which is not relevant for nonresident service providers.

[32] QStV, art. 16.

UNITED KINGDOM

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

A. General

The United Kingdom seeks to impose tax on nonresidents that carry on a trading activity in the United Kingdom in two ways:

- First, companies that carry on a trading activity in the United Kingdom through a U.K. permanent establishment ("PE") (as judged under U.K. domestic legislation or under the terms of an applicable tax treaty) are subject to U.K. corporation tax (currently at the rate of 20%, soon to be reduced to 19% and, by 2020, to 17%) on the profits of the trade that are applicable to that PE;[1] and
- Second, any nonresident person that carries on a trade in the United Kingdom (and is not subject to corporation tax as a result of doing so through a U.K. PE) is subject to income tax (at the rate of 20%) on the profits of the trade (or if only part of the trade is carried on in the United Kingdom, on that part of it that is so carried on).[2] However, this is subject to the requirements of any applicable tax treaty (as, in general, a U.K. tax treaty would prevent a nonresident being subject to U.K. tax on profits of a trade unless that trade was carried on through a PE as defined in that treaty).

It follows that most nonresidents doing business in the United Kingdom or that have U.K. clients need only consider whether they have a U.K. PE to determine whether they will be subject to U.K. tax. Because the United Kingdom has a large number of tax treaties (currently with more than 130 jurisdictions), it is rare to encounter nonresidents that could be subject to U.K. tax under U.K. domestic legislation and that cannot rely on the terms of a tax treaty. Such persons may need to consider the question of whether they are trading *in*, or trading *with*, the United Kingdom (trading *in* the United Kingdom gives rise to a liability to U.K. tax, whereas trading *with* the United Kingdom does not).

B. Permanent Establishment

The United Kingdom's rules on PEs largely follow OECD guidance. A PE exists in the United Kingdom if a nonresident company has a fixed place of business (such as a place of management, branch or office) in the United Kingdom or if a dependent agent acts on behalf of the nonresident company and has and habitually exercises in the United Kingdom authority to do business on behalf of the company. Temporary and preparatory activities are in each case excluded.

C. Trading in or with the United Kingdom

The question of whether a nonresident is trading in the United Kingdom rather than with the United Kingdom is rather more difficult to answer, as there is no guidance in U.K. legislation that provides a clear position. Instead, nonresidents must rely on the principles set out in a series of cases, many of which were decided decades if not centuries ago and the facts of which bear little resemblance to the modern business world. Nevertheless some key principles can be relied upon:

- Where the contract is entered into is important. A series of cases in the late 1800s, including the "Champagne" cases (so called because they concerned whether producers selling champagne in the United Kingdom were liable for U.K. tax), established the importance of where a contract is made. In *Grainger & Gough* (1896), it was held that where a champagne producer sold wine in the United Kingdom through agents in the United Kingdom but under contracts entered into outside the United Kingdom, the producer was not liable to U.K. tax at all on the profits of those trades. The case established the key distinction between trading in the United Kingdom and trading with the United Kingdom, which remains a distinguishing feature of the scope of U.K. tax today.
- However, subsequent cases have accepted that multiple factors may be relevant in determining where trading is treated as taking place. In *Smidth & Co. v. Greenwood* (1921), Lord Atkin decided the case by reference to the question "where do the operations take place from which the profits in substance arise?"

It follows that what determines whether a trade is treated as taking place in the United Kingdom will vary from case to case, and there is no one-size-fits-all threshold.

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II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

A nonresident company that has a U.K. PE through which it carries on a trade will be required under English corporate law rules to register that PE at Companies House (the English register of all companies and businesses). (Similar obligations apply to companies in Scotland and Northern Ireland.) All companies that register at Companies House are automatically notified to HM Revenue & Customs ("HMRC" the United Kingdom's tax authority) and are therefore required to file tax returns and pay tax and may be subject to penalties and other actions in the event of failure to do so. HMRC may treat any agent that constitutes a PE of a nonresident as the "U.K. representative" of the nonresident for tax collection purposes and may pursue the representative for tax in the absence of payment by the nonresident.[3]

A nonresident that does not have a U.K. PE faces no such procedure forcing it in practice to register but, as a person with a liability to U.K. tax, it is nevertheless required to file a U.K. tax return and account for the tax that is due. In the same way as for a PE, a person that constitutes a branch or agency may be treated by HMRC as a U.K. representative for tax collection purposes.[4] However, this obligation is not backed up by any procedural rules such as a withholding tax and, in the absence of any U.K. branch or agency or other assets, it may be difficult for HMRC to enforce payment of U.K. tax liabilities from a nonresident. Indeed, this fact is acknowledged in HMRC's published guidance on the imposition of tax on nonresidents, where it says:

> If you are considering a non-resident trading in the UK with no apparent permanent establishment/branch or agency, you should keep in mind the practical difficulty that the absence of access to the machinery provisions for assessment and collection of the tax from the UK permanent establishment/branch or agency would cause.[5]

However, the importance of settling all liabilities, especially where circumstances could change in the future leading to an increased presence of the taxpayer in the United Kingdom should not be overlooked.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

As noted in II., above, no withholding applies and no other requirement must be complied with by either the service provider or the recipient of the services beyond the requirement for the service provider to register for and pay U.K. income tax.

It should be noted that, with effect from April 1, 2017, a nonresident company that is subject to income tax on the profits of a trade carried on in the United Kingdom otherwise than through a PE (and that is not relieved from U.K. tax under the terms of a tax treaty) may find it more economical to arrange matters so that it has a U.K. PE and so becomes subject to U.K. corporation tax, rather than U.K. income tax. This is because, effective April 1, 2017, the rate of corporation tax paid by companies will be reduced to 19% (from the current level at the time of writing of 20%), whereas the rate of income tax paid by nonresidents will remain at 20%. In 2020, the economic incentive to increase a presence in the United Kingdom will increase as the rate of corporation tax is due to decrease to 17% at that time (while no reduction in the rate of income tax has been announced).

