

"International tax news, explained"

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27 September 2019



HAPPY FRIDAY!

Margrethe Vestager is still celebrating the **Fiat & Starbucks cases** – but she is keeping everyone **at arm's length!**

Bread without spread can't be breakfast in **Germany**; the **UK** tax authorities have been **double counting** tax revenue **since 2011** (where's **Margaret Hodge?**); **inverted duty structures** are on track in **India**; and **Greta Thunberg** doesn't pull any punches in **New York!**

Macron bribes the **yellow vests**; **school bags and kimonos** create tension in **Japan**; **"free"** tax compliance services become very expensive in **South Africa**; **New Zealand** feasibility improves; and the **Czech Republic** will soon join **France** in the **US "bad book"**!

And, at week's end, everyone is asking this question: who will lose their job first – **Trump or Johnson?**

Have a great weekend!
Steve

#AskSteve



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[Why did you stay at Deloitte for the whole of your career?](#)

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Episode 5
[What type of education is required to be an international tax advisor?](#)

IN TODAY'S VIDEO PODCAST

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1. EU State aid cases: Fiat & Starbucks
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WORTH READING

Steven C. Wrappe and Marenglen Marku

["How U.S. Tariffs Affect Transfer Pricing and What Companies Are Doing"](#)

Tax Notes Today International, Tax Analysts, September 24, 2019

INTERNATIONAL TAX QUIZ

ACO is a company which is resident in country A. ACO carries on a dredging business. ACO was interested in bidding for a dredging contract in regard to a harbour in country B. As ACO had no office or employees in country B, ACO engaged a third party consulting firm resident in country B (BCO) to study, and prepare a report on, the density of the sediment in the country B harbour. Based on that report, ACO prepared and submitted its bid (to the harbour authority) for the dredging contract. As ACO's bid was the lowest price, it won the contract. According to ACO's budget, it expected to derive a small profit from the project.

The performance of the dredging contract was expected to take 3 months. ACO identified a team of senior, skilled employees in its country A headquarters to lead the dredging project "on the ground" in country B. Those employees relocated to country B for the duration of the contract. Those employees hired additional employees in country B to supplement the project team. The necessary dredging equipment was hired (by the relocated employees in country B) from third party providers in country B.

After the dredging work commenced, it became obvious that the BCO report was deficient in many respects. The report grossly underestimated the density of sediment in the harbour. As a result, ACO was required to perform a significant amount of additional work to complete the contract. It took 2 years for the work to be completed. Instead of achieving the budgeted profit, the dredging contract caused ACO to suffer a significant loss (due to unbudgeted salaries and hiring charges, and penalties levied by the harbour authority in accordance with the contract).

ACO could not seek redress from BCO, as BCO had become insolvent, and its directors and employees could not be found.

What will be ACO's tax treatment in countries A and B, under the A/B treaty (which is identical to the 2014 OECD model treaty, with Art. 23A)?

Answer in next week's ITB email alert!

[Last week's question & solution](#)

XCO is a company which is resident in country A. XCO is a partner in a partnership which is formed under country B law.

The partnership conducts a trading business from a leased building in country B – its major assets are inventory, debtors and goodwill.

Under country B law, the partnership is viewed as fiscally transparent. In contrast, under country A law, the partnership is viewed as a taxable entity (a company), and XCO's interest in the partnership is viewed as shares in the company.

XCO sells its interest in the partnership for a profit. That profit is taxable under both the country A tax law and the country B tax law. Under the country A tax law, a foreign tax credit is available for foreign tax paid by residents on foreign source taxable profits. XCO's profit on the sale of its interest in the partnership is treated as having a domestic source under the country A tax law.

What is the treatment of that profit under the A/B treaty (identical to the 2014 OECD model treaty, with Art. 23B)? The MLI does not apply to the A/B treaty.

Country B:

1. The partnership's trading business is an enterprise: Art. 3(1). That enterprise has a PE at the building in country B: Art. 5(1). Therefore, XCO (a partner in the partnership) also carries on that enterprise and has a PE at that building - see paragraph 43 of the 2017 OECD Commentary on Art. 5.
2. Thus, Art. 13(2) permits country B to tax XCO's profit on the sale of its interest in the partnership's movable property – i.e., inventory, debtors, goodwill, etc.

Country A:

1. If country B does levy tax on XCO's profit, Art. 23B(1) requires country A to grant XCO a credit for the country B tax, regardless of the fact that, under country A domestic law:
 - i. the profit has a domestic source, and
 - ii. country A views the transaction as a sale of shares in a company (on which view, Art. 13(5) provides that the profit shall be taxable only in country A).
2. In regard to 1(ii), see the example in paragraph 32.4 of the 2014 (and 2017) OECD Commentary on Arts. 23A and 23B.

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