Michael Lang / Helmut Loukota / Robert Waldburger / Mike Waters / Ulrich Wolff*)

Triangular Situation: Partnership with Sub-Permanent Establishment in Third Countries

DREIECKSSACHVERHALT: PERSONENGESELLSCHAFT MIT UNTERBETRIEBSSTÄTTE IN DRITTSTAATEN

Michael *Lang* leitete bei der 3rd International Tax Law Summer Conference (6. bis 10. Juli 2003) in Rust (Österreich) am 7. Juli 2003 eine Podiumsdiskussion zum Generalthema „Tax Treaties – What happens when states disagree – qualification and classification conflicts in tax treaty practice", an der mit Helmut *Loukota*, Robert *Waldburger*, Ulrich *Wolff* und Mike *Waters* hochrangige Experten der Abteilungen für Internationales Steuerrecht der österreichischen, deutschen, schweizerischen und britischen Finanzverwaltung teilnahmen. Mike *Waters* und Helmut *Loukota* sind auch Vorsitzender und Stellvertretender Vorsitzender der für DBA-Fragen maßgebenden „Working Party I" des OECD-Steuerausschusses in Paris. Die Experten diskutierten bei dieser Konferenz – nicht in amtlicher Funktion, sondern in privater Eigenschaft – Fallstudien zu DBA-Fragen, die in der Folge auszugsweise wiedergegeben werden.

Facts: A German partnership (transparent according to German tax law, treated as a permanent establishment according to Art. 5 OECD Model in Germany) operates construction projects in Switzerland and in the UK that last 13 (or 11) months. The partners of the German partnership are residents of Austria.

Which countries have taxing rights, which countries have to credit foreign taxes, which countries have to exempt foreign income?

Helmut Loukota: Austria has to allocate to the German partnership all income that is derived by the partnership regardless of whether the source is in Germany or anywhere else. But it is decisive that the partnership constitutes a permanent establishment according to the tax treaty between Germany and Austria for the Austrian partners. In that case Austria is obliged to exempt all income allocated to the partnership. However, one cannot allocate to a German permanent establishment income that has to be allocated to a Swiss or a UK permanent establishment. Germany is only allowed to tax those profits that are allocable to German permanent establishments. As a result, Germany must not tax profits allocated to any other permanent establishment situated elsewhere. Therefore under the Austro-German treaty Germany is not allowed to tax the profits of the permanent establishments situated in the UK and in Switzerland. Under the Austro-Swiss treaty we then have to accept that Switzerland has the taxing rights for the profits allocated to the Swiss permanent establishment and Austria has to grant exemption. In relation to the

*) Univ.-Prof. Dr. Michael *Lang* is Head of the Department of Austrian and International Tax Law at the Vienna University of Economics and Business Administration and is also in charge of the LL.M. Program in International Tax Law offered by this university. Dr. Helmut *Loukota* is the Head of the Division of International Tax Law in the Ministry of Finance in Vienna (Austria) and Vice-Chairman of Working Party 1 of the Committee of Fiscal Affairs of OECD, Robert *Waldburger* is the Managing Director of the Institute of Public Finance and Fiscal Law at the University St. Gallen and Head of the International Division of the Federal Tax Administration in Bern (Switzerland), Mike *Waters* is Assistant Director of the International Division of the Inland Revenue in the United Kingdom (London) and Chairman of Working Party 1 of the Committee on Fiscal Affairs of OECD, Ulrich *Wolff* is Head of the Department of International Tax Law in the Federal Ministry of Finance in Berlin (Germany). – Michael *Lang* chaired a panel discussion at the 3rd International Tax Law Summer Conference in Rust (Austria) on July 7, 2003 on the topic of "Tax Treaties – What happens when states disagree – qualification and classification conflicts in tax treaty practice" with Helmut *Loukota*, Mike *Waters*, Robert *Waldburger* and Ulrich *Wolff* as fellow panellists. Everybody contributed or participated exclusively in his personal capacity and not as a representative of any government or of the OECD.

UK we use the credit system. Therefore the UK may tax the profits allocated to the UK permanent establishment. But Austria taxes these profits as well and allows a tax credit for the UK tax. We have already informed taxpayers about this view in two cases.

Michael Lang: Let us assume the construction projects in Switzerland and the UK last only 11 months.

Helmut Loukota: Then Germany would have the taxing right: Since in such case no third-country-permanent establishments exist, neither in Switzerland nor in the UK, no profits could be allocated to these countries.

Michael Lang: Between the countries involved we have tax treaties that are in line with the OECD Model Convention insofar as the minimum period for construction projects to be deemed as permanent establishments is 12 months. But let us assume we have to deal with treaties that provide for other periods, either 6 months or 18 or 24 months and the period differs from treaty to treaty. Which treaty is relevant to decide under which conditions the construction project constitutes a permanent establishment in the UK and in Switzerland, and Germany therefore must not tax the third country sourced income?

