# The Role of Tax Treaties in Reducing Corporate Tax Complexities Arising from a Mobile Workforce

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# Those managing and involved in global mobility will be well aware that employees working in new locations may result in changes to tax compliance obligations for both the employee and the employer. Understanding and managing these changes is key in mitigating mobility related tax risks.

Avoidance of Double Taxation Agreements play a pivotal role in establishing certain criteria that can reduce the cross-border tax complexities and compliance obligations in short-term secondments and assignments. As such, a high-level understanding of how Avoidance of Double Taxation Agreements work is essential. This article focuses on managing international corporate tax risks through the use of these agreements.

## What are Avoidance of Double Taxation Agreements?

An Avoidance of Double Taxation Agreement is a bilateral agreement between two countries (hereafter referred to as "contracting countries") that provides relief to taxpayers in situations where the same income or receipt is being taxed in both countries. These agreements are also commonly referred to as "double tax agreements" or simply "tax treaties".

In addition to eliminating double taxation, tax treaties also facilitate the exchange of information between tax authorities of the contracting countries to prevent fiscal evasion and to facilitate the resolution of disputes relating to taxing rights in accordance with internationally accepted standards.

To eliminate double taxation, tax treaties provide different rules for different types of income and receipts, to allocate the taxing rights between contracting countries.

However, tax treaties do not create a tax liability if under the domestic tax law of a contracting country, a tax liability does not exist. This means that, the purpose of tax treaties is to provide relief to taxpayers and not to make their tax position more onerous than what is provided for in the domestic tax law of the contracting countries.

## How are Double Tax Treaties Used in Practice?

Most jurisdictions have their own tax rules to impose tax on income derived by foreign businesses from activities undertaken in their jurisdictions. Countries usually need to connect a foreign business to its tax system based on certain domestic rules before any taxes can be levied on the business – otherwise, every business engaging in cross-border commercial activities would be taxable anywhere at anytime.

Tax treaties sit on top of and can override the domestic tax rules. A tax resident of a country may utilise the benefits of the tax treaties concluded by that country. As aforementioned, tax treaties provide different rules for different types of income and receipts for the allocation of taxing rights between contracting countries. By applying the appropriate allocation rules, double taxation may be mitigated.

Let's say Company Z, which is a resident of Country A, derives income from Country B. In this case, the key allocation rules under the tax treaty between Country A and Country B can be broadly summarised as follows:

1. Only Country A has the right to tax the income in question. As such, the income will not be taxable in Country B.
2. Country A has the right to tax the income. However, if certain conditions are met, the income can also be taxed in Country B and Country A will provide a tax credit for the tax suffered in Country B or apply other methods to eliminate double taxation.
3. The right to tax the income is given to Country B in which the income has a source. However, Country A is not precluded from taxing that income. As such, if Country A also taxes the income, it will provide a tax credit for the tax suffered in Country B or apply other methods to eliminate double taxation.
4. Both countries have the right to tax the income. However, the rate of tax in Country B is reduced if certain conditions are met. Country A will provide a tax credit for the tax suffered in Country B or apply other methods to eliminate double taxation.

One such allocation rule that falls under point 2 above is provided under the Business Profits Article of tax treaties.

## The Business Profits Article

Let's take a hypothetical case of Company X that is a Singapore tax resident. The employees of Company X are required to travel to Country B to perform work for the benefit of Company X.

Firstly, it must be determined whether Country B, under its domestic tax law, will impose tax on any income that is considered as being derived by Company X in Country B. If so, Company X could look to the Business Profits Article of the tax treaty between Singapore and Country B for possible relief.

The application of the Business Profits Article is relevant to the extent the income of Company X that is taxable under Country B's domestic tax law falls within the Business Profits Article of the tax treaty. Otherwise, another article of the tax treaty that is relevant to that income shall apply.

Under the Business Profits Article, business profits of Company X shall only be taxed in the country of residence (that is, Singapore) unless it is attributable to a permanent establishment ("PE") in the source country (in this case, Country B). This means that if Company X does not have a PE in Country B, its business profits should be exempted from tax in Country B.

Where income tax in Country B cannot be eliminated for Company X because the conditions under the Business Profits Article are not met, then the same treaty can provide the basis for a tax credit in Singapore to eliminate double taxation.

## What is a PE?

Though PE is defined in all tax treaties under the PE Article, the exact definition may vary slightly from treaty to treaty. However, the basic definition of PE provided in the first paragraph of the PE Article is generally the same in all treaties - PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "fixed place" connotes the existence of a distinct geographical place with a certain degree of permanence[1].

The PE Article provides examples of fixed place of business (such as an office, branch and factory) and provisions for certain activities to constitute a PE even if there is no fixed place of business, for example, the presence of a dependent agent who habitually exercises the authority to conclude contracts.

A building site, a construction, assembly or installation project, or supervisory services in connection therewith will also give rise to a PE if such site, project or services last for a stipulated time (usually beyond 183 days) in the source country.

