Income from Inactivity under Article 15 of the OECD Model Tax Convention – Part 2

In Part 2 of this article, the author continues the examination of the topic of the taxation of income from inactivity under Art. 15 of the OECD Model Tax Convention by considering stand-by fees, severance payments and sign-on fees. Compensation for the cancellation of an employment, sickness benefits and disability allowances and income derived from non-competition agreements were dealt with in Part 1, which was published in the October 2009 issue of the Bulletin for International Taxation.

5. Stand-By Fees

5.1. In general

A stand-by fee is a payment for being on call and being prepared to perform services that may or may not be used, depending on future events. Examples of stand-by fees include payments to emergency workers such as firefighters, who may be called on to perform services in the territories covered under their contract, which could be anywhere in the world. Actors residing in State R who have signed an exclusive contract with a film studio established in State W (see also the German case law referred to in 5.2.), employees who are temporarily redundant, but who have to be on call to perform projects outside their residence state (for example, in the IT sector), and airline pilots on call to take over a flight.

In the author’s opinion, it is necessary to determine whether or not the employee, whilst on call, exercises an employment within the meaning of Art. 15 of the OECD Model Tax Convention (the “OECD Model”) and whether or not the compensation can be allocated accordingly.

5.2. Case law and tax authorities

German case law

From a German civil law perspective, being on call is regarded as an offer of employment services and, therefore, as an activity. This activity is deemed to be performed at the place where the individual is physically present and where he offers his employment services. The German Federal Tax Court ruled that, with regard to an individual who had to be available even though he was never called on to exercise an activity, the work was deemed to have been performed at the place where he was actually present during the time he was committed to being available.

The Netherlands case law

The Netherlands Supreme Court, in one of its decisions, follows the reasoning of the German Federal Tax Court. The Court held that stand-by services provided by a Mexican resident TV presenter had to be regarded as the exercise of an employment within the meaning of Art. 15(1) of the Mexico-Netherlands tax treaty. This employment was exercised at the place where the TV presenter was physically present on stand-by (in the case in question the residence state, i.e. Mexico). The part of the remuneration involving the stand-by services did not fall within the second rule, but, rather, the first rule of

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68. Id.
69. See, for example, the decision of the Tax Court of Canada, 22 December 2005, Sattlerei v. Canada, International Tax Law Reports, 2006, pp. 563-594.
70. German labour law distinguishes between readiness for work (Arbeitsbereitschaft), on-call service (Bereitschaftsdienst) and stand-by (Ruhezeitdienst). These three concepts are not defined in national legislation, but are derived from case law. Readiness for work covers a situation in which the worker must make himself available to his employer at the place of employment and is also obliged to remain continuously attentive to be able to intervene immediately should the need arise. Whilst an employee is on call, he is obliged to be present at a place determined by the employer; on or outside the latter’s premises, and to keep himself available to answer his employer’s call. But he is authorized to rest or to occupy himself as he sees fit as long as his services are not required. When an employee is on stand-by service he is not obliged to remain waiting in a place designated by the employer, but it is sufficient for him to be accessible at any time so that he may be called on at short notice to perform his professional tasks. Under German law only readiness for work, as a general rule, is deemed to constitute full-time work. Conversely, both on-call service and stand-by are categorized as rest time, except when the employee does in fact perform his professional tasks (compare the decision of the Federal Labour Court (Bundesarbeitsgericht) of 20 October 2000, B 9.2001, p. 735 and the German Federal Tax Court of 27 August 2002, BStBl II 2002, p. 883, which regarded stand-by time as working time). See also the decision of the FCI 9 September 2003, Case C-71-02, Landesverwaltungsgericht Kiel v. Norbert Jäger, regarding the German on-call duty, which is discussed in this section.
74. In this connection, reference can be made to the decision of the Netherlands Supreme Court, 9 February 2007, RN 2007/113 involving the base salary of a professional soccer player that also encompassed stand-by services (being reserve for a football match).
Art. 15 of the tax treaty in question, which was patterned on the OECD Model. This resulted in the residence state having the exclusive authority to tax that part of the remuneration.

US regulations

According to US Treasury regulations, being on call is regarded as the performance of services.

European Court of Justice (ECJ), Case C-151/02, Jaeger (9 September 2003)

Although it did not involve a tax treaty, it is interesting to consider Jaeger, in which the ECJ held that on-call duty by a doctor on terms that required him to be physically present in the hospital was to be regarded in its totality as constituting working time for the purposes of EC Directive 93/104, even though the person concerned was permitted to rest at his place of work during the periods when his services were not required. This Directive consequently precludes Member State legislation that classifies an employee’s periods of inactivity in the context of such on-call duty as rest periods.

5.3. Evaluation

The author is of the opinion that an employee being on call, in return for which he receives compensation, exercises employment, in the context of which it is irrelevant whether or not the employee actually has to perform activities. From a tax law perspective, it would appear to be important whether or not the employee is remunerated for being on call (the remuneration may depend on whether the employee is on call, stand-by or ready to work) and whether or not being on call includes the performance of an activity. Generally, this is the case and the employment is exercised where the employee is present while on call. As a result the fee can be allocated directly.

The author also believes that, in general, it is irrelevant whether or not the employee is obliged to be present at his place of work. The act of being ready to perform should be viewed as providing services. This appears to be supported by the decision of the ECJ in Jaeger, although it cannot automatically be extended to on-call duties performed other than at the employer’s premises. The ultimate characterization may depend on a combination of domestic tax and labour law elements, at least if tax law relies on the labour law classification in this respect. Although it is not anticipated that this issue will pose problems, it may be advisable to include a phrase in the Commentary to clarify the classification.

6. Severance Payments

6.1. Relevance of the labour law characterization

The nature of a severance payment may depend in part on the characteristics attributed to the payment by the relevant labour law system. It is, however, the tax law characterization that is primarily relevant in this frame-work (see also Art. 3(2) of the OECD Model, which states that the classification under tax law supersedes classification under other laws, such as labour law).

In its decision of 19 December 1997, A.F.T. (1998), No. 5, p. 182, the Brussels Court of Appeal rejected the taxpayer’s reference to the labour law characterization. In the taxpayer’s view, the severance payment received on termination of that employment could not be taxed in Belgium, as, from a Belgian labour law perspective, it did not constitute remuneration for past employment or compensation for the loss of future income. The Court of Appeal, however, ruled that the severance payment represented compensation for services performed in the past (see 6.2.3.). The author believes that the Court of Appeal was correct in applying a tax law classification to the severance payment in question and not regarding the labour law characterization as decisive. As far as the author can judge, this is one of the few decisions in which the labour law characterization of a severance payment was an issue in a tax treaty case.

The labour law characterization can only be relevant if the domestic tax legislation of the state applying the tax treaty does not classify a severance payment. Most jurisdictions regard severance payments as income from employment.