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

A nonresident service provider with a U.K. income tax liability is required to register for U.K. income tax, and must file a U.K. income tax return and pay any income tax due by no later than January 31 in the year following the end of the tax year (April 6 to the following April 5) in which the tax liability arose. There is no requirement to appoint a U.K. tax agent.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Appointing a subcontractor could, depending on the terms under which the subcontracting takes place, cause the nonresident to be treated as having an agency in the United Kingdom. This could bring the nonresident into the charge to U.K. tax through permitting the charging of U.K. tax under the terms of any relevant tax treaty. It could also make it easier for HMRC to collect any tax due as the agent could be treated as the U.K. representative of the nonresident.

An example of a similar situation is afforded by *Firestone Tyre & Rubber Co. Ltd. (as agents for Firestone Co, of USA) v. Lewellin* (1959), in which a U.K. subsidiary company acted as agent for its U.S. parent company in fulfilling orders for European customers. The U.K. subsidiary accounted to its parent company for the sale proceeds less its sale costs plus 5%. The U.K. subsidiary was held to be acting as the U.S. parent company's agent and the U.S. parent company was therefore held to be trading in the United Kingdom through the agency of its subsidiary.

However, not all U.K. subsidiaries of nonresident parents are treated as agents of their parents and similarly not all subcontractors are treated as agents. The position will depend on their activities, or, to revert to the case-law, the location where the profits in substance arise. It will also depend on the basis on which the subcontractor takes on the work. If it acts as an independent agent, it may well not be treated as a PE. If it does not act as an agent at all and instead undertakes an activity on its own account, then that would not cause any other person to become liable to U.K. tax.

VI. Exceptions to the General System

The rules requiring payment of tax are generic rules and applicable to foreign service providers of all types.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

Foreign service providers with PEs in the United Kingdom are obliged to register those establishments

at Companies House. This gives rise to a variety of filing and accounting obligations. Companies House provides details of all registrations to HMRC.

Any person coming to work in the United Kingdom must meet visa requirements. While the United Kingdom continues as a member of the European Union, access to the United Kingdom is unrestricted for EU nationals. Nationals of other states face different entry requirements.

If any employees are engaged in the United Kingdom, the employer may be required to register as such for employment tax purposes even in cases where it is not otherwise subject to U.K. tax, though the presence of an employee in the United Kingdom may itself be a factor in the treatment of the nonresident employer as liable to U.K. tax. However this is a complex area and the position will depend on individual circumstances.

VIII. Difference If There Is an Applicable Tax Treaty Between the United Kingdom and the Foreign Service Provider's Country of Residence

The United Kingdom's tax treaties are critical in determining whether a nonresident is subject to tax in the United Kingdom. Most of the United Kingdom's tax treaties restrict the ability of the United Kingdom to impose tax on nonresidents by reference to business profits where the nonresident does not have a PE in the United Kingdom. In practice, this ensures that, in the great majority of cases, U.K. tax only applies to foreign service providers that have PEs in the United Kingdom through which their trade is carried on.

NOTES

[1] Corporation Tax Act 2009, sec. 5(3).

[2] Income Tax (Trading and Other Income) Act 2005, sec. 6(5).

[3] Corporation Tax Act 2010, sec. 970.

[4] Taxation (International and Other Provisions) Act 2010, sec. 835E.

[5] HMRC International Manual, para. INTM264020.

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UNITED STATES

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I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

Generally, the provision of services by a nonresident service provider becomes taxable in the United States when the nonresident service provider is engaged in a trade or business within the United States (a "UST/B") within the meaning of Section 864(b) of the Internal Revenue Code of 1986, as amended (the "Code").[1]

Historically, the IRS has been hesitant to issue rulings on whether a nonresident is engaged in a UST/B, and accordingly the applicable law has mostly been developed in the courts. Unfortunately, the courts have not articulated bright-line rules or clear thresholds. Instead, the determination of whether a nonresident service provider is engaged in a UST/B is based on all of the facts and circumstances related to the service provider's economic activities in the United States.

The standard that has emerged in the courts is that such activities must be "considerable, continuous and regular" in order to constitute a UST/B.[2] Generally, this standard requires some kind of continuous or sustained activity,[3] and does not include isolated, noncontinuous or casual transactions.[4] However, certain highly-significant activities, such as the participation of a boxer in a world championship bout or an opera singer's attendance at a single recording session, can be considered a UST/B despite the general standard.[5] Also, a UST/B must consist of active conduct, as opposed to passive conduct such as investing in securities for one's own account.

The Code provides that the performance of personal services within the United States constitutes a UST/B.[6] This provision of the Code includes exceptions for certain nonresident alien individuals who are employees of foreign persons and who are not present in the United States for more than 90 days during a taxable year and do not earn compensation that exceeds U.S. $3,000.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

Generally, withholding on a payment of income connected with the conduct of a UST/B (ECI) is not required as long as the recipient of the payment provides the payor with an IRS Form W-8ECI.[7] This general rule does not apply, however, to payments to nonresident individuals for personal services, which are specifically subject to withholding.[8]

The rate of withholding applicable under the Code to payments to nonresident individuals for services is 30%.[9] These payments must be reported to the IRS on IRS Forms 1042 and 1042-S.

Services income paid to entities is generally not subject to federal income tax withholding, as long as the applicable documentation requirements are met.

