Article 15 of the double tax treaties: will the “headquarter approach” be increasingly applied?

Recent Belgian court judgments and the 2015 bilateral agreement between Belgium and Luxembourg on the application of Article 15 have led to developments that require monitoring to see if they will be followed by other states.

The basic principle of Article 15 OECD Model Convention

Belgian tax residents are taxable in Belgium on their worldwide income, i.e. on both Belgian source income and non-Belgian source income. Tax treaties may exempt certain foreign income in Belgium.

Regarding cross border employment income, Article 15 of the tax treaties allocates the taxing authority to either the work state or the residence state, depending upon the fulfillment of a number of conditions. If the work state is competent to levy taxes on (part of) a Belgian tax resident’s income, then Belgium will normally exempt that part of the income (so-called “exemption with progression”).

In principle, the work state is (subject to the fulfillment of certain conditions) only entitled to tax that part of the income that is related to the individual’s “physical presence” on its territory. So, if a Belgian tax resident would also render services in a third country (other than the usual work state), the income related to those activities is, in principle, taxable in Belgium (unless a tax treaty would provide otherwise).

An example: If a Belgian resident is employed by a Dutch employer, and works partly in the Netherlands, partly in Belgium, and only occasionally in a third country, the application of the double tax treaties will lead to taxation in the Netherlands for the days spent in the Netherlands, and (in principle) to taxation in Belgium for the days spent in Belgium and the third country days.

Case law

In 2014, the Court of First Instance of Leuven delivered a judgment that was criticized as it did not apply the physical presence-rule laid down in Article 15. The case related to a Belgian resident, an employee of a German company, rendering services primarily in Germany and occasionally in third states, but not in Belgium.

Relating to the taxing authority, the Court ruled that the services rendered outside Germany were in this case intrinsically connected to the work in Germany, meaning that the physical presence condition was not required to allocate full taxing authority to Germany. In that way the
“headquarters” approach, which previously had already been applied to truck drivers (but recently no longer applied by the Belgian Supreme Court), was applied by the Court.

On 9 October 2015, the same issue was treated by the Court of Appeal of Liège, this time in a Belgian-Dutch case. The Court held that the physical presence in the Netherlands had to be demonstrated for the salary received from a Dutch employer to be taxable in the Netherlands. Therefore, salary relating to days spent in third countries could not be taxable in the Netherlands, but was taxable in Belgium.

The tax payer argued that the days spent outside the Netherlands were closely related to the Dutch days and his Dutch employment since he received his instructions in the Netherlands and his travel always started or ended there. However, the Court stated that the physical presence-test had to be applied.

The bilateral agreement between Belgium and Luxembourg

The question can be raised how this case law should be evaluated in view of the Belgian-Luxembourg bilateral agreement on cross border employment. In 2015, the two governments agreed on a common application of a so-called “24 days rule” whereby the taxing authority of Belgium/Luxembourg under Article 15 in cross-border employment situations will not be affected if the employment outside the state where the employment is usually exercised does not exceed 24 days on an annual basis.

An example: if a Belgian resident, working for a Luxembourg employer and usually working in Luxembourg, spends a limited number of days outside Luxembourg, then the work days spent outside Luxembourg remain taxable there.

The reasoning behind this agreement is the same as the reasoning made by the Court of First Instance of Leuven: if the days spent outside the work state are so closely related to the work performed in the work state, then they should be taxable in that same state.

However, there is a very important difference that must not be ignored: Belgium and Luxembourg have jointly agreed to apply this “de minimis rule” (24 days) that will be inserted into the tax treaty when it is next revised.

It seems to us that, to the extent that states have not entered into a bilateral agreement on this principle, the courts can in principle not unilaterally decide to apply it.

We expect that in the future more changes to Article 15 may occur. We referred to the Belgian-Luxembourg bilateral agreement above, but Luxembourg already has the same type of agreement (however with a 20 day “de minimis rule”) with Germany.

Maybe more states are set to follow….

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