Helmut Loukota: It is clear that the tax treaty between Germany and the UK on the one hand and Germany and Switzerland on the other hand are not applicable since the taxpayer is the Austrian partner who is a resident neither of Germany nor of Switzerland nor of the UK. Furthermore, the tax treaties concluded by other countries and not by Austria cannot have any influence on Austria's taxing rights. Therefore, I think only the Austrian tax treaties with the UK and Switzerland are relevant.

Michael Lang: But how can a tax treaty between Austria and the UK or Austria and Switzerland prevent Germany from levying taxes?

Helmut Loukota: In fact it is the non-discrimination clause of the Austro-German treaty that requires equal treatment of the German permanent establishments of the Austrian partners to enterprises resident in Germany. So it is in the first place the Austro-German treaty that prevents Germany from exercising taxing rights on profits of the UK or Swiss permanent establishments. It follows therefrom that the construction periods of the German-UK treaty and the German-Switzerland treaty are of primary relevance. However, if we assumed that the German-UK treaty provided for a 18 months construction period whereas the Austro-UK treaty was based on the OECD-12months-period, then the Austro-UK treaty would indirectly exert an influence on the tax treatment in Germany. It is true, at first sight, that equal treatment with German enterprises would leave the full taxing right in the hands of Germany. Because in the case of a 13 months construction site in the UK German enterprises remain taxable in Germany and the UK has to grant tax exemption. But in the case under consideration – as already explained – the German-UK treaty does not apply. But the Austro-UK treaty does, which permits UK taxation. Therefore the Austrian partners of the German partnership would be subjected to double taxation which would be contrary to the non-discrimination clause. As German enterprises are generally entitled under German domestic law to obtain relief from international double taxation, at least by way of a foreign tax credit, Germany is (indirectly) prevented from exercising its full taxing rights by virtue of the Austro-UK treaty, which – in contrast to the German-UK treaty – allocates taxing rights to the UK that finally must be credited against the German tax.

Ulrich Wolff: I start with the situation in which the construction project lasts only 11 months. In this case Germany has the taxing right according to the Austro-German treaty for all the profits earned by the partnership. Switzerland and the UK have to refrain from taxation due to their treaties with Austria. Austria must not levy taxes because all the profits are allocated to a German permanent establishment.

If the construction project lasts 13 months, Germany is still in a position to levy taxes on the profits that derive from the activities in Switzerland and the UK. The reason is that Germany does not have to apply the tax treaties between Germany and these countries because the taxpayer is only a resident of Austria. There is no treaty protection. However, Germany would grant a credit for taxes levied in the UK or in Switzerland. The legal basis for this credit granted to non-residents is German domestic law, not a treaty (Sec. 50 para. 6 German Income Tax Act).

Helmut Loukota: I now have to react: I believe that the view expressed by Ulrich *Wolff* does not honor the Austro-German tax treaty. In my opinion Germany can only tax profits that are allocated to the German permanent establishment. Whenever there is a permanent establishment somewhere else to which the profits have to be allocated to, Germany loses its taxing rights.

Ulrich Wolff: Since the German tax treaties with the UK and Switzerland are not applicable, there is no tax treaty provision that could lead to the result that parts of the profits of the partnership have to be allocated to another permanent establishment.

Mike Waters: The positions of the Austrian and the German tax authorities would not be relevant for the UK. From a UK perspective it would be necessary to classify the foreign entity. How Germany or Austria treat this partnership is not relevant for this classification. We apply our own criteria.[2]) If we conclude that the German partnership is transparent for the purposes of UK tax law, we would ignore the German partnership and see the Austrian partners each having a permanent establishment in the UK Our taxing right would depend whether the construction project lasts for more than the twelve months specified in the UK-Austria tax treaty.

Suppose we conclude that this entity is opaque for tax purposes, we do not have a German resident since this partnership is not liable to tax in Germany. On the other hand, the tax treaty between the UK and Austria is not applicable because there is no Austrian entity active in the UK. However, according to the OECD Partnership Report and the revised OECD Commentary, the UK tax authorities should admit a claim from the Austrian partners. So in the end we should apply the tax treaty between Austria and the UK.

Robert Waldburger: Switzerland only has taxing rights if the construction project lasts more than twelve months.

Michael Lang: Suppose we reverse the situation: We have a partner in Austria, the partnership in Switzerland and the construction projects in Germany and the UK. What would the Swiss position be?

Robert Waldburger: We would be in line with the position of the Austrian tax authorities: I do not see a legal basis for Switzerland to tax German or UK sources if the construction projects last more than twelve months.

Ulrich Wolff: I have a question for Mike *Waters*: Let us assume there is a UK partnership operating a factory in the UK and a construction project that is connected with this UK factory in Switzerland and Austria. How does the UK deal with such a situation?

Mike Waters: It is very difficult to see how a construction project carried on in Austria or Switzerland can give rise to profits attributable to a permanent establishment situated in the UK. However, if this is the case, the UK would apply the twelve-months-period according to tax treaty law. It would be a very strange situation if we applied the tax treaty between Austria and the UK to determine if there is a permanent establishment in Switzerland or in Germany.

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[2]) See in detail *Ullah*, Avoidance of Double Non-Taxation in the U.K., in: *Lang* (ed.) Avoidance of Double Non-Taxation (2003) 423 (434 FN 32).