75. Treas. Reg. Sec. 1.861-4 gives the following example in this respect: "B, a nonresident alien individual, was employed by Corp A, a domestic corporation, from March 1 to December 25 of the taxable year, a total of 300 days, for which B received compensation in the amount of $80,000. Under its employment contract with Corp A, B was subject to call at all times by Corp A and was in a payment status on a 7-day week basis. Pursuant to that contract, B performed services (or was available to perform services) within the United States for 180 days and performed services (or was available to perform services) without the United States for 120 days. None of its $80,000 compensation was for fringe benefits as defined in paragraph (b)(2)(ix)(D) of this section. B determined the amount of compensation that is attributable to his labor or personal services performed within the United States on a time basis under paragraph (b)(2)(ix)(A) and (E) of this section. B did not assert, pursuant to paragraph (b)(2)(ix)(C)(i)(D) of this section, that, under the particular facts and circumstances, an alternative basis more properly determines the source of that compensation than the time basis. Accordingly, B must include in income from sources within the United States $48,000 ($80,000 x .60) of his compensation from Corporation A." Under this contract, the individual was on call at all times, was paid on a seven day week basis and received his pay regardless of the number of days he actually performed services. Compare also Goldberg, Part 1, note 1, regarding a comparable example that was included in a previous proposed version of the regulations.

76. Goldberg, Part 1, note 1, also commented that if the contract could require the individual to perform services anywhere in the world and no such services were performed, it would not be irrational to tax the individual on the basis of where he was on each day of this contract, given that the contracted services were not only for actual performance, but also for the act of being ready to perform.

77. This contains minimum health and safety requirements concerning the organization of working time.

78. See also joined Cases C-397/01 to C-330/01, Pfeif et al. (5 October 2004) – social workers manning ambulances within the framework of a service for medical emergency assistance founded by the German Red Cross.


80. Reimer, Part 1, note 2, p. 128, adopts the approach that a stand-by fee should be allocated to the previously provided services. Apparently, this author takes a kind of "accrual approach."

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Under Netherlands law, there are several grounds on which an employee may be entitled to a severance payment:

- one of the parties requests the dissolution of the employment contract (Art. 7:685 of the Netherlands Civil Code): the judge may decide to grant a payment or remuneration, but is not obliged to do so;
- the employer voluntarily grants a payment to the employee, or the employee's entitlement to such a payment is based on a social plan or a collective labour agreement;
- the parties mutually agreed to a payment when they signed the employment contract ("golden handshake" or "leaving bonus").

It is, of course, difficult to establish the level of damage or loss caused by a dismissal. This is even more so if it is relatively easy for the employee to find a new and comparable job. Judges generally use a fixed formula to determine the amount of the payment when they are called on to rule on the dissolution of an employment contract. The purpose of this payment is to compensate the employee for the potentially lower salary that he may earn elsewhere. In other words, the severance payment constitutes compensation for the loss of income that the taxpayer would have otherwise received if he had been able to continue performing his employment activities (see the decision of the Netherlands Supreme Court of 4 May 1988, BNB 1988/235). The severance payment must then be regarded as compensation for loss of future income, although it may constitute income from former employment for tax law and social security contribution purposes.

In other jurisdictions, establishing the amount of severance payments is a less complex process, as such payments are deemed to consist of compensation only for the loss of salary resulting from the failure to honour the notice period.

6.2. Interaction between the various elements

6.2.1. Opening comments

A severance payment, as such, does not lead to the exercise of an employment, given the payment's character as compensation. In this respect, it is also important to establish the reason why it is being paid. The cause for the severance payment may be decisive in determining its allocation (compensation for the loss of future or past employment or compensation for social hardship as result of the dismissal) and, because of the interrelation between various elements, there are three conceivable approaches in this context with respect to the place of exercise:

1. allocation to the future employment, in the context of which the place of exercise is determined fictitiously;
2. the residence state of the recipient of the severance payment is entitled to tax that payment; and
3. allocation to the employment that has been exercised in the work state in the past, in the context of which the place of exercise coincides with some or all of these past services.

6.2.2. Replacement approach in combination with a fictitious determination of the place of exercise

This approach allocates the severance payment, or, at least, the element compensating the loss of income, to the place where the employment would have been exercised in the future if it had not been prematurely terminated. The place where the employment would have been exercised must be deduced from the facts of the case and/or the employment contract. If it is impossible to determine the place where the employment would have been exercised if the employment had not been prematurely terminated, the entire severance payment will be taxable in the employee's residence state and no further allocation occurs (in fact, the first rule of Art. 15 of the OECD Model applies).

This view was discussed by Netherlands Advocate-General Wattel in his Advisory Opinion of 12 March 2003 (included in BNB 2004/344) and is based, inter alia, on the decision of the Netherlands Supreme Court of 10 August 2001, BNB 2001/353, regarding compensation granted for the cancellation of a promised employment, and on the fact that, at least in the Netherlands, severance payments generally contain an element compensating the loss of future income. In BNB 2001/353, the Supreme Court appeared to have rejected the allocation of a severance payment to the place where the employment, according to the facts of the case and/or the contracting parties' expectations, would have been exercised in the future if it had continued. The Court believed that the...
payment was to be allocated to the country where the terminated employment had actually been exercised. According to the Court, a severance payment had to be distinguished from compensation for the cancellation of an employment because the latter does not involve any actual employment being exercised. The allocation should then be to the place where the employment would actually have been exercised if the employment had not been cancelled (see Part I. 2.2.). This was confirmed by the Supreme Court in its decisions of 11 June 2004, BNB 2004/344 and 345, in which the Court held that a severance payment was generally related to the exercise of the former employment. The Court did not make any reference to the part of the severance payment designated as compensation for the loss of future income and was of the opinion that the severance payment should generally be allocated to the services performed in the past.

6.2.3. The residence state of the recipient is exclusively entitled to tax the severance payment

The German Federal Tax Court followed this approach in its decision of 10 July 1996, BStBl II, 1997, p. 341. The severance payment was regarded as "salaries, wages, and other similar remuneration" (see Part I. 1.1.) within the meaning of Art. 15 of the 1970 Germany-Liberia tax treaty. The German Federal Tax Court held, however, that the settlement did not constitute additional remuneration for past services and was not paid in consideration of a specific activity performed within or outside Germany, but was instead compensation for the loss of a job. Accordingly, the severance payment could not be attributed to services performed in the work state. As the taxpayer was a German resident when the remuneration was paid, Germany, as the residence state, was entitled to tax the entire amount.

In its ruling of 10 February 1999, BNB 1999/153, the Netherlands Supreme Court reached a result similar to that in BStBl II, 1997, p. 341, although the grounds on which the Netherlands Supreme Court based its decision and its reasoning differed from those of the German Federal Tax Court. The Supreme Court held that the connection between the severance payment and the employment exercised abroad was too remote (the recipients dismissal came eight years after he had last performed services abroad) for this payment to be regarded as deriving from the employment exercised in the work states. Consequently, the entire severance payment was subject to tax in the Netherlands, i.e. the recipients residence state and the state where he exercised his employment at the time of the dismissal.

