ITB International Tax Bytes *by Steve Towers*

"International tax news, explained"

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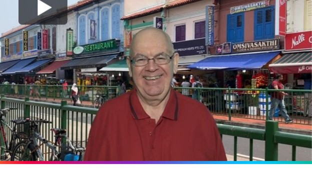

HAPPY FRIDAY!

A Canadian DST? Trudeau makes himself even more popular in the **US!**

Switzerland becomes unbearable, **Peru** creates a **retrospective GAAR, Serbia** swaps its view, and **Australia** experiences **evaporating fuel** (global warming?)

Angola finally takes the plunge, but **Zambia** gets cold feet; **Boris** throws the dice, but **Donald** throws a tantrum; and the **European Court of Justice** shows us what's really important: "never mind the **food safety**, it's the **VAT fraud** we're interested in"!

The **WTO** causes eyes and champagne corks to pop in **Washington**, **Denmark** rules that compliance is not core, and **Japan** pays consumers to go cashless!

But at the end of the week, we're left with this question: **is Alexander Downer really a spy?**

Have a great weekend!
Steve

Curious about ITB? Watch this video!

#AskSteve

Episode 7
Why did you stay at Deloitte for the whole of your career?

Episode 6
How do you deal with difficult clients?

IN TODAY'S VIDEO PODCAST

(For ITB video subscribers, please log in to access the video and documents/reports)

1. Digital taxation
2. Trade and other global developments
3. Asia Pacific
   - Australia, India, Japan
4. Europe
   - Denmark, ECJ, EU, Finland, France, Germany, Serbia, Switzerland, Ukraine
5. Africa
   - Angola, Egypt, Zambia
6. Middle East & Central Asia
   - Uzbekistan
7. Americas
   - Peru, US
8. Treaties
9. Worth reading

WORTH READING

Karen Moser
"Recent Developments and Challenges Regarding Exit Taxes in the Context of Tax Treaties: Article 13 of the OECD Model and Change of Residence"
Bulletin for International Taxation, IBFD, 2019 (Volume 73), No. 10 (subscription service)

H. David Rosenbloom and Fadi Shaheen
"The TCJA and the Treaties"
Tax Notes International, Tax Analysts, September 9, 2019 (subscription service)

INTERNATIONAL TAX QUIZ

XCO is a company which is resident in country X. Mr A is the 100% shareholder in XCO, and he is XCO's only employee and director. Mr A is resident in country Y.

XCO enters into a secondment agreement with YCO, which is a large company resident in country Y. XCO and YCO are unrelated and deal with each other at arm's length. Under the agreement, XCO seconds Mr A to YCO to work at YCO's office in country Y in the role of chief compliance officer, for an indefinite period. Mr A does not become YCO's employee (in legal form). However, YCO's senior executives control and take responsibility for Mr A's day to day activities, and Mr A (in many respects) acts as if he is YCO's employee. For tax purposes, country Y applies the "economic employer" approach.

Under the secondment agreement, YCO pays XCO $50,000 per month. Mr A's salary from XCO is $10,000 per month.

The income tax rates (for both companies and individuals) in country Y are significantly higher than the corresponding rates in country X.

The country Y domestic tax law contains an anti-avoidance provision in regard to schemes to divert personal services income. The country Y tax authorities use that provision to levy income tax on Mr A on the $50,000 per month which is paid to XCO (and they do not levy tax on the $10,000 per month salary which is paid to Mr A). The country Y tax law does not contain any CFC or similar rules.

The country X tax authorities levy income tax on XCO on that same $50,000 per month which is paid to XCO.

Thus, there is double tax on the $50,000 per month (country X taxes XCO, and country Y taxes Mr A).

The X/Y treaty is identical to the 2014 OECD model treaty (with Art. 23B). Can the X/Y treaty remove the double taxation?

Answer in next week's ITB email alert!

Last week's question & solution

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)?

B tax:

1. ACO has a PE in B, at the dredging site in the harbour: Art. 5(1) & (3), A/B treaty.
2. B is permitted to tax the profits attributable to ACO's PE: Art. 7(1).
3. Determining the profits attributable to ACO's PE (in accordance with 2010 OECD Art. 7 report):
   i. Merely because ACO has derived a global loss on the contract does not mean that a profit cannot be attributable to the PE.
   ii. The PE and HQ are assumed to be separate and independent enterprises: Art. 7(2).
   iii. Functions allocated to HQ: decision-making in regard to the bid.
   iv. Functions allocated to PE: recruitment of B employees, hiring of equipment, and performance of dredging contract.
   v. Significant risks allocated to HQ: risk involved in engaging BCO for report on sediment, risk in bidding too low.
   vi. Significant risks allocated to PE: risk in performing contract in inefficient manner.
   vii. Significant assets allocated to HQ: technical knowhow in regard to bidding for contract, technical knowhow / skills of HQ employees relocated to B.
   viii. Significant assets allocated to PE: technical knowhow / skills of PE employees who were relocated from HQ.
   ix. A likely characterisation of the PE is a service provider, due to the fact that its role was limited to performing a contract which was won by the HQ.
   x. The key issue to determine is to what extent the loss incurred on the contract was due to the low bid price (which, in turn, was caused by the incorrect report from BCO), or alternatively was due to the inefficient performance of the contract by the PE employees.
   xi. If it is clear that the loss was wholly or substantially due to the low bid price, then (to that extent) the loss should be allocated to the HQ. That would mean that a profit should be attributed to the PE, to reward it for the efficient performance of the contract (within the context of a low bid price).

A tax:

1. If a profit is attributed to the PE, that profit should be exempt from B tax: Art. 23A(1).

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