Although payments of services income to partnerships are generally not subject to federal income tax withholding, partnerships are required to withhold tax on allocations of ECI to their foreign partners. The rate of withholding is 35% for foreign partners that are corporations and 39.6% for other foreign partners. A partnership must use IRS Forms 8804, 8805, and 8013 to report and pay the withholding: Form 8804 is used to report the aggregate amount of withholding required, Form 8805 is used to report the amount of each foreign partner's withholding to that partner and to the IRS, and Form 8013 is used to for the actual payment to the IRS.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

In the case of a nonresident entity, compensation for services performed in the United States that do not rise to the level of a UST/B is not subject to U.S. federal income tax. Compensation for services provided by an individual is subject to the 30% withholding described in II., above.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

The service recipient is considered a "withholding agent" with respect to payments to a nonresident service provider.[10]

A withholding agent must either withhold the full amount of the applicable withholding tax or must obtain documentation upon which it may rely (or properly apply presumption rules) to use a reduced or zero rate of withholding tax.[11] A withholding agent

that fails to withhold the proper amount of tax is itself liable for the unwithheld amounts.[12]

If a withholding agent withholds too much, then the nonresident service provider can seek a refund on its annual U.S. federal income tax return. If a withholding agent does not withhold enough, then the nonresident service provider is required to pay the underlying tax.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

The question of whether the activities an independent agent are attributed to its principal for the purposes of determining whether the principal is engaged in a UST/B is not entirely clear under U.S. federal tax law. Generally, courts and the IRS have taken the position that activities of an independent agent are attributed to the principal if the independent agent performs services for the principal with some degree of regularity.[13] However, some courts have held that activities of an independent agent are not attributed where the activities of the agent are "ministerial" and require little judgment or discretion.[14]

VI. Exceptions to the General System

There are no such exceptions.

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

In general, an employer will have to register with the federal, state and local government in order to withhold and deposit employment taxes. Pension and other rules may require inclusion of U.S. employees in certain benefit plans. Having an office or employees in the jurisdiction may constitute nexus, requiring registration and payment of state and local sales and use taxes. Federal employment rules require visas for nonresident employees, and certification of immigration status is required for non-citizens. A host of other rules and regulations may also apply, depending on the nature and scope of the underlying business.

VIII. Difference If There Is an Applicable Tax Treaty Between the United States and the Foreign Service Provider's Country of Residence

Most of the United States' tax treaties provide that income from a UST/B is not subject to tax by the United States unless that income is attributable to a permanent establishment (PE) in the United States.[15] Generally, the United States' tax treaties provide that a PE includes an office or other fixed place of business, and many of the tax treaties include a list of specific types of establishment—such as a place of management, a branch, a factory, a workshop and a mine, an oil or gas well, and a quarry[16]—that are considered to be PEs. In addition, if an agent of the nonresident service provider (other than an independent agent acting in the ordinary course of business) exercises the authority to conclude contracts in the name of the nonresident service provider, then any PE of the agent is attributed to the nonresident service provider.[17]

A number of treaties provide that an enterprise is considered to have a PE in a country if it provides services through employees or other personnel for a specified amount of time. For instance, the United States-China tax treaty provides that an enterprise will be considered to have a PE if it provides services in the relevant country for more than six months within a 12-month period. The applicable time period in such treaties ranges from 90 days in the case of the United States-Bermuda, -India, -Jamaica and -Thailand tax treaties, up to 12 months in the case of the United States-Kazakhstan tax treaty.

In addition, the United States-Bulgaria and United States-Canada tax treaties have a provision under which an enterprise is considered to have a PE in a country if it provides services through an individual that is present in that country for 183 days or more in a 12-month period and if more than 50% of the gross active business revenues of the enterprise consists of income derived from the services performed in that country by that individual.[18]

A nonresident service provider is required to disclose to the IRS that it is taking a position that the service provider's ECI is not subject to U.S. federal income tax because such income is not attributable to a U.S. PE of the service provider under an applicable tax treaty.[19] In order to make the disclosure, a nonresident service provider must file a U.S. federal tax return and attach a completed IRS Form 8833.[20]

* * *

NOTES

1 All statutory references are to the Internal Revenue Code of 1986, as amended (the "Code"). All regulatory references are to U.S. Treasury Department regulations promulgated under the Code.

2 *See, e.g.*, *de Amodio v. Comm'r*, 34 T.C. 894 (1960).

3 *Linen Thread Co. v. Comm'r*, 14 T.C. 725 (1950).

4 *Continental Trading, Inc. v. Comm'r*, 265 F.2d 40 (9th Cir. 1959).

5 *See, e.g.*, *Johansson v. U.S.*, 336 F.2d 809 (5th Cir. 1964); *Ingram v. Bowers*, 57 F.2d 65 (2d Cir. 1932).

6 Section 864(b).

7 Treas. Reg. § 1.1441-4.

8 Section 1441(c)(1).

9 Treas. Reg. § 1.1441-4(b).

10 Treas. Reg. § 1.1441-7.

11 Treas. Reg. § 1.1441-1T(b)(7).

12 Section 1461.

13 *See de Amodio v. Comm'r*, 34 T.C. 894 (1960); Rev. Rul. 55-617.

14 *Spermacet Whaling & Shipping Co. v. Comm'r*, 30 T.C. 618 (1958).

15 *See, e.g.*, United States-Canada tax treaty, Art. VII(1).

16 *See, e.g.*, United States-Canada tax treaty, Art. V(2).

17 *See, e.g.*, United States-Canada tax treaty, Art. V(5).