6.2.4. The severance payment is allocated to the place where the terminated services were previously provided

6.2.4.1. In general

Under this third approach, the severance payment is taken to reflect the termination of the employment exercised in the work state and so also serves to compensate these services, which may be based on the fact that the entitlement to the severance payment accrued during the years of service. The years taken into account may be limited for various reasons (see 6.2.4.2.). This would result in the payment being divided into one part relating to the services performed in the work state (or in various work states) and one part attributable to the residence state. In general, such an allocation can be made on the basis of the time-proportionate method, unless (1) the severance payment only relates to the termination of an employment exercised exclusively in the work state or (2) the payment is calculated on the basis of inter alia, the most recently earned salary or the average salary. In such situations, departure from the time-proportionate method could be justified, at least if there is a different approach.
ence between the compensation level and the structure of the activities performed in the work state or various work states and the residence state.91

6.2.4.2. Applying a time-proportionate method

If a time-proportionate method is applied in allocating the severance payment to services performed in various work states, the question arises as to the year or years that should be taken into account or used as the basis for the allocation. Various options are conceivable in this respect:

- all the years in which labour activities are performed on behalf of the employer that terminated the employment relationship and that are used in calculating the final severance payment. If services have been performed in the work state in all or some of these years, the severance payment must be attributed to these services under the third approach (for example, the accruals approach). Whether or not the work state is also entitled to tax that part of the severance payment depends on whether the conditions in Art. 15(2) of the OECD Model are met:
  - the tax year in which the taxpayer receives the severance payment. If services have been performed in the work state in that particular year, the severance payment is attributed to that year. If no activities have been performed in that year, the most recent tax year in which such activities were performed is taken into account:
    - the most recent tax year in which services were regularly performed;92 and
    - the year in which the employment is terminated. If the employment was exercised in the work state when the employment was terminated, the severance payment should be allocated proportionally to these services.93

If the year in which the payment is received is regarded as decisive, it is still possible for the services to have been performed in different states in that year. The remuneration must then be divided, unless the most recent place of labour is considered to be decisive.94

The author prefers to allocate the severance payment, at least if this approach is taken to be correct, by taking into account all the relevant years in which the employee has worked for the employer in question and on which the calculation of the severance payment is based. If it is agreed that the severance payment also relates to services performed in the past, it would be appropriate to attribute it to all the services performed previously and to allocate the payment accordingly. The inclusion of these years in the calculation of the severance payment may be considered to be a sufficient connection for the severance payment to be allocated to those services.95 Basing the allocation of the severance payment on the situation in the tax year in which it is received or in the most recent year in which regular professional services were performed may also lead to undesirable results, for instance, if the work state allocates the severance payment on the basis of the year in which it is received (the year in which the conditions of Art. 15(2) are cumulatively met), whilst the residence state allocates the severance payment based on all the relevant years.

Example

X is a resident of State R and has been working in State W for his State R resident employer for the past few years. In each of these years, he was present in State W for a period or periods exceeding 183 days in a calendar year (Art. 15(2)(a) of the R-W tax treaty, which is similar to the OECD Model in its pre-1992 version). 96 The taxation right in respect of the services performed in State W was assigned to that country. The employment with his employer was terminated with effect from 1 March 2009 and he received a severance payment as of that date. The 183-day period of the R-W tax treaty was not exceeded in 2009. Suppose

92. See also the decision of the Brussels Court of Appeal, 19 December 1997, (revised by Peeters (1998), Art. 15(2) seq. and by Baeten, supra note 90. The Court of Appeal followed the taxpayer's view in its allocation of the severance payment, which view the tax authorities did not dispute. The taxpayer was eligible for the conditions outlined in the Foreign Executives Circular (Circular voor Buitenlandse Kaderreden, Circular 8 August 1983, CRR 624:325,294), which resulted in his remuneration being divided into a taxable part (in respect of the activities performed in Belgium) and a non-taxable part (regarding the activities performed outside Belgium: the 'foreign travel exclusion'). The taxpayer proposed following the same division for the severance payment at issue: the tax authorities accepted this division for the regular salary in the final year before the year in which the severance payment was attributed. The most recent tax year in which regular professional activities are performed is also used under Belgian tax legislation, which contains a provision granting a special tax rate to, for instance, severance payments paid as a lump sum. Consequently, this severance payment is subject to the tax rate that applied in the most recent tax year in which regular and normal professional activities were performed (Art. 17(13) of the Belgian Income Tax Code). The Court of Appeal believed that, due to the lack of more appropriate standards, this most recent tax year could also be used to specify the part of the severance payment that could be allocated to Belgium (work state). Peeters (1998), Part 1, note 1, pp. 6–7, emphasized that the Court used the most recent tax year because of the lack of a more appropriate standard. The Court, therefore, took a pragmatic approach, which, according to Peeters, does not exclude the possibility of all the relevant years being used to calculate the severance payment in another case. In a later publication, Peeters, Part 1, note 53, p. 206, added that this pragmatic approach should be rejected, as it results in a coincidental and discretionary allocation. Peeters also questions whether or not this approach can be reconciled with the wording of Art. 15 of the OECD Model.
93. The Belgian tax authorities, in their Circular of 25 May 2005, AFZ 2005/0652 (08/2005), point 3.5, adopt this approach for 'compensatory severance payments', i.e. the former employee is compensated for the employer disrespecting the statutory notice period when terminating the employment. Peeters, Part 1, note 53, p. 210, presumes that a non-compensatory severance payment involves payments that are paid in states ('other than Belgium') where an employment can be terminated without a notice period or payments that are treated in Belgium as surplus to the statutory compensation. Peeters also remarks that the tax authorities do not give any legal reasoning for this distinction, so it may be questionable whether or not the Belgian tax courts will follow this approach. The non-compensatory payments are, according to the tax authorities, allocated by taking into consideration all the activities that were relevant in the framework of the terminated employment.
94. See the annexes to Advocate-General Walle, Advisory Opinion, 12 March 2003, included in BNR 2004:344, point 4.5. The Belgian tax authorities in their Circular of 25 May 2005, AFZ 2005/0652 (08/2005) refer to the total activities with regard to non-compensatory severance payments. It is, however, not entirely clear what has to be understood under 'total activities' in this respect. See also R. de Baere and A. De Reymaecker, 'Ontslagvergoedingen: gewijzigd administratief standpunt', Fiscalis International (2005), No. 260, p. 3.
96. Under the tax treaty based on the pre-1992 version of the OECD Model, the 183-day period is calculated on the basis of the fiscal year concerned instead of on the basis of any 12-month period commencing or ending in the fiscal year concerned. It is assumed that the fiscal year coincides with the calendar year in both contracting states involved.
that case law in State W allocates the severance payment on the basis of the services in the year in which it is received. This would mean that the severance payment would not be taxable in State W despite the payment possibly relating to activities previously performed in State W. This results from taking the services performed in the tax year in which the severance payment is received (2009) as the basis for its allocation.