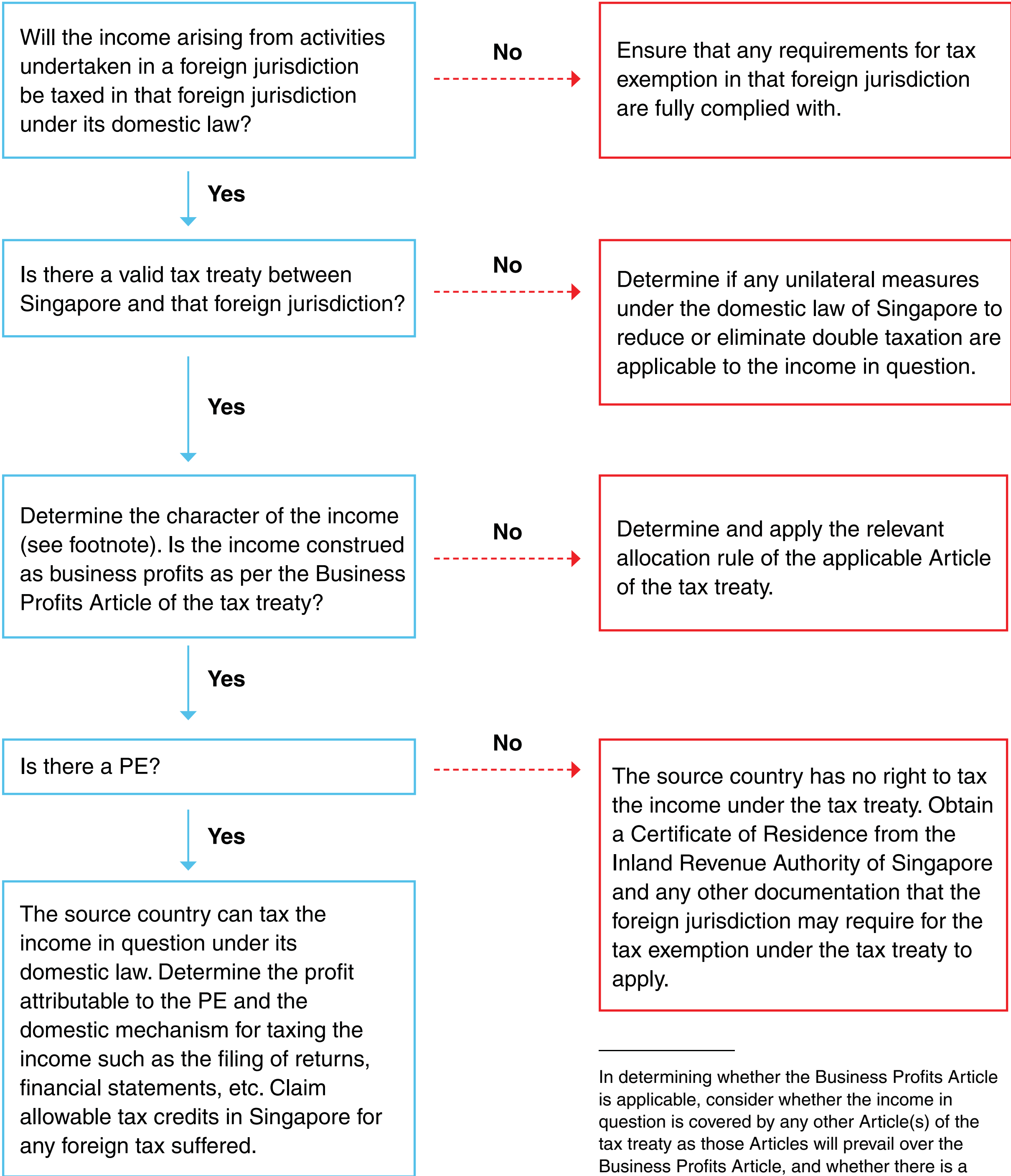
In addition, some Singapore tax treaties have deeming provisions relating to the furnishing of services. Accordingly, furnishing of services by an enterprise through its employees, or other personnel engaged by the enterprise for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned shall give rise to a PE. In some tax treaties, the time threshold could be shorter, such as 90 days.

[1]Paragraph 6 of the Commentary to Article 5 of the OECD Model Tax Convention on Income and on Capital 2017.

## Applying the Business Profits Article

The Business Profits Article demarcates PE as the allocation key, i.e., the source country cannot tax the business profits of an enterprise that does not carry on a business through a PE in that country. Hence, managing PE will allow for the mitigation of tax in the source country. The process of managing PE is complex due to differing circumstances.

Below is a general summary of the step-by-step application of the Business Profits Article by a Singapore tax resident company. In the following, it is assumed that any income tax exemptions under domestic law are not applicable to the income.




In determining whether the Business Profits Article is applicable, consider whether the income in question is covered by any other Article(s) of the tax treaty as those Articles will prevail over the Business Profits Article, and whether there is a specific definition of "business profits" in the tax treaty that might exclude the income in question.

## Conclusion

Global mobility professionals and those involved in managing cross-border employees' work require a high-level understanding of tax treaties. The rules in those treaties can simplify or reduce compliance considerations in situations where employees are working internationally for a relatively short period.

The key point when handling cross-border employees is to work with the business' stakeholders to highlight if actively managing the employees' presence in a country can reduce compliance and related costs that often the business would not have built into the overall project.

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