18 United States-Canada tax treaty, Art. V(9); United States-Bulgaria tax treaty, Art. 5(8).

19 Treas. Reg. § 301.6114-1(b)(5)(i).

20 Treas. Reg. § 301.6114-1(d).

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APPENDIX Foreign Service Providers: An EU Perspective

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I. Regulatory Framework – Role of the Court of Justice of the European Union

Under the impetus of the Court of Justice of the European Union, ("CJEU"), direct tax measures of the Member States are considered to fall within the ambit of what are known as the "fundamental freedoms" that the Treaty on the Functioning of the European Union ("TFEU") confers on EU citizens, *i.e.* the free movement of persons (consisting of the freedom of movement of workers and the right of establishment), the freedom to provide services, the free movement of capital and, less relevantly for the direct tax area, the free movement of goods. Indeed, since the seminal ruling in *Schumacker,*[1] it is settled case law of the CJEU that although, as EU law currently stands, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nonetheless be exercised consistently with EU law. In other words, national direct tax provisions (including international tax conventions) of the Member States must not compromise the freedoms enshrined in the TFEU.

The freedom to provide services (Articles 56-62 of the TFEU) prohibits restrictions with respect to nationals of Member States who are established in a Member State other than that of the person for whom the services are intended.[2] The person providing a service may, in order to provide the service, temporarily[3] pursue his/her activity in the Member State where the service is provided, under the same conditions as are imposed by that State on its own nationals. The freedom to provide services not only assures the provider of a service the right to enter the market of another Member State and to be treated there in the same way as a domestic service provider, but also protects the recipient of that service. The freedom to provide services is "residual" in that it only applies insofar as the services at issue are not governed by the provisions relating to freedom of movement for goods, capital or persons.[4]

The concept of "services" within the meaning of Article 56 of the TFEU implies that services are ordinarily provided for remuneration and that the remuneration constitutes consideration for the service in question and is agreed upon between the provider and the recipient of the service.[5] Thus, the decisive factor that brings an activity within the ambit of the Treaty provisions on the freedom to provide services is its economic character, that is to say, the activity must not be provided for nothing. That being said it is not, however, necessary for the person providing the service to be seeking to make a profit.[6] "Services" include in particular: activities of an industrial or commercial character; activities of craftspeople; and activities of the professions.

According to settled case law of the CJEU, Article 56 of the TFEU precludes the application of any national legislation that, without objective justification, impedes a provider of services with respect to actually exercising the freedom to provide them.[7] It is not only rules that differentiate based on nationality (direct or overt discrimination) that amount to discrimination; rules that apply other differentiating criteria but in fact lead to the same result as a directly discriminatory rule (indirect or covert discrimination) are prohibited as well. This is particularly relevant in matters of direct taxation where distinctions are rarely made based on nationality but are more often based on residence.[8] Moreover, the CJEU prohibits not only dis-

criminatory measures but also equally applicable restrictive measures[9] because they hinder intra-Community trade and make the exercise of the Treaty freedoms less attractive.[10]

The CJEU's approach towards testing a national tax measure on its compatibility with the fundamental freedoms (the freedom to provide services among them) involves a two-stage process, the second stage consisting of a further three-step analysis. First, the CJEU examines whether the fundamental freedoms are applicable to the situation at issue. Second, once it is established that the fundamental freedoms are applicable, the CJEU's analysis addresses the following three questions (consecutively):

- Are the persons being compared in a comparable situation? To establish whether this is the case, the CJEU verifies whether the characteristics that are relevant to the measure at issue are identical. If they are not, the situations are not comparable.
- Has there been a difference in treatment between the situations at issue? If there has been no difference in treatment and the situations are comparable, there is no (overt or covert) discrimination; if there has been no difference in treatment and the situations are not comparable, there is discrimination. If there has been a difference in treatment and the situations are comparable, there is discrimination; if there has been a difference in treatment and the situations are not comparable, there is no discrimination.

Is there a justification for the discrimination or differentiation?

As regards the "justification test," direct or overt discrimination can only be justified on (one of) the grounds of justification expressly mentioned in the TFEU, i.e. public policy, public security, public health and the exercise of public authority (closed justification system),[11] whereas indirect or covert discrimination or a measure that is restrictive with respect to the fundamental freedoms may be justified if the measure at issue relies on objective grounds other than nationality and is proportionate. There is no exhaustive list of possible "objective grounds" (open justification system).[12] Potential justifications for indirectly discriminatory or restrictive tax measures considered by the CJEU include:

- The coherence of the tax system;
- A loss of tax revenues;
- Prevention of double use of losses;
- The effectiveness of fiscal supervision;
- The principle of territoriality; and
- The balanced allocation of taxing powers between Member States.[13]

Inherent in the justification test is the proportionality test, i.e., justification based on objective considerations independent of the nationality of the persons concerned must be proportionate to the legitimate aim of the national provision(s) at issue. In other words, the relevant tax measure must be appropriate, suitable or likely to secure the attainment of the objective that it pursues and must not go beyond what is necessary to attain it. National legislation is appropriate for ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner and if there is no, less burdensome, alternative that is equally capable of realizing the Member State's policy choice.[14]

II. Selected Case Law

CJEU case law in the direct tax area originating under the freedom to provide services has been far less abundant than that originating under the freedom of establishment.[15]

In *Bachmann*,[16] the Belgian legislation disallowing the deduction for tax purposes of insurance premiums paid to foreign insurers not established in Belgium was also challenged as being contrary to the freedom to provide services. Mr. Bachmann argued in substance that provisions such as the Belgian rules at issue, which require an insurer to be established in Belgium as a condition for the eligibility of insured persons to benefit from certain tax deductions in Belgium, operate to deter those seeking insurance from approaching insurers established in another Member State. The CJEU acknowledged that such provisions amounted to a restriction on the freedom to provide services, but nonetheless considered—having regard to the (alleged) direct link between the deductibility of the insurance premiums and the taxation of the sums payable by insurers—that the Belgian legislation was justified by the need to ensure the coherence of the Belgian tax system. *Safir*, *Danner*, *Skandia and Ramstedt* and *Commission v. Denmark* concern very similar matters (albeit they show an increased reluctance on the part of the CJEU to accept the grounds of justification invoked by the respective Governments).[17]