From a theoretical viewpoint, it would be possible to subscribe to the approach that takes into account all the relevant years when allocating the severance payment. Nevertheless, this approach may lead to practical difficulties if, for instance, the employee had a long career within the company or group of companies that dismissed him. It may then be difficult to establish in which states and during which periods of time the employee performed his services. The Netherlands Supreme Court tried to overcome these practical difficulties in BNB 2004/344 and 345 by formulating specific rules for allocating severance payments to employment exercised in various states in the past.

Specifically, the Netherlands Supreme Court in BNB 2004/344 and 345 held that the severance payment should be allocated on the basis of the individual's history of performing labour activities. The basis on which the Supreme Court allocated the severance payment to the former work state was the ratio of (1) the part of the entire salary that was taxable in the work state by virtue of Art. 15(1) and (2) of the Netherlands OECD-patterned tax treaties at issue during a specified reference period, to (2) the total salary received during that period. The percentage resulting from that fraction determines the part of the severance payment that can be allocated to the work state and/or states. This may be expressed by the following fraction:

\[
\text{the part of the regular salary taxable in the work state during the reference period} = \frac{\text{total salary during the reference period}}{}
\]

The reference period that is taken into consideration consists of (1) the part of the year between 1 January and the date on which the employment is terminated and (2) the four calendar years preceding 1 January in the year in which the employee is dismissed. Special circumstances may justify departing from these allocation rules. In any event, the Supreme Court held that if the severance payment was not borne by an employer residing in the work state or by a permanent establishment (PE) of the employer located in the work state, the connection between the severance payment and the labour history in that work state would not suffice to regard the severance payment as remuneration in respect of an employment exercised in the work state within the meaning of Art. 15(1), second part of the first sentence and the second sentence of the OECD Model. This is remarkable, as these requirements are already included in Art. 15(2)(b) and (c) of the OECD Model and, therefore, it does not appear to be logical to impose them under Art. 15(1). The Supreme Court, in its decision of 11 April 2008, BNB 2008/180, elucidated that this connection, i.e. the severance payment being borne by an employer residing in the work state or by a PE of the employer situated in the work state, is only relevant for the taxation rights of the work state under Art. 15 of the OECD Model. The former employee at issue worked and lived in the United Kingdom when he was dismissed and the severance payment was granted. As a result, it could not be established that the Netherlands, as the previous work state, was entitled to tax the entire severance payment, as the severance payment was not charged to the accounts of the PE that the former Netherlands resident employer maintained in the United Kingdom.

Example

Z resides in the Netherlands. He has an employment relationship with Y BV (a company residing in the Netherlands) and Y BVBA (a company residing in Belgium), which belongs to the Y group. Y BVBA should be regarded as an employer within the meaning of Art. 15(2)(b) of the 2001 Belgium–Netherlands tax treaty. Z performs services both in Belgium and in the Netherlands. The salary that related to his services performed in those countries was paid directly by Y BV and Y BVBA (these amounts are in conformity with the salary attributable to the services performed in each of these states). By virtue of Art. 15(1) of the Belgium–Netherlands tax treaty, Belgium has the authority to tax the salary that is attributable to the activities Z performed there (the conditions of Art. 15(2)(b) of that treaty are not met). Z is entitled to relief from double taxation in the Netherlands on this part of the salary.

On 1 June 2009, the employment relationship with the Y group was terminated and Z was granted a severance payment of EUR 1 million. In the preceding years, Z received the following remuneration:

- 2008: salary EUR 220,000 (EUR 125,000 paid by Y BVBA);
- 2007: salary EUR 150,000 (EUR 100,000 paid by Y BVBA);
- 2006: salary EUR 150,000 (EUR 50,000 paid by Y BVBA); and
- 2005: salary EUR 100,000 (EUR 25,000 paid by Y BVBA).

For the period 1 January 2009 to 1 June 2009, Z received a salary of EUR 100,000, of which EUR 50,000 was paid by Y BVBA.

The fraction discussed previously can be calculated as follows:

\[
\frac{350,000 (50,000 + 125,000 + 100,000 + 50,000 + 25,000)}{700,000 (100,000 + 200,000 + 150,000 + 150,000 + 100,000)} = 50\%
\]

97. See also the decisions in BNB 2005/56 and BNB 2005/57.
98. In the Court's view, the requirement for the salary to be borne by a PE of the employer in the work state or paid by, or on behalf of, an employer residing in that state was necessary to establish a connection between the severance payment and the individual's history of performing labour activities.
99. Art. 15(1) and (2) of the former 1970 Belgium–Netherlands tax treaty; Art. 16(1) and (2) of the 1968 Luxembourg–Netherlands tax treaty; and Art. 15(1) and (2) of the 1980 Netherlands–United Kingdom tax treaty.
100. Compare the decision in BNB 2005/57, in which the Court of Appeal adopted the presence of a special circumstance justifying departing from the specific allocation rules formulated by the Supreme Court, i.e. the taxpayer exercised different functions within a group of companies (this could not be affected by the Supreme Court on appeal).
101. Apparently the Supreme Court took the view that the causality to regard a payment as 'salaries, wages and other similar remuneration' differed from the causality that is demanded to allocate the severance payment to an employment exercised in the work state in the past.
102. See, in the same sense, P. Kavelaars in his annotation to BNB 2005/57 and R. Prokisch in his annotation to BNB 2004/344. Kavelaars suggests imposing the burden of proof on the tax inspector if this requirement of the Netherlands Supreme Court continues to be applied, although Kavelaars is also of the opinion that this requirement is irrelevant for establishing a connection with the exercise of the employment in the work state and that it can only play a part for the purposes of Art. 15(2) of the OECD Model.
Accordingly, 50% of the severance payment (EUR 500,000) is attributable to Belgium, provided that this part of the payment is paid by or on behalf of Y BVBA.

The advantage of the rules provided by the Supreme Court is that, in some cases, they resolve the practical difficulties involved in allocating the severance payment to employment exercised in different states in the past. This approach also takes into account differences that may exist between the remuneration levels in the various countries and other circumstances that may result in a method other than a time-proportionate approach being used to allocate the payment. The Supreme Court also defined the connection that is required between the severance payment and the services performed before the termination of the employment. The decision of the Netherlands Supreme Court of 10 February 1999, BNB 1999/153 demonstrated that the connection between the severance payment and the employment exercised in the work states in the past was too remote where the employee's dismissal came eight years after he had last performed services in those states.

In its decisions of 11 June 2004, BNB 2004/344 and 345, the Supreme Court set this period at four years plus the period from 1 January in the year of the dismissal until the date on which the dismissal took effect.

