

## Contracting abroad: when to pay local tax

### Contractor or 'employee'?

The first and most important element in determining the correct location to pay tax is whether you are a full-time employee or a contractor. As an employee, you will typically be exempt from local tax for the first 183 days, whereas as a contractor your tax liability will be local from day one.

### What the law says

Let's quickly recap the 183-day rule itself, by quoting the relevant Article (15) from the **OECD Model Tax Treaty**.

#### “ARTICLE 15”

##### INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
  - a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
  - b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
  - c) the remuneration is not borne by a permanent establishment which the employer has in the other State.”

### Interpreting the law

This of course then leads on to the argument often presented by a contractor that they are employed by their own limited company or UK-based umbrella company, and are therefore exempt from local tax for the first 183 days.

#### Matt Walters

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International tax planning for UK contractors and freelancers, includes a single point of contact with a team of tax specialists providing compliant and tailor-made solutions for individuals working abroad.

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As a contractor, most countries will deem you to be working, for the purposes of interpreting the 183-day rule, as an employee of your client company. The income derived from the contract is therefore deemed to be sourced locally from day one, and should be taxed locally from day one. This interpretation is known as the “economic employer” interpretation, wherein the company benefiting from the product of your work is considered to be your employer; as opposed to the “employer of record” interpretation, wherein the company that has an employment contract with you is deemed to be your employer.

## A ‘non-IR35’ issue

It is important to note that these readings of the word “employer” only apply to their relevance to the OECD Model Tax Convention; they do not mean that the economic employer has any liability to you for employer burdens, such as social security. (Further reading - **Contractors’ Questions: Is IR35 a factor overseas?**)

## Why Sweden and Finland are popular

A large majority of European countries follow the “economic employer” model, meaning that in most countries contractors’ tax must be paid locally from day one. The countries currently adhering to the “employer of record” model are Sweden and Finland. In these countries only it is therefore possible for a contractor employed by a foreign company to be exempt from local tax for 183 days. Care should be taken, however, as if the contract remains in the country for more than 183 days the tax liability will be backdated to day one of the contract.

## Most contractors are liable

The conclusion of this guide, therefore, is that contractors working in foreign countries (save for the exceptions of Finland and Sweden) will typically be liable for tax in their country of work (i.e. where they are physically located while performing the tasks) from the first day of the

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## Further information for IT Contractors:

**IR35**  
**Agency workers directive**  
**IT Contract Guides**  
**IT contracting forum**  
**IT contract jobs**

**Guides to S660/Income Shifting**  
**Limited Company Guides**  
**Umbrella Company Guides**  
**Contractor Expenses**  
**First Timers Guides**

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# CUK 2-Minute Guide



contract. It dispels the myth that the first 183 days are tax free, and crushes the misconception that the tax location is determined by contract currency or the location of an employment umbrella or other structure.

## Forewarned is forearmed

Finally, a reminder: tax is often complex and many factors come into play when determining how and where to pay. As a UK-based contractor, you should always seek local professional advice before accepting a contract overseas and ensure that the structure that you intend to use complies with the legislation in your host country.

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