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# GLOBAL TAX WEEKLY

## a closer look

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**SUBJECTS** TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

**SECTORS** MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

**COUNTRIES AND REGIONS** EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU



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## GLOBAL TAX WEEKLY a closer look

### Global Tax Weekly – A Closer Look

Combining expert industry thought leadership and the unrivalled worldwide multi-lingual research capabilities of leading law and tax publisher Wolters Kluwer, CCH publishes Global Tax Weekly — A Closer Look (GTW) as an indispensable up-to-the minute guide to today's shifting tax landscape for all tax practitioners and international finance executives.

Unique contributions from the Big4 and other leading firms provide unparalleled insight into the issues that matter, from today's thought leaders.

Topicality, thoroughness and relevance are our watchwords: CCH's network of expert local researchers covers 130 countries and provides input to a US/UK

team of editors outputting 100 tax news stories a week. GTW highlights 20 of these stories each week under a series of useful headings, including industry sectors (e.g. manufacturing), subjects (e.g. transfer pricing) and regions (e.g. asia-pacific).

Alongside the news analyses are a wealth of feature articles each week covering key current topics in depth, written by a team of senior international tax and legal experts and supplemented by commentative topical news analyses. Supporting features include a round-up of tax treaty developments, a report on important new judgments, a calendar of upcoming tax conferences, and "The Jester's Column," a lighthearted but merciless commentary on the week's tax events.

**CONTENTS****FEATURED ARTICLES****Recent Transfer Pricing Developments**

Duff &amp; Phelps

5

**US Tax Reform Legislation –  
Highlights From The First Drafts**

Stuart Gray, Senior Editor, Global Tax Weekly

12

**Tax Changes For Corporate Taxpayers  
Announced In Luxembourg's Budget Bill 2018**Dr. Paloma Schwarz, Avocat au Barreau  
de Luxembourg

25

**Topical News Briefing: A Good Gig  
For The Tax Man**

The Global Tax Weekly Editorial Team

29

**The Fiscal Trip Wires Of Corporate  
Global Mobility**Georg Weishaupt and Alexander Hutter,  
MTG, Germany

31

**Issues Posed By The Cloud Economy And  
E-Commerce In Colombia**

Adrian Rodriguez, Lewin &amp; Wills, Colombia

40

**Topical News Briefing: Senate Tax Reform  
Proposals – No Rubber Stamp**

The Global Tax Weekly Editorial Team

44

**NEWS ROUND-UP****Brexit**

46

Irish Government Optimistic On Brexit Talks

Barnier Gives UK Ultimatum Over Brexit Progress

**International Trade**

53

WTO Says Trade Protectionism Abating

Hong Kong, ASEAN Nations Sign Free Trade Deal

Australia Says TPP-11 Deal 90 Percent Complete

**US Tax Reform**

49

Tax Bill Would Increase Taxes For A Quarter Of  
Americans: Study

IRS Agrees Initiatives To Tackle Big Business Tax Issues

**International Tax Compliance**

56

Apple Fires Back At Tax Avoidance Accusations

Dassault Responds To Paradise Paper Leaks

Offshore Centers Chide Paradise Papers' Coverage

Oxfam Calls For UK Action To 'End Tax Scandals'

## **Environmental Taxes**

EU Approves Linking With Swiss Emissions Trading Scheme

Japan Tourism Agency Proposes New Departure Tax

## **Country Focus: China**

China To Drop Trade Barriers To Foreign Car Makers

Taiwan Announces Perks For Skilled Foreign Expats

China Cuts Corporate Tax For Tech Firms

**60**

## **VAT, GST, Sales Tax**

Saudi Arabia Clarifies VAT Rates, Including On Financial Services

Irish Revenue Clarifies VAT Rules On Money Transfer Services

India Slashes List Of Items Subject To 28 Percent GST

Isle of Man Tackles VAT Avoidance Allegations

**64**

**62**

**TAX TREATY ROUND-UP**

**68**

**CONFERENCE CALENDAR**

**70**

**IN THE COURTS**

**80**

**THE JESTER'S COLUMN**

**91**

The unacceptable face of tax journalism

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## The Fiscal Trip Wires Of Corporate Global Mobility

by Georg Weishaupt and Alexander Hutter, MTG, Germany

*A synopsis of the potential traps and pitfalls for small and mid-sized globally mobile enterprises from a German point of view.*



### 1. Introduction

In an ever faster globalizing world with supply and demand markets for a great variety of a company's everyday operational aspects on the other side of the world, emerging companies especially face a number of challenges. Among these are the competition for and the retention of human resources.