Nevertheless, the reference period appears to have been chosen at random, whilst the fraction that takes this period as its starting point may also still lead to arbitrary and undesirable results. Netherlands resident employees who have worked exclusively outside the Netherlands for a considerable time could be confronted with a severance payment being entirely or partially allocated to the Netherlands if the final part of their career was spent in the Netherlands. This would not take into account the fact that most of their employment had been exercised outside the Netherlands. If an employee exercised his employment exclusively outside the Netherlands for a period of, for instance, 20 years, in the context of which the taxation right was accordingly assigned to another contracting state, whilst he worked for the entire reference period in the Netherlands, the whole severance payment would be taxable in the Netherlands. If this employee were to work for one year of the reference period outside the Netherlands and the remainder of this period in the Netherlands, the majority of the severance payment would be allocated to the Netherlands.

The author believes that it is more equitable, in these cases, to take into account all the years included in the calculation of the severance payment to allocate it to the work state or states. It is also not entirely clear whether or not the reference period includes periods during which the employee was unable to perform his duties due to illness, disability or parental leave or periods during which he did not work because of a Sabbatical leave. Including these periods may result in further distortions in the allocation of severance payments.

In addition to these remarks, it should be noted that the Supreme Court's approach may lead to double taxation or double non-taxation in relation to states where all the years relevant in calculating the severance payment are included to make the proper allocation. The same may apply in respect of Belgium if the approach of the Brussels Court of Appeal of 19 December 1997, Algemeen Fiscaal Tijdschrift (1998), No. 5, p. 182 is followed (in this case, the severance payment was allocated on the basis of the most recent tax year in which regular services were performed) or when the point of view of the Belgian tax authorities is taken into account. The author believes that, rather than the Supreme Court unilaterally formulating an approach that must be followed to allocate a severance payment, it would be better for the contracting states to conclude bilateral arrangements (via a protocol or a mutual agreement) on the method of allocating a severance payment to the work state (see also 6.3). Several mutual agreements have been concluded in this respect, inter alia, between Germany and the Netherlands, and Belgium and Germany.

Belgium and the Netherlands did not conclude a mutual agreement regarding the allocation of severance payments.
under Art. 15 of the 2001 Belgium–Netherlands tax treaty.  

According to these mutual agreements the severance payment is allocated on a time-proportionate basis to the employment exercised in the work state in the past. This allocation occurs by taking into account all the years during which the employee provided services on behalf of the employer (or companies related to that employer) with whom the employment relationship was terminated. This deviates from the case law of the Netherlands Supreme Court (BNN 2004/344 and 345), the German Supreme Court (BStBl II, 1997, p. 341) and the Brussels Court of Appeal (Algemeen Fiscaal Tijdschrift (1998), No. 5, p. 182). It is beyond the scope of this article to elaborate on the status of mutual agreements. It is, however, questionable whether these mutual agreements are binding on taxpayers and tax courts.  

6.3. Evaluation  

The case law and publications referred to in 6.2. demonstrate the existence of a range of differing opinions on the way in which severance payments should be allocated in cross-border situations and how the place of exercise must be determined. These differing views could result in double taxation or double non-taxation, as the following illustrates.

Example  

Z resides in Belgium and works exclusively in Germany for a German employer (X GmbH). His employment is terminated by X GmbH. Given the decision of the German Federal Tax Court of 10 July 1996, BStBl II (1997), p. 341, Germany assigns the taxation right in respect of the severance payment to Belgium (the employee's residence state), while based on the decision of the Brussels Court of Appeal of 19 December 1997, Algemeen Fiscaal Tijdschrift (1998), No. 5, p. 182 et seq., the severance payment is taxable in Germany (the work state).

The author would prefer that the contracting parties include a specific provision, either in their tax treaty or in the protocol accompanying that treaty, to specify the allocation of severance payments and, possibly, to determine the place of exercise. This would give the contracting states the opportunity to take specific circumstances into account that may be present in one or both of the states. The contracting states could opt for taxation of the severance payment in either the work or the residence state, as a result of which double taxation or double non-taxation would, in any event, be avoided. The Commentary on the OECD Model does not resolve the issue of double taxation nor of double non-taxation in such a case, as it could be argued that the allocation of a severance payment is not regarded as a qualification conflict. This conclusion could, to a certain extent, also be applied with regard to determining the place of exercise. Consequently, double taxation or double non-taxation in these types of situations would have to be resolved through the mutual agreement procedure.

An example of such a tailor-made tax treaty provision is Art. 18(3) of the 1999 Italy–United States tax treaty, which states that severance payments or lump sum pay-ments made on the termination of employment and received after a change of residence are taxable only in the state where the services were performed.  

This provision is intended to prevent theoretical tax planning techniques relating to changes of residence, which may otherwise be encouraged by differences between the effective personal income tax rates in the two states.  

10. There is only a mutual agreement between the Netherlands and Belgian competent authorities regarding: Netherlands Fiscale Actuiten (Fiscaal Verdrag). Under Netherlands tax law, it is possible to convert a severance payment into a standing right (staarrecht). Under Art. 11(2)(g) of the Netherlands Wage Withholding Tax Act, a conversion tax is tax exempt although the latter allowances stemming from that standing right will be taxed. Circular of the Belgian tax authorities of 28 April 2004, AFZ/2004/031.3 (AFZ 8/2004) stated that the conversion of the severance payment into a standing right, which conversion is tax exempt in the Netherlands, can be taxed in Belgium, provided that the individual to which such a severance payment is granted resides in Belgium. This is based on the fact that the provision to which Belgium must grant relief from double taxation contains a subject-to-tax clause (Art. 23(1a) of the 2001 Belgium–Netherlands tax treaty). At the severance payment was not taxed in the Netherlands when it was converted into a standing right, the Belgian tax authorities were of the opinion that the requirements to be entitled to relief from double taxation were not met because actual taxation did not occur at that moment. The latter payments will be classified either as life annuities under Art. 18(7) in connection with Art. 18(1a) of the 2001 Belgium–Netherlands tax treaty (assigning the taxing right to the residence state) or under the other income provision if the payments are not characterized as a life annuity within the meaning of Art. 18(7) of that treaty. See point 63 et seq. of the Circular. This Circular is discussed by K. Liewens and J. Houwen, “Circulaire over toepassing nieuw pensioenrecht,” Internationale Fiscale Actuiten (2004), No. 6, pp. 1–12. To resolve this issue the Belgian and Netherlands competent authorities concluded a mutual agreement (1 September 2005, CPP 2005/2036, Belgian State Gazette, 13 October 2005, 34025 34027, as discussed by I. Pattyn, “Belgie en Nederland gaan preventief dubbele belasting vermijden,” Internationale Fiscale Actuiten (2005), No. 10, pp. 2.5 and by L. Janssens, “Regeling inzake grensoverschrijdende ontslaguitkeringen,” FL (2005), No. 263, pp. 1–2 and the resolution of the Netherlands State Secretary for Finance of 22 June 2006, CPP2006/1044M, State Gazette, No. 120, in which the Belgian competent authorities expressed their willingness to adopt a broad interpretation of the expression ‘taxed’ in Art. 23(1a) of the 2001 Belgium–Netherlands tax treaty. Within this framework, the Netherlands exemption for standing rights is not regarded as an effective exemption but rather as a postponement of tax. Consequently, Belgian grants relief when the severance payment is converted into a standing right.  

