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International Taxation of Income from Cross-Border Services

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Overview

- Increasing Importance
- Technical Issues
 - Taxation of Company, Employees, or Both?
 - Personal Services or Intercompany Services?
 - PE Implications?
 - Compliance Obligations?
- Trends
 - Increased Pressure on PE Threshold?
 - Blurring of Services and Intangibles Transactions?
 - Implications for International Trade and Investment?

Increasing Importance

- Services are significant portion of economy in many countries and increasing portion of cross-border trade
- Communications and travel advances are facilitating increased performance of services at a distance from customers
 - → Increased “outsourcing” of service functions, to both unrelated customers and related parties
 - → Increased visits by service providers to customers and by related company personnel to service affiliates
 - → Increased cross-border secondments

Implications

- For businesses
 - Customer service concerns
 - Competitiveness concerns → cost minimization pressures
- For governments
 - Potential effect on tax base
 - Political concerns re implications for local employment?

Technical Issues

Taxation of Company

- PE exposure?
- Attribution of profits if PE?
- Transfer pricing issues?
- Withholding taxes?
- Employee-related compliance obligations?

Company—PE Exposure?

- Does foreign company have—
 - A “fixed place of business” PE?
 - A “dependent agent” PE?
 - A “services” PE (where treaty permits)?
- As a result of—
 - Outsourcing of functions to unrelated party?
 - Functions performed by local affiliate?
 - Short-term stewardship visits by employees to local affiliate?
 - Longer-term secondment of employees to local affiliate?

Company—Attribution of Profits?

- How are the profits attributable to the PE, if any, determined?
 - Interpret treaty provisions with reference to
 - Domestic legislation?
 - OECD Commentary?
 - Current OECD project on profit attribution?
 - Position of non-OECD Members?
- Increase in cross-border controversies

Company—Transfer Pricing Issues?

- Was service provider compensated appropriately?
- How to determine appropriate intercompany prices?
 - Domestic law?
 - OECD Transfer Pricing Guidelines?
 - Position of non-OECD Members?
- Increase in cross-border controversies

Company—Withholding Taxes?

- Gross-basis withholding taxes on service fees under domestic law?
 - Income taxes
 - Indirect taxes (e.g., Indian “service tax”)
- Withholding permitted by treaty?
 - “Fee for included services” under India-U.S. Treaty?

Company—Employee-Related Obligations?

- Is company contractually required to “equalize” the taxes of seconded employees?
- Must company withhold taxes in respect of personal income tax obligations of seconded employees?

Taxation of Employees

- Treaty provisions
- Who is the employer?
- PE implications for employer?

Employees—Treaty Provisions

- General OECD policy:
 - Exempt non-resident employees from local income taxation if on short-term visits (183 days or less)
 - Exceptions for high earners (artistes, athletes, etc.)
- General UN policy:
 - Same, with additional exceptions (e.g., for top management officials)
 - But note services PE provisions (6-month threshold)

Employees—Who is Employer?

- Some countries respect employment contracts; others apply substance-over-form analysis
 - Concern about “loan-out” arrangements
 - Growing focus on seconded employees
- Under services contract, does company provide services or may its employees be considered employees of service recipient?
 - OECD project

Trends

Trends

- Increased Pressure on PE Threshold and on Employee Taxation?
- Blurring of Services and Intangibles Transactions?
- Implications for International Trade and Investment?

Increased Pressure on PEs, Employees

- Conflicting views of employee:
 - As protected from local income taxation by treaty if short-term presence?
 - As creating a PE for the foreign affiliate (because conducting its business)?
 - As employee of the local entity (because conducting *its* business)?
- Can both foreign affiliate and employee be subjected to local income taxation? Can Articles 7 and 15 apply simultaneously?

Services vs. Intangibles

- Increased focus on taxation of “high-value” services
 - See new U.S. “services regulations” on transfer pricing under section 482
- Can intangible assets be transferred in the guise of services?

Trade and Investment Implications

- Effect on location decision of
 - Uncertainty
 - Excessive tax and compliance burdens