In terms of competition, it is worth pointing out that talented staff are no longer found exclusively in the traditional ways within the more or less immediate surroundings of a business. Applicants from a different time-zone can apply just as easily as somebody who lives two blocks down the road.

The second aspect, that of staff retention, contains two different elements. First, nowadays applicants have different expectations about the way they work. A home office or a completely digital office accessible from anywhere in the world, at any time, is increasingly more normal than in other generations before. Secondly, some employees have a strong desire to work abroad – whether for long or short periods, and with or without family. Companies will need to adjust to these expectations in order to attract and retain employees.

On top of these developments, emerging companies will have to heavily branch into international business and send employees abroad for a variety of short- and long-term projects at some point in order to keep following their growth path. And as good as a lot of these emerging companies are in their particular field of business, very often the principles of international taxation are not one of their strong suits.

It is at this point that a professional has to make sure that the pursuit of a business growth path, combined with the desire to internationally attract, utilize and keep employees, aligns and is in compliance with the international tax requirements and laws.

The following article aims at highlighting the hazards and risks in this area from a German tax point of view, as well as elaborating strategies to mitigate unwanted tax risks.

## **2. Business And Tax Risk Environment**

The article will examine the following business scenario:

*An A-GmbH (Gesellschaft mit beschränkter Haftung) is a German corporation with limited liability. It is very successful in the programming of hardware devices for automotive suppliers and manufacturers. It fully owns a number of subsidiaries in both EU and non-EU countries, as follows.*

*Group A: There are a few employees who have been assigned to Germany for two–three years from foreign A-GmbH subsidiaries.*

*Group B: There are also some employees who have a work contract with a foreign subsidiary, but have been working in Germany on a big project for a significant period.*

*Group C: There are a number of people who are hired through foreign A-GmbH subsidiaries, but their job is to internationally acquire projects, also in Germany. They travel a lot for their international business activities – including to Germany.*

*Group D: There is one person that does not work in Germany. However, he has a German work contract which states that his work is to be carried out exclusively abroad, in country X. In a few months his German work contract is planned to be changed over to a work contract with the subsidiary in country X.*

*The A-GmbH would like to know what fiscal pitfalls might exist regarding the above-mentioned employee situations, and how they could be managed.*

Given the above-mentioned business environment, the following questions typically arise:

1. When does an employee become subject to German taxation rules?
2. Is there a double taxation agreement ("DTA"), which provisions apply and what do they stipulate?
3. Under which circumstances would the German company be forced to withhold (wage) tax based on a foreign employee's work?
4. How can potential tax risks regarding international mobility be managed best from a German point of view?

### **3. German Taxation Principles**

#### ***3.1 General***

German tax law contains stipulations for the unlimited taxation of a German tax resident's world income according to §§ 8, 9 AO, § 1 I EStG and the limited taxation of a non-German tax resident's Germany-sourced income according to §§ 1 IV, 49 EStG. The crucial determining factor between the two tax treatments is the establishment of a domicile or tax residence in Germany according to §§ 8, 9 AO.

According to § 8 AO, domicile is where a person maintains an abode under circumstances which lead to the conclusion that this residence will be kept and used. The person has to be in a position where he can exercise legal powers over the residence regarding its immediate accessibility and availability as an abode. Even though the law does not require a minimum amount of time spent there, a certain amount of regular time spent there is necessary. Finally, the residence has to regularly be used as an abode. Hence, infrequent stays for holiday or relaxation purposes do not render such residence to be seen as an abode.

§ 9 AO stipulates that a person's tax residence is where circumstances indicate that he will not be in this particular area on a temporary basis. Tax residence will be established from the onset regardless after six continuous months of residence. Residence will also be established regardless of whether a person holds an abode or whether his stay in that abode is voluntary.

For understandable reasons the question of the establishment of a tax domicile or residence has been subject to a large variety of court cases and there is often no simple answer, with a thorough understanding of the person's overall life environment required.

The consequences of establishing a German tax domicile or residence is that Germany can tax the taxpayer's worldwide income, in accordance with German national and supranational legislation.

Where the person in question does not have a tax domicile or residence according to §§ 8, 9 AO, he is subject to German (limited) taxation only on his German domestic income.

According to § 49 I Nr.4 lit.a EStG, employment income (§ 19 EStG) is subject to limited taxation provided that the work is exercised or utilized solely in Germany.

Below we explore circumstances in which work could be deemed to be utilized or exercised in Germany, thereby risking establishing a greater tax liability there.