11. The German Federal Tax Court, in its decision of 10 July 1997, BStBl II, p. 17, held that a mutual agreement regarding the interpretation of the term ‘temporary’ (tijdelijk) as used in Art. 10(2)1(1) of the 1959 Germany–Netherlands tax treaty, validly concluded between their respective competent authorities under Art. 25(2) of that treaty, is binding from an international public law perspective (volkerrechtsrecht) (verbiedelijk). Due to the fact that the provision of Art. 5(2) of the German Constitution had not been complied with, the German Federal Tax Court decided that the mutual agreement was not binding on the German tax courts and the taxpayer concerned. See also F. Engelen, Interpretation of Tax Treaties under International Law (Amsterdam: IBFD 2004), Doctoral Series, Vol. 7, p. 433. The Netherlands Supreme Court, in its decisions of 29 September 1999, BNN 2000/16 and BvNN 2000/17, ignored this mutual agreement because it was not properly announced or published. The Supreme Court held that a common interpretation that is reached in a mutual agreement may be binding on the tax authorities but it does not deprive the judge of the obligation to explain and interpret a tax treaty if the taxpayer relies on such an interpretation or explanation during a proceeding. A comparable approach was taken by the Court of Appeal in its decision of 30 October 1997. In this respect, see Algemeen Fiscaal Tijdschrift (1998), No. 2, pp. 90 and 91.  


13. Double non-taxation could be avoided if a provision similar to Art. 23(4) of the OECD Model is included in the tax treaty in question.  


other words, the provision currently has only a limited scope and should also be extended to cover situations other than changes of residence.

The author believes that there are two preferred options in this respect, both of which are discussed in 6.2, i.e. either the severance payment is allocated to the employment exercised in the work state or it is not. The approach that should be followed depends on the facts and circumstances of the situation in question. In the author's opinion, the allocation of a severance payment to an employment exercised in the work state should be waived if it can be established that the severance payment would not have accrued during the performance of services in the work state and so cannot be regarded as a subsequent payment. The reason for granting the severance payment is the dismissal and the ensuing damage, i.e. loss of income, social hardship, etc., which results in the payment being taxable in the employee's residence state. This conclusion is also the same if, at the time of signing the employment contract, the employee and employer had already agreed on a leaving bonus or golden handshake in the event of a possible involuntary termination of the employment, which is customary for senior executives of multinationals. The amount of the payment is independent of the duration of the employment. Such a payment may also have been granted because of the individual in question being dismissed from his employment relationship.

One advantage of not allocating the severance payment to an employment exercised in the work state is that no distinction must be made between the various elements that can comprise the reason for payment, such as grief, confidentiality regarding issues concerning the former employer, keeping the dismissal confidential, the loss of income, a gap in accrued pension rights, notice period, remaining holidays, etc. A consequence of the other approaches described in 6.2, i.e. the second and the third approaches, is that a distinction must be made between the various elements, in the context of which some must be allocated to the employment exercised in the work state, whilst others are taxable in the employee's residence state, as they have no or an insufficient connection with the employment exercised in the work state. A disadvantage of the severance payment being taxable in the employee's residence state is that it could give rise to schemes under which the employee would move to a low-tax jurisdiction immediately before receiving the severance payment. This objection could, however, be removed by including a provision in the specific tax treaty to discourage these types of schemes (for example, the Italy–United States tax treaty) or including a subject-to-tax clause in the tax treaty for this purpose. The tax treaty provision should also specify that a severance payment is taxable in the employee's residence state.

Although the German Federal Tax Court shares this view, other jurisdictions regard the severance payment as deferred compensation attributable to previously exercised employment. Under this approach, the severance payment has a relationship to the services performed in the past, i.e. these working years are at least taken into account in the calculation of the severance payment, and there are, therefore, sufficient grounds on which to allocate the severance payment to those services (accrual approach). The author is of the opinion that all the years that counted towards determining the amount of the severance payment should be taken into account in the allocation. This approach avoids the possibility of the allocation being determined by arbitrary factors linked to a single year, in other words, the year in which the payment is received or the last year in which regular professional activities are performed. This also applies, to a certain extent, to the approach formulated by the Netherlands Supreme Court, where the severance payment is allocated on the basis, inter alia, of the ratio between (1) the regular salary that was taxable in the work state during a specified reference period and (2) the entire salary enjoyed during that reference period. This approach has the advantage of resolving the practical difficulties that may arise if all the years that are relevant for calculating the severance payment are taken into account and also defines the connection that is required between the severance payment and the services performed in the work state in the past. Nevertheless, it may still lead to arbitrary results and to double taxation or double non-taxation. The latter possibility is due to the fact that the Netherlands Supreme Court has unilaterally formulated these rules, whilst they are not applied in other states. Accordingly, it would be preferable to include these rules in a tax treaty provision (or in a protocol accompanying that treaty) or, alternatively, to apply them through the mutual agreement procedure.

It has been suggested, based on the decision of the Netherlands Supreme Court of 10 August 2001, BNB 2001/353, that the severance payment should be allocated to the place where the employment would have been exercised in the future, at least for that part of the payment intended to compensate the loss of future income (replacement approach in combination with the fictitious determination of the place of exercise). This allocation largely depends on the way in which the severance payment is characterized under the domestic law of the relevant jurisdiction. In the Netherlands, a severance payment may partly be intended to compensate the loss of future income, whereas this may be different under the domestic law of other states. The Supreme Court rejected this reading in its decisions of 11 June 2004, BNB 2004/344 and 345.

Kavelaars has made various suggestions for the allocation of severance payments to employment exercised in the work state or states in the past and to overcome the difficulties resulting from the theory that the Netherlands Supreme Court developed in its above case law. If the severance payments causally relate to a particular employment or to specific activities, the payment should be allocated accordingly. When the severance payment

cannot causally be connected with certain activities, the year in which the former employee worked within a group of companies is taken as the base to allocate the severance payment, unless the manner in which the severance payment is calculated clearly points to another allocation.

Although the author would prefer that the contracting states agree on the allocation of severance payments either in a protocol accompanying the tax treaty or in a mutual agreement (provided that the mutual agreement is published in the prescribed manner, which is often not the case (in respect of the Netherlands, for instance, publication in the Bulletin of Treaties is required), consideration could, nevertheless, be given to including a statement in the Commentary on the OECD Model. As stated earlier in this section, the author would prefer to assign the taxation right on the severance payment to the residence state, following the arguments of the German Federal Tax Court, which circumvents certain practical difficulties when the payment relates to a long career where the activities were performed in various countries.