In the *Eurowings*[18] case, lease payments for an aircraft made to a lessor that was an Irish limited company were the subject of a 50% add-back for German tax purposes although they would have been fully deductible had the lessor been resident in Germany and, thus, subject to German trade tax. After having recalled the obligation of Member States to exercise their tax competence consistently with EU law, the CJEU held that, since leasing is a service within the meaning of (now) Article 57 of the TFEU, (now) Article 56 of the TFEU requires not only the abolition of any discrimination on account of nationality against a person providing services but also the abolition of any restriction on the freedom to provide services imposed on the grounds that the person providing the services is established in a Member State other than that in which the services are provided. The Court went on to note the differences in the tax rules under examination and their dissuasive effect on German undertakings leasing goods from lessors established in other Member States. It considered that any legislation of a Member State that reserves a fiscal advantage for the majority of undertakings that lease goods from lessors established in that State while depriving those leasing from lessors established in another Member State of such an advantage, gives rise to an unjustifiable difference of treatment based on the place of establishment of the provider of services.

In *Gerritse*,[19] the Court held that a national provision that denies nonresidents a deduction for business expenses for tax purposes, when residents are allowed such a deduction, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on the

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grounds of nationality, which is contrary in principle to (now) Articles 56 and 57 of the TFEU.

Lindman[20] concerned Finnish rules under which winnings from lotteries held in other Member States were regarded as taxable income of the winner chargeable to income tax, while winnings from lotteries held in Finland were exempt from tax. The CJEU concluded that the rules had a manifestly discriminatory character, which was incompatible with the freedom to provide services.

Laboratoires Fournier[21] involved a French rule under which a tax credit for research was available to resident companies only if the research was carried out in France. According to the CJEU, a national measure that limits the benefit of a tax credit for research only to research carried out in the Member State concerned makes the provision of services constituted by the research activity subject to different tax treatment depending on whether the research is carried out in the Member State concerned or in other Member States; such a measure thus differentiates according to the place where the services are provided, which contravenes the freedom to provide services.

At issue in *Scorpio*[22] was whether, in general, a (German) withholding tax affecting nonresident service providers, such as artists and sportsmen/sportswomen, was in line with the fundamental freedoms, as (German) resident artists and sportsmen/sportswomen were not subject to such withholding tax but instead could file income tax returns at the end of the year and were only taxed after the filing of such returns by way of an annual income tax. The CJEU held that this difference in tax treatment was an obstacle to the freedom to provide services, but that such legislation was nevertheless justified by the need to ensure the effective collection of income tax. A related question was whether expenses directly linked to the performances of the nonresident artistes and sportsmen/sportswomen should be deducted, so that the German withholding tax would only be levied on net income after the deduction of expenses, i.e., the profit from the performances. The CJEU held, building further on *Gerritse*, that the freedom to provide services precludes national legislation that does not allow a recipient of services that is the debtor with respect to the payment to be made to a nonresident provider of services, when withholding tax at source, to deduct the business expenses that that service provider has reported to it and that are directly linked to the service provider's activity in the Member State in which the services are provided, whereas a provider of services resident in that State is taxable only on net income, that is, the income received after deduction of business expenses.[23]

In the infringement procedure case *Commission v. Belgium*,[24] the Commission criticized a Belgian tax measure designed to deal with tax fraud in the construction sector. Under the rule concerned, principals and contractors that had recourse to unregistered contractors and subcontractors had to withhold 15% of payments made to such unregistered contractors and subcontractors and pay it over to the Belgian tax authorities. The principal or contractor was jointly and severally liable for the tax debts of the unregistered contractor or subcontractor (although this liability was subject to a cap). According to the CJEU, given the disadvantage for unregistered service providers of not being able to dispose immediately of part of their income (which they could only recover at the end of an administrative procedure), those of them that were not established in Belgium were likely to be deterred from accessing the Belgian market. Moreover, in the Court's view, the joint liability for tax debts of the unregistered service provider that was imposed on the principal or contractor was liable to dissuade the latter from having recourse to the services of providers established in other Member States. Even if joint liability applies without distinction when an unregistered service provider is used, regardless of whether that service provider is established in Belgium or in another Member State, while it does not deprive service providers that were not registered and not established in Belgium of the ability to supply their services there, the disputed provision does make access to the Belgian market difficult for them. The Court thus concluded that both the withholding obligation and the joint liability constituted a restriction on the freedom to provide services for which no proportional justification was available.[25]

In *Jundt*,[26] a restriction on the freedom to provide services constituted by the fact that the national legislation concerned confined the application of an exemption from income tax to remuneration paid by universities (i.e., public-law persons) established on national territory, in return for teaching activities carried out on a secondary basis, and did not apply that exemption where the remuneration was paid by a university established in another Member State, was held not to be justified by overriding reasons relating to the public interest.

At issue in *Commission v. Belgium*[27]were Belgian tax provisions exempting interest derived from savings deposits from income tax (subject to an annually indexed cap). To benefit from the exemption, the savings accounts concerned had to be opened with a bank established in Belgium and the deposits had to satisfy certain criteria concerning currency, methods of withdrawal and deduction, structure, level and calculation of remuneration. The Court found the provisions to have the effect of discouraging Belgian residents from using the services of banks established in other Member States, as interest payments made by those banks were not eligible for the exemption, and of discouraging holders of Belgian savings accounts from transferring their accounts to banks established in other Member States, thus restricting the freedom to provide services provided for in Article 56 of the TFEU. The Court dismissed all justifications of the restriction put forward by Belgium (the need to guarantee the effectiveness of fiscal supervision and the ineffectiveness of Directive 77/799 on mutual assistance; the need to prevent double exemption and to prevent tax evasion and avoidance). The Court further held that the national provisions were precluded under the freedom to provide services contained in the European Economic Area (EEA) Agreement.