### ***3.2 Domestic exercise***

The work is exercised in Germany if the employees, who have work contracts with foreign subsidiaries, are physically located in Germany and are personally active in their employment there. A temporary or short-term activity will suffice. Depending on the nature of such employment, an interruption of this activity or a break from it might not be enough to keep from establishing what Germany might consider a "domestic exercise."<sup>1</sup> Whether the wage is paid through a German employer is of no significance under these circumstances.<sup>2</sup>

It is however essential that the work will be carried out under circumstances, that at least imply an assignment-based employer-employee relationship.<sup>3</sup> Requirements in this regard are that:

1. The employee performs his duties for a limited period of time;
2. The receiving company has entered into a labor agreement with the employee or is considered the economic employer.

A company will be considered an economic employer once an employee has been integrated in the employer's daily processes and operations, has been subjected to applicable directions and stipulations, and his remuneration is borne by the receiving company. Any activity exceeding a period of three months will automatically – but not irrefutably – constitute "integration."

### ***3.3 Domestic exploitation***

The concept of exploitation describes usage at a place that could be different from that of exercise.<sup>4</sup>

The circumstances have to be such that the employee exploits the result of his work when and where he makes it accessible to his employer.<sup>5</sup> It is irrelevant how the employer uses the results.<sup>6</sup>

The criterion of exploitation also requires an employer-employee relationship as described in section 3.2.

### ***3.4 Summary***

German unlimited taxation is based on a German domicile (per § 8 AO) or a tax residence (per § 9 AO).

German limited taxation requires a foreign employee to be working or exploiting his work in Germany.

Both require at least a deemed employer-employee relationship. The constitution or avoidance of such has to be the subject of professional and in-depth fiscal analysis and consulting.

## **4. German Taxation Rights According To Double Taxation Agreements**

### ***4.1 General***

Double taxation agreements ("DTAs") are used to bilaterally assign the tax claims of two countries – they will never constitute one.<sup>7</sup>

Hence, a country has to have a taxation right first – typically founded in the country's national legislation – before this right can be differently assigned according to the applicable stipulations of a DTA.

For Germany, these national claims may be unlimited or limited ones. German unlimited taxation is based on the foreign employee's domicile (per § 8 AO) or tax residency (per §9AO) in Germany.

German limited taxation depends on a German domestic employment according to § 49 I Nr.4 lit. a EStG.

Only German unlimited or limited taxation rights can be subject to the special assignment provisions of a DTA.

### ***4.2 Default mechanism under DTA for income from employment***

Under the OECD Model Tax Convention ("MTC"), all income from employment is assigned to the country where the work is being carried out, per Art. 15 I MTC.

The definition of "employment" and "carrying out" might – depending on the country – be defined under the respective DTA itself, or it may need to be interpreted by the regulations laid out under the national legislation for comparable situations.

However, there is an exemption to the above-mentioned default case, if:

1. An employee is present in the other state for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the fiscal year concerned; and
2. The remuneration is paid by, or on behalf of, an employer who is not a resident of the other state; and
3. The remuneration is not borne by a permanent establishment which the employer has in the other state,

the taxation right will remain with the country of which the employer is considered tax-resident. These stipulations aim at facilitating sending employees abroad for short-term projects and assignments.

Given Germany's central location in Europe, it is not unusual for people in border-areas to be tax-resident in one country and work in another. For this reason, Germany has entered into DTAs with Switzerland, Austria and France that contain special provisions regarding cross-border work commutes.

Generally speaking, if:

1. The employee tax-resides within a defined border region; and
2. Exercises his employed work inside a defined border-region of the other state; and
3. Returns daily/regularly to his country of tax-residency,

the taxation right will be assigned to the country of which the employee is a tax resident.

However, the border region is defined differently in all DTAs. The DTA with France covers all German tax residents inside an area of 20 kilometers (Art. 13 V b). For France, it covers all French tax residents living in the "border departments," working within 30 kilometers on the German side (Art.13 V c).

The DTA with Austria covers an area of 30 kilometers on both sides of the border. The DTA with Switzerland has no border region at all.

To avoid undue hardships regarding the regular/daily return, all DTAs have a maximum amount of days for which the employee does not have to return from the state in which they work. For Austria and France, this number is 45 days; and for Switzerland it is 60 days.

## **5. Case Analysis**

Given the above explanations, the following provisions will provide a short analysis of the case groups A–D as laid out under section 2 above.

### ***Group A: Assignments to Germany for a few years from foreign subsidiaries***

It can be assumed that the employees will – regardless of the existence of a DTA – be considered tax-residents of Germany according to §§ 8, 9 AO. Nothing else should result from a default DTA.