7. Sign-On Fees

7.1. In general

A sign-on fee is intended to induce an employee to sign a contract with a certain employer. Signing a contract could be regarded as the exercise of an employment given its direct connection with the employment that will be exercised in the future (depending on the manner in which the sign-on contract is drafted). In fact, signing-on can be regarded as the pre-contractual phase to the exercise of the employment. There is no need to fictitiously determine the place of exercise, but, rather, to establish which place of exercise underlies this fee, i.e. direct allocation.

If this employment relationship requires the employee to simultaneously perform activities in another state, the issue arises as to whether or not this fee should be allocated entirely to the state where he will provide his principal services and where his employer is established or also to services provided in another state. The author believes that, in general, a sign-on fee should be allocated to the activities performed in the state where his employer resides and where the employee exercises part of his employment. The employer has persuaded the employee to sign a contract with him and to provide services on his behalf by promising or paying the employee a fee. This may be different if a fixed pattern of activities existed and the duration of the activities performed in this fixed pattern were clear in advance. In these situations, an allocation to employment exercised in another state is conceivable and feasible in practice.

This approach avoids the practical difficulties that would arise in a situation in which an employee enters into a permanent employment relationship with an employer residing in State A and then exercises his employment in 15 different jurisdictions during his career in the 25 years following the signing of the original contract. It would be practically impossible in such circumstances to allocate a sign-on fee received in year X to services provided in 15 other states during years X+1 to X+25. In this respect, it is assumed that one of the conditions of Art. 15(2) of the tax treaties concluded between State A and the 15 other states was not met, thereby resulting in the assignment of the taxation right. If these conditions are cumulatively met, the allocation will, of course, not be an issue. At the time of the sign-on fee being paid, the employer and the employee do not know the precise pattern of the activities and how long this employment relationship will last.

7.2. Case law and views of the tax authorities

United States

The Internal Revenue Service (IRS), in Rev. Rul. 74-108, endorsed an allocation to services provided in various jurisdictions, if such is feasible, and provided that the employment is partly exercised in each of those states. The sign-on fee that was the issue in Rev. Rul. 74-108 differs from the example given in 7.1. Specifically, Rev. Rul. 74-108 apportions the fee to services provided within and outside the United States, in which context the extent of activities performed outside the United States could be established in advance. The US team pay-

117. Compare Reimer, Part I, note 2, p. 129
118. The attribution of sign-on fees is especially common in the world of sports, where attribution to a jurisdiction is precarious because of the nature of Art. 17 of the OECD Model, which grants tax jurisdiction to the state where the personal activities of the sportsman are exercised.
119. Rev. Rul. 74-108 involved the following provision on sign-on fees: "The sign-on fee is paid to induce the player to sign and become bound by the provisions of the agreement. The agreement does not require the player actually to pay for the club, it is merely a preliminary agreement that is separate and distinct from a uniform player contract, which binds a player to play soccer for a salary. When a player enters into an agreement, the taxpayer places him on its reserve list thereby protecting such player from recruiting efforts of any other club and preventing him from negotiating to play or playing for any other professional soccer club. Part of the sign-on fee is attributable to future services, but the team anticipates agreement and the fee will induce the player to sign and become bound by the uniform player contract if the club wishes to use his services and a separate employment contract is negotiated for this purpose. According to the IRS, the sign-on fee, or bonus, was paid to ensure that if the non-resident alien played professional soccer, he would provide his services to the taxpayer only and to no other professional soccer club (see Richard A. Allen, 50 T.C. 466 (1968)). The bonus was paid as compensation for the promises made by the non-resident alien in the sign-on arrangement, which in essence amounted to a non-competition agreement. Such compensation is fixed or determinable annual or periodic income and its source is the place where the party making the promise forfeited his right to act (Koflund Co. v. 1 T.C. 180 (1943)). Compensation received for a promise not to compete is taxable as ordinary income and does not constitute income from the sale of property, either real or personal (John D. Beals, Jr., 31 B.T.A. 906, aff'd 82 F. 2d 168 (3d Cir.) 1112 C.B. 227 (1936)). In this case, the sign-on fee is paid in return for the non-resident alien promise not to compete either within or outside the United States. Accordingly, the sign-on fee is attributable to services both within and outside the United States and the income must be apportioned appropriately. A portion of a sign-on fee is paid by a US team to a foreign professional soccer player. Consequently, the IRS held this fee to be income from sources within the United States. The ruling allows for more than one basis for allocating income, including, for example, the relative value of the player's services within and outside the United States, or the portion of the year during which soccer was played within and outside the United States. If there is no reasonable basis for allocation elsewhere, the ruling concluded that the entire sign-on fee is deemed to constitute income from sources within the United States. It is, however, unclear why the ruling concluded as such.
the fee belonged to a league consisting of seven US teams and four non-US teams, which makes it easy to draw up a schedule of games contested within and outside the United States. The example discussed in 7.1 demonstrates that it is impossible to allocate a sign-on fee to services provided in various states if there is no fixed and determinable pattern of activities and there is also uncertainty about the ultimate duration of these activities.

The US Tax Court confirmed Rev. Rul. 74-108 in Ken Linseman 82 T.C. (1984). Linseman received a sign-on fee from a US club to enter into an agreement with that club and to play hockey on its behalf. As was the case in Rev. Rul. 74-108, the Tax Court regarded the sign-on fee as a non-competition agreement and decided that its “locus” was where the taxpayer forfeited his right to act.121 Where the contract does not specify a territory, the Court indicated that the location could be the place where he may otherwise act, which in the case of hockey could be worldwide, given the National Hockey League, the World Hockey Association, minor league hockey, European hockey, etc., and decided that such an analysis would be exceedingly complex. The Court held that a more practical analysis was required and that the primary purpose for such a fee was to induce the player to sign a contract with the club paying the fee122 and that, therefore, the most reasonable allocation was on the basis of the number of games that the club contemplated playing within and outside the United States during the season following the season in which Linseman received the bonus.123 This undoubtedly followed the parties’ expectations.124

Although the rule formulated in the Linseman case may appear to be reasonable and practical, it nevertheless remains rather arbitrary to base the allocation of the sign-on fee on the services provided in the first year. This may, however, be justified, according to the author, if the activities are performed in the same fixed yearly pattern throughout the course of the employment relationship. It must also be possible to determine the pattern of activities in advance. This was clearly possible in the Linseman case. Otherwise, the author would prefer an allocation of the entire sign-on fee to the United States (the employer’s residence state, where a significant part of the employee’s services were provided).

The Netherlands

The decisions of the Netherlands Supreme Court of 5 June 1996, BNB 1996/260 and 10 February 1999, BNB 1999/173 involved the payment of sign-on fees by Netherlands soccer clubs to non-residents of the Netherlands. The fees were allocated entirely to the employment that was to be exercised in the Netherlands. The decisions did not, however, say anything about the fact that the employment was expected to be exercised in states other than the Netherlands. From that perspective, it is regrettable that the decisions of the Court are anonymous and that, therefore, it is not known whether the clubs at issue also play international games.