In *Commission v. Belgium*,[28] the CJEU found a (Belgian) withholding tax on interest payable on debts backed by Belgian securities when the securities are deposited or registered in an account in a financial institution established in another Member State of the EU or a State belonging to the EEA, such interest

being exempt from withholding tax when the securities are deposited or registered in an account in a financial institution in Belgium, to be incompatible with Article 56 of the TFEU.

Brisal[29] concerned a Portuguese withholding tax on interest paid to nonresident financial institutions that was imposed on the gross amount of the interest paid, whereas resident financial institutions were (only) taxed on their net income. While accepting that nonresident taxpayers may be subject to withholding taxes even if comparable residents pursuing the same activity are not, the CJEU held that the freedom to provide services[30] prohibits nonresidents being taxed on gross income when comparable residents are taxed on net profits; rather, Member States have to grant those nonresidents the same right to deduct actual expenses directly connected with the activity generating the income being taxed.[31] Referencing its previous case law in *Gerritse,*[32]*Conijn*[33] and *Centro Equestreda Leziìria Grande,*[34] the Court reiterated that resident and nonresident service providers are in a comparable situation in relation to the deduction of business expenses directly connected to the activity pursued.[35] To this end, in the Court's view, business expenses directly related to the income received in the Member State in which the activity is pursued must be understood to be expenses occasioned by the activity in question, and therefore necessary for pursuing that activity; specifically as regards the granting of loans, expenses meeting that criterion would be:

- Specific expenses such as travel and accommodation expenses, and legal or tax advice (insofar as deductions for such expenses are also granted to residents); and
- The attributable portion[36] of general expenses or overheads including the fraction of the general expenses of the financial institution that may be regarded as necessary for the granting of a particular loan.[37]

NOTES

[1] Case C-279/93, *Schumacker*. Cf. the landmark decision, outside the tax context, in Case 6/64, *Costa v. ENEL*: "[T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, without being deprived of its character as Community law and without the legal basis of the Community itself being called into question. The transfer by the States from their domestic legal system to the Community legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail."

[2] Services that the provider renders without moving from the Member State in which he/she is established for recipients established in other Member States constitute the provision of cross-border services for purposes of Article [56] TFEU (see, *inter alia*, Case C-384/93, *Alpine Investments* and Case C-243/01, *Gambelli and Others*). Thus, the Treaty rules on the freedom to provide services cannot be applied to cases that have no factor linking them with any of the situations governed by Community law and all elements of which are purely internal to a single Member State (Joined Cases C-64/96 and C-65/96, *Nordrhein-Westfalen í. Uecker and Jacquet í. Land Nordrhein-Westfalen*; Case C-134/95, *USSL N° 47 di Biella v INAIL* and Case C-332/90, *Steen v. Deutsche Bundespost*).

[3] The temporary nature of the provision of services is to be determined in light of its duration, regularity, periodicity and continuity (Case C-55/94, *Gebhard*).

[4] Case C-159/90, *Grogan*. *See also:* Case C-205/84, *Commission v. Federal Republic of Germany* and Joined Cases C-286/82 and C-26/83, *Luisi & Carbone*.

[5] *See* Case 263/86, *Humbel and Edel*; Case C-109/92, *Wirth*; and Case C-355/00, *Freskot*.

[6] *See, inter alia*, Case C-157/99, *Smits and Peerbooms* and Case C-281/06, *Jundt*.

[7] *See,* in particular, Case C-381/93, *Commission v. France* and Case C-118/96, *Safir*.

[8] *See , e.g.,* Case C-175/88, *Biehl*, in which the CJEU held that even though the criterion of permanent residence in the national territory applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against taxpayers who are nationals of other Member States; in the case of companies, *see, e.g.,* Case C-330/91, *Commerzbank*, in which the CJEU emphasized that the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination that, by the application of other differentiation criteria (*i.e.*, fiscal residence in the case at hand), lead in fact to the same result.

[9] "Restrictive" measures mean "all trading rules enacted by Member States that are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade;" hence, a national (tax) rule may be incompatible with Community law if it creates an indirect hindrance to the exercise of the free movement rights or has potential restrictive effects, even though the restriction has not yet taken place (Case 8/74, *Procureur du Roi v. Dassonville*).

[10] It should be noted, however, that many of the cases that are generally perceived as representing the application of a restrictive-based reading of the fundamental freedoms amount in fact to genuine discrimination cases. Indeed, in determining the existence of an obstacle to free movement, the CJEU has consistently focused on the existence of a difference in treatment between domestic and cross-border situations. Arguably, therefore, both approaches are complementary components of the fundamental freedoms. Accordingly, where a national tax measure applies without any distinction based on a prohibited criterion, the concept of nondiscrimination is insufficient; in such cases, the situation can be remedied by having recourse to the restriction component of the fundamental freedom at issue.

[11] *See* TFEU, Arts. 45(3) and (4), 51, 52 and (as regards the freedom to provide services) 62.

[12] Broadly, the "objective grounds" test within the open justification system requires the restrictive national measure at issue to have an acceptable ("legitimate") ground of justification (the "end" or "objective" of the national measure), and that ground must be pursued by proportionate means. This is an elaboration of the *Cassis de Dijon* (or "rule of reason") doctrine developed by the CJEU with respect to the free movement of goods. In Case 128/72, *Cassis de Dijon*, the CJEU held that any national measure liable to hinder or make less attractive the exercise of the Treaty freedoms can be justified only if it fulfills four conditions: it must be applied in a nondiscriminatory manner; it must be justified by overriding reasons based on the general interest; it must be suitable for securing the attainment of the objective that

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it pursues; and it must not go beyond what is necessary to attain that objective.