They will be subject to German unlimited taxation of their world income according to §1 I EStG, including their income from employment.

In the absence of a DTA, Germany will tax the employment income. No special provisions regarding the assignment of the German taxation right apply.

In case of a DTA, Germany will tax the employment income. However, it is possible to optimize the assignment regarding the 183-day rule in terms of wage payment and payroll-split models.

### ***Group B: Work contract with a foreign subsidiary, spending considerable project time in Germany***

Depending on their living situation in Germany and the state with which they have their work contracts, the employees could be considered tax residents of Germany according to §§ 8, 9 AO – even a DTA might still result in them qualifying as tax-residents of Germany.

Depending on their tax residency, further analysis needs to be done into the nature of their work and where, when and how it is performed in order to determine whether Germany has unlimited or limited taxation rights.

Depending on (un)limited taxation rights, the fiscal consequences will vary in case of the existence or lack of a DTA.

Also, given the ongoing project work in Germany, analysis needs to be done on whether a permanent establishment – under both German national and DTA legislation – could be constituted.

***Group C: Work contracts with foreign subsidiaries, but international job travel – including in Germany***

The analysis essentially corresponds with Group B. However, one would expect for Group C to be less likely to become tax residents of Germany and potentially constitute a permanent establishment – under both national and DTA legislation.

***Group D: Person does not physically perform work in Germany***

In this instance, the German work contract stipulates that all work be carried out exclusively abroad. The German work contract will be changed over to a work contract with a foreign subsidiary.

One would need first need to determine whether there is a tax residency in Germany. If so, the income from employment is subject to unlimited German taxation. If not, one would need to look into if and to what extent the work carried out abroad might be used or exploited in Germany.

If Germany substantiates any taxation rights, one would need to see if a DTA applies and which country assumes taxation rights based on which stipulations.

## **6. Mitigation Strategies**

All of the examples given above predominantly revolve around whether one is a tax resident of Germany or not. It is hence imperative to point out to management and employees the consequences related to this, and under which circumstances it can be avoided – or constituted if so desired.

However, it is essential to look into the individual's living situation in both Germany and abroad since this will determine whether he is tax resident or not for German purposes and later on for potential DTA evaluation.

For purposes of clarity, underlying contracts and supplementary corporate documentation have to outline:

- The duties/services carried out;
- The location of every duty carried out;
- The content, use and exploitation of the particular duty;
- Reporting procedures;
- The bearing of any remuneration;
- The inclusion of any intangible asset;
- The usage of any "fixed" place where the duties are carried out.

This is important to help support any arguments and optimization strategies regarding German taxation rights.

Is also contributes to meeting compliance requirements regarding circumstances (partially) outside of the area of the German law, § 90 II AO.

Finally, any documentation in the area of international mobility can be made part of, and its contractual basis can be further used for, transfer pricing documentation.

## **7. Summary**

International mobility in numerous ways touches on a wide spectrum of business operations. It is important to create an awareness of the key triggers of German taxation rights – tax residence and habitual abode, and the use and exploitation of the individual's work.

Engagement with countries with which no DTA exists can lead to immediate tax consequences. DTAs offer possibilities to steer taxation rights in a particular direction.

Comprehensive documentation in this area is imperative to avoid any unwanted fiscal consequences for both businesses and employees in the areas of compliance, income taxation, and transfer pricing.

It is the responsibility of a tax consultant to actively ask his clients about international mobility since awareness of the subject on the client side often is low.

## **ENDNOTES**

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<sup>1</sup> Vgl. Blümich/Reimer/Wied, 136. Aufl. 2017, EStG § 49 Rn. 156, m.w.N.

<sup>2</sup> Vgl. Schmidt/Loschelder, 36. Aufl. 2017, EStG § 49 Rn. 87, m.w.N.

<sup>3</sup> Vgl. Blümich/Reimer/Wied, 136. Aufl. 2017, EStG § 49 Rn. 156, m.w.N.

<sup>4</sup> Vgl. Blümich/Wied/Reimer, 136. Aufl. 2017, EStG § 49 Rn. 158-159, m.w.N.

<sup>5</sup> Vgl. Schmidt/Loschelder, 36. Aufl. 2017, EStG § 49 Rn. 87, m.w.N.

<sup>6</sup> Vgl. Blümich/Wied/Reimer, 136. Aufl. 2017, EStG § 49 Rn. 158-159, m.w.N.

<sup>7</sup> Vgl. Brähler (2014), Internationales Steuerrecht, 8. A., S. 21.