7.3. Evaluation

The allocation of a sign-on fee to future employment services may cause difficulties when it is not clear where the services will be provided and for what time period the performance of these services will take place (if this is clear, such as in BNB 1996/260, the sign-on fee may be allocated to the employment that will be exercised in the future). The author would prefer to include in the tax treaty or in the Commentary on the OECD Model a rule stating that a sign-on fee would be allocated entirely to the state where the employer paying the fee resides, provided that the employee in question also renders services in that state.

8. Conclusions

8.1. Summary

This article addresses different forms of income from inactivity: compensation for the cancellation of an employment, stand-by fees, sickness benefits and disability allowances, sign-on fees, income derived from a non-competition agreement and severance payments. These types of income highlight the various issues that may arise under the second rule of Art. 15 of the OECD Model, i.e. the exercise of an employment, the place where the employment is exercised, and if various places of exercise can be distinguished or if none exist, the place where the income should ultimately be allocated.

The following provides an overview, according to the category of income from inactivity, with regard to the exercise, place of exercise and allocation, as well as suggested amendments to the Commentaries (see 8.2):

Compensation for the cancellation of an employment: the second rule does not apply, but, rather, the first rule, i.e., allocation of the taxation right to the state of residence. This solution avoids practical difficulties surrounding determining the place where

120. If the sign-on bonuses are paid after the employment contracts were signed, they are distinguishable from the sign-on bonuses under consideration in Linseman and Rev. Rul. 74-108. According to the IRS, these bonuses are characterized as advance compensation for personal services. Compare the IRS Memorandum of 31 January 2002, Part 1, note 1, and IRS Legal Memorandum drafted by G. M. Sellinger (chief branch 1, associate chief counsel international), ILM 1994-9, Doc. 2000-7383 (referred to in Tax Notes International (25 September 2000), pp. 1449 and 1450 and discussed by J. P. Fuller, US Tax Review, Tax Notes International (25 September 2000), p. 1449).

121. Goldberg, Part 1, note 1, p. 566. In a Memorandum of the IRS for Associate Area Counsel, which was drafted by W. Edward Williams (Senior Technical Reviewer Branch 1 (International) of 31 January 2002, Part 1, note 1), it was stated that the Court held in Linseman that the sign-on fee was not to be regarded as a non-competition agreement, but, rather, as an agreement to induce the player to play for the club at issue.

122. Compare also Allen v. Commissioner, 50 TC. 466 (1968), which is referred to in Mairin, Part 1, note 48, p. 133.

123. See also the IRS Memorandum of 31 January 2002, Part 1, note 1, p. 6. This involved the 1977/78 season. On the same day that the sign-on agreement was executed, Linseman signed a standard player contract that obligated him to play for the team from the 1977/78 through 1982/83 hockey seasons.

the employment would be exercised if the employment had not been cancelled. It also appears to conform to the main principle underlying the second rule (source principle). The connection with the work state is not sufficient with regard to this compensation to give the work state the right to tax that income, as the exercise of the employment did not materialize and the recipient of that compensation did not make use of the work state's infrastructure.

- Sickness benefits and disability allowances: it is difficult to draw general conclusions with regard to these income categories, as they largely depend on the domestic law of the state applying the tax treaty. Nevertheless, the author would tend to uphold as criterion the physical presence of the employee whilst the employee is ill or disabled. As a result, the residence state would have the exclusive authority in many cases to tax these benefits and allowances, which would also be in line with the use that this employee makes of the infrastructure and facilities in that state. The best solution would, however, be to include sickness and disability allowances in a separate tax treaty provision.

- Income derived from a non-competition agreement: refraining from competing against the former employer is the exercise of an employment and the right to tax the remuneration in question should be assigned to the state in which the individual is physically present to observe the obligations imposed by the non-competition agreement (this is in accordance with the principle on which the second rule is based).

- Stand-by fees: being on call should be regarded as the exercise of the employment that takes place where the employee is physically present whilst being on call (this is also in conformity with the principle on which the second rule is based).

- Severance payments: such payments should not be allocated to the exercise of the employment in the work state when they did not accrue during the performance of the services in the work state (the reason for the payment is the dismissal and the resulting damage). In this situation, the residence state is exclusively entitled to tax the severance payment, which would also be in line with the principle underlying the first rule because the payment has an insufficient link with that state in order to justify the allocation of a taxation right. If the severance payment accrued whilst providing services in the work state, it could be allocated to the exercise of the employment in that state, in which context all the years that were relevant for calculating this payment should be taken into account unless the payment is attributable to a certain activity.

- Sign-on fees: allocation is made to the state of residence of the employer, provided that the employee renders services in that state.

8.2. Recommendations

The Commentary should devote attention to the difficulties that may arise with regard to income from inactivity, especially with regard to determining the place of exercise and the allocation of the income. Even though contracting states should bilaterally agree on these aspects, as they largely depend on the approach chosen in this respect, which may be influenced by domestic law, the following comments relating to the nature of the income from inactivity could be considered:

- Severance payments: the residence state should have the exclusive authority to tax that payment, as the reason for allocating it is generally the dismissal and the resulting damage, i.e. loss of income, social hardship, etc.

- Compensation for the termination of an employment: the taxation right should be exclusively allocated to the residence state.

- Non-competition agreements: refraining from competing against a former employer residing in the work state under a non-competition agreement should be regarded as the exercise of an employment, which takes place where the recipient of the income derived from the agreement is physically present to comply with the obligations imposed by the agreement, and to which the income is allocated.

- Standby fees: an employee who is on call, stand-by or ready to work should be deemed to exercise an employment at the place where he is physically present to be available to provide the required service, and to which the fee can be directly allocated.

- Sign-on fees: these should be allocated to the state where the future employment will be exercised, which should be determined according to the facts and circumstances, including the parties' expectations. It is impossible or extremely difficult to allocate the fee to an employment (for example, it cannot be established where the employment will be exercised and for which time period), it has to be allocated to the state where his future employer, i.e. the person paying the fee, resides, provided that the recipient will exercise his employment in that state. If he will not exercise his employment in that state, the fees should be taxable only in the recipient's state of residence.

Finally, with regard to the classification of income from inactivity under Art. 15 of the OECD Model, provided that a sufficient relationship with an employment exists, the Commentary could:

- indicate that the term "salaries, wages and other remuneration" requires a connection with an employment, i.e. the employment is the reason for allocating that remuneration and that the explanation of this term as defined by the work state is decisive in this respect; and

- state, in addition to the "benefits in kind" of Para. 2.1 of the 2008 Commentary, that the term "salaries,
wages and other remuneration” in general encompasses the following remuneration: severance payments (unless they may be characterized as pensions or similar remuneration), compensation for a cancelled employment, sign-on fees, income derived from a non-competition agreement with respect to the former employer, and stand-by fees.