[13] On the "weight" of these various grounds of justification, *see* Faes, 7450 T.M., *Business Operations in the European Union Taxation*, at III.A.3. A relatively recent trend in CJEU case law is to put together two or more grounds of justification in most cases the need to preserve a balanced allocation of taxing powers and the prevention of tax avoidance in the combined light of which restrictive tax measures are considered to pursue legitimate objectives that are compatible with the Treaty and constitute overriding reasons in the public interest, and also considered apt to ensure the attainment of those objectives. In parallel, and perhaps logically, this expansion of the scope of (potential) justification for what in essence is held to be a restrictive measure is counterbalanced by a more stringent application of the proportionality test.

[14] *See, e.g.*, Case C-250/95, *Futura Participations*; Case C-9/02, *de Lasteyrie du Saillant*; Case C-446/03, *Marks & Spencer*; and Case C-337/08, *X Holding BV*.

[15] There are, however, a significant number of cases concerning indirect taxes. *See, e.g.*, Case C-18/93, *Corsica Ferries*, Case C-381/93, *Commission v. France*, and Joined Cases C-430/99 and C-431/99, *Sea-Land Service* (tariffs or charges imposed for port and maritime transport services); Case C-17/00, *De Coster* (Belgian local tax on satellite dishes); Case C-92/01, *Stylianakis* (Greek airport tax imposing on flights of more than 750 km a charge double that imposed on shorter flights); Case C-134/03, *Viacom Outdoor* (local tax on the posting of bills); Joined Cases C-544/03 and 545/03, *Mobistar and Belgacom Mobile* (Belgian local taxes on transmission pylons, masts and antennae for GSM and on external antennae).

[16] Case 204/90, *Bachmann*.

[17] Case C-118/96, *Safir*; Case C-136/00, *Danner*; Case C-422/01, *Skandia and Ramstedt*; Case C-150/04, *Commission v. Denmark*. *See also* Case C-334/02, *Commission v. France*, concerning a less favorable tax regime applied to investment income where the investment company was not established in France.

[18] Case C-294/97, *Eurowings*.

[19] Case C-234/01, *Gerritse*.

[20] Case C-42/02, *Lindman*.

[21] Case C-39/04, *Laboratoires Fournier*.

[22] Case C-290/04, *Scorpio*.

[23] *See also* Case C-345/04, *Centro Equestre da Leziìria Grande*. Cf. Case C-318/05, *Commission v. Germany*, which concerned German legislation that made the granting of tax relief subject to the condition that school fees be paid to private schools approved by the German State or authorized or recognized by the law of the *Land* in question, which presupposed that they were established in Germany. In the CJEU's view, the legislation generally excluded the possibility of taxpayers in Germany deducting from the taxable amount a part of the school fees for sending their children to a private school established outside German territory, save for school fees paid in another Member State to German schools recognized by the permanent conference of the Ministers of Education and Culture of the *Lander* or to European schools, whereas that possibility was available for school fees paid to certain German private schools. The Court held the legislation, for which it saw no objective justification, to be incompatible with (*inter alia*) the freedom to provide services (see also Case C-76/05, *Herbert Schwarz, Marga Gootjes-Schwarz*).

[24] Case C-433/04, *Commission v. Belgium*.

[25] Cf. Case C-678/11, *Commission v. Spain*—obligation for pension funds established in Member States other than the Kingdom of Spain and offering occupational pension schemes in that Member State and insurance companies operating in Spain under the freedom to provide services to appoint a tax representative resident in that Member State considered to be incompatible with TFEU, Art. 56; and Case C-98/14, *Berlington Hungary* (tax on slot machines operated in amusement arcades).

[26] Case C-281/06, *Jundt*.

[27] Case C-383/10, *Commission v. Belgium*. Cf. Case C-387/11, *Commission v. Belgium*, where different rules for the taxation of income from capital and movable property according to whether the income is earned by resident investment companies or nonresident investment companies with no PE in Belgium were found to fall foul of the freedom of establishment (and the free movement of capital).

[28] Case C-589/14, *Commission v. Belgium*.

[29] Case C-18/15, *Brisal KBC Finance Ireland*.

[30] Both the CJEU decision and the opinion of advocate General Kokott are based on the freedom to provide services only. Arguably, the correct freedom under which the case ought to have been considered might have been the free movement of capital.

[31] Thus, the CJEU in *Brisal* advocates application of withholding tax on net interest rather than gross interest. This seems, at least conceptually, in conflict with Article 11(2) of the OECD Model Tax Convention in which the withholding tax limitation in the source State is expressed with reference to "the gross amount of the interest." In her Opinion, Advocate General Kokott counters this perceived contradiction by stating that it cannot be inferred from the OECD Model Tax Convention that, in general, the source State should be obliged to tax gross income: "Article 11(2) of the OECD Model [Tax] Convention merely provides that the source State—in addition to the State in which the interest recipient is resident—may tax interest, albeit that this tax must not exceed a specific percentage of the gross amount of the interest. However, this merely sets a maximum amount as regards the outcome of the tax, and does not give the source State any instructions as regards taxation. On the contrary, it appears from the commentary on the OECD Model [Tax] Convention [namely, commentary on Article 11, paragraphs 7.1 and 7.7] that in precisely a case such as the present, in which interest payments are made to banks, many source States do not impose any tax." (Opinion, paras. 60 and 61).

[32] Case C-234/01, *Gerritse*.

[33] Case C-346/04, *Conijn*.

[34] Case C-345/04, *Centro Equestreda Leziìria Grande*.

[35] The CJEU explicitly rejected the Portuguese government's claim that financial services should be distinguished from other services based on a perceived impossibility of establishing any characteristic link between costs incurred and interest income received. The Court pointed out that the TFEU does not support such a distinction and that services provided by financial institutions cannot, as a matter of principle, be treated differently from the provision of services in other areas of activity. Relying on *Dijkman and Dijkman-Lavaleije* (Case C-233/09) and *X* (C-498/10), the Court reiterated that "unfavorable tax treatment contrary to a fundamental freedom cannot be regarded as compatible with EU law because of the potential existence of other advantages," specifically noting that the restriction at issue "cannot be justified by the fact that non-resident financial institutions are subject to a tax rate which is lower than the rate for resident financial institutions."

[36] The Court explicitly refused the deduction of costs calculated on a notional basis, i.e., calculating the overheads by reference to indices such as those provided by Euribor or Libor.
[37] It is significant that the scope of directly linked expenses for interest income in *Brisal* is significantly wider than that set forth by the CJEU in *Société Générale* (Case C-17/14) with respect to expenses directly linked to the receipt of dividends that may be taken into account by non-residents.

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Jonas Sigrist qualified both as an attorney-at-law and a Swiss certified tax expert. He graduated with summa cum laude from the University of Zurich, where he specialized in international taxation and social security contributions. Jonas has developed broad experience in acquisitions, mergers, spin-offs, reorganizations, relocations, and tax reliefs. His tax practice also covers international employment and employee stock and option plans. His client portfolio varies from multinationals to small and medium-sized companies in life sciences, commodities, financial services, and other sectors. He joined Pestalozzi's tax department as an associate in 2009, after he gained several years of experience in corporate taxation with a Big Four accounting firm and as a consultant in financial services. He has regular speaking engagements and frequently publishes in tax journals.

UNITED KINGDOM

Charles Goddard *
Rosetta Tax LLP, London

Charles Goddard is a partner with Rosetta Tax LLP, a U.K. law firm which specializes in providing "City" quality, cost-effective tax advice to businesses and professional services firms. Charles has wide experience of advising on a range of corporate and finance transactions. His clients range from multinational blue-chip institutions to private individuals. The transactions on which he has advised include corporate M&A deals, real estate transactions, joint ventures, financing transactions (including Islamic finance, structured finance and leasing), and insolvency and restructuring deals.

James Ross *
McDermott, Will & Emery UK LLP, London

James Ross is a partner in the law firm of McDermott Will & Emery UK LLP, based in its London office. His practice focuses on a broad range of international and domestic corporate/commercial tax issues, including corporate restructuring, transfer pricing and thin capitalization, double tax treaty issues, corporate and structured finance projects, mergers and acquisitions and management buyouts. He is a graduate of Jesus College, Oxford and the College of Law, London.

UNITED STATES

Patricia R. Lesser *
Buchanan Ingersoll & Rooney PC, Washington, D.C.

Patricia R. Lesser is associated with the Washington, D.C. office of the law firm Buchanan Ingersoll & Rooney PC. She holds a licence en droit, a maitrise en droit, a DESS in European Community Law from the University of Paris, and an MCL from the George Washington University in Washington, D.C. She is a member of the District of Columbia Bar.

Peter A. Glicklich*
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Peter Glicklich is a partner in the corporate tax group. For over 25 years, Peter has counseled North American and foreign-based multinationals on their domestic and international operations and activities. Peter advises corporations in connection with mergers and acquisitions, cross-border financings, restructurings, reorganizations, spin-offs and intercompany pricing, in diverse fields, including chemicals, consumer products, real estate, biotechnology, software, telecommunications, pharmaceuticals and finance. He has worked with venture funds, investment banks, hedge funds, commodities and securities dealers and insurance companies. Peter is a contributing editor of the *Canadian Tax Journal*, and a contributor to the *Tax Management International Journal*. He was a national reporter for the International Fiscal Association's project on Treaty Non-discrimination, and is the author of *BNA Tax Management Portfolio: Taxation of Shipping and Aircraft*. Peter is a frequent speaker and author of numerous articles. Presently, Peter is the Finance Vice-President and an Executive Committee member of IFA's USA Branch, and a member of the U.S. Activities of Foreign Taxpayers and Foreign Activities of U.S. Taxpayers Committees of the Tax Sections of the American Bar Association; the International Committee of the Tax Section of the New York State Bar Association; and Tax Management Advisory Board — International. Peter is included in *The International Who's Who of Corporate Tax Lawyers 2004*, *The Best Lawyers in America*, and *Super Lawyers*. Peter graduated with high honors from the University of Wisconsin — Madison and received his J.D. (cum laude) from the Harvard Law School. Peter joined the firm as a partner in 2003.

URUGUAY

Ana Lucía Ferreyra*
Pluspetrol, Montevideo

Ana Lucía Ferreyra, a William J. Fulbright Scholarship (2002-2003) and University of Florida graduate (LL.M. 2003), currently works as Tax Counsel for New Business at Pluspetrol. Previously, she was a partner at Teijeiro y Ballone Abogados offices in Buenos Aires, Argentina. She is a member of the International Bar Association and has been appointed as Vice-Chair of the Tax Committee for the period 2016-2017. Mrs. Ferreyra has authored several publications related to her practice in *Practical Latin American Tax Strategies, Latin American Law & Business Report, Worldwide Tax Daily, International Tax Review, Global Legal Group, Errepar*, among others. She has been speaker on tax matters at IBA, IFA Latin America, and IFA Argentina congresses and seminars. She has been a professor of International Taxation at the Master Program in Taxation, Argentine Catholic University and CIDTI, Austral University.

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