ITB International Tax Bytes *by Steve Towers*

"International tax news, explained"

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13 September 2019

HAPPY FRIDAY!

"Not so fast, Bruno"; **Silicon Valley** celebrates **double the Vestager** (thank you, Bernie Becker); and **Pascal** says that there will be **"no big losers or big winners"** (um, why are we doing this?)

QFIIs break free; **Norway** shows deference (Bogarting again?); **Hirschhorn** gives systemically important advice; and, yes, a **€ 3 million penalty** for failure to register does seem a little excessive!

India exposes conversion costs; **Kazakhstan & Uzbekistan** are joined at the hip; **Thailand** cashes in on the trade war; and **Nigeria** decides on a nice, round number (7.2%)!

But, at the end of the week, we're left to wonder: does **Altera** now have **more briefs** than **Calvin Klein?**

Have a great weekend!
Steve

#AskSteve

Episode 7
To be released on 25 September 2019

Episode 6
How do you deal with difficult clients?

Episode 5
What type of education is required to be an international tax advisor?

IN TODAY'S VIDEO PODCAST

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

1. Digital taxation
2. IFA Congress
3. Other global developments
4. Asia Pacific
   - Australia, China, Hong Kong, India, Philippines, Taiwan, Thailand
5. Europe
   - Belgium, Denmark, ECJ, EU, Germany, Greece, Norway, Slovakia, Sweden, UK
6. Africa
   - Nigeria, Uganda
7. Middle East & Central Asia
   - Kazakhstan, Uzbekistan
8. Americas
   - Mexico, US
9. Treaties
10. Worth reading

WORTH READING

Antonio Cuoco
"The Principal Purpose Test as Introduced by the OECD MLI: Is It Time for a Compromise with EU Tax Law?"
Intertax, Kluwer, Volume 47, Issue 10 (subscription service)

Stewart Lipeles, Joshua Odintz, Katie Rimpfel, and Matthew Mauney
"The TCJA Is Not for Losers"
Tax Management International Journal, Bloomberg BNA, September 13, 2019 (subscription service)

INTERNATIONAL TAX QUIZ

XCO is a resident of country A. XCO owns a building in country B. The building contains 10 residential apartments, all of which are leased to tenants who are unrelated to XCO. A real estate agent in country B (YCO) manages the building for XCO.

XCO financed its purchase of the building by borrowing money from ZCO, which is an unrelated bank resident in country C. The loan is secured by a mortgage on the building.

The A/B, A/C, and B/C double tax treaties are identical to the 2014 OECD model treaty. The MLI does not apply to any of those treaties.

ZCO is the beneficial owner of the interest which is paid by XCO on the loan, and ZCO does not have a PE in country A or country B.

In regard to (i) rent paid to XCO, and (ii) interest paid to ZCO, what is the treatment under each of the A/B, A/C, and B/C treaties?

Answer in next week's ITB email alert!

Last week's question & solution

XCO is a company which is resident in country X. XCO owns 100% of the shares in YCO, which is a company resident in country Y. XCO is a pure holding company; its only assets are the shares in YCO. YCO has a "fixed place of business" PE in country Z, from which it derives profits. YCO also derives profits from its business operations in country Y. The X/Y, X/Z, and Y/Z treaties are identical to the 2011 UN model treaty (with the rate in Art. 10(2)(a) being 10%), and the MLI does not apply to those treaties. YCO pays a dividend to XCO. That dividend is subject to country Z tax, at the rate of 30% (the country Z corporate income tax rate) on a "net" basis – i.e., after subtracting allowable deductions. YCO has no collection obligations, under country Z law, in regard to that dividend; instead, XCO is required to report the dividend by filing a country Z corporate income tax return. The dividend is also subject to 20% dividend withholding tax under the country Y law. XCO is the beneficial owner of the dividend, and XCO does not have a PE in either country Y or country Z. Can the country Z tax and the country Y tax on the dividend be reduced or eliminated under a treaty?

Country Y tax:

1. Domestic law: 20% on gross dividend.
2. Treaty limitation: 10% on gross dividend: Art. 10(2)(a), X/Y treaty.

Country Z tax:

1. Domestic law: 30% on "net" dividend.
2. X/Z treaty:
   i. Art. 10(2) and Art. 10(5) do not apply, as the dividend-paying company (YCO) is not a resident of a Contracting State.
   ii. If Art. 7 applies, XCO would be exempt under Art. 7(1).
   iii. However, a country Z court might take the view that Art. 7 does not apply, on the basis that XCO can be viewed as engaged in only a passive investment activity, which does not qualify as an "enterprise" (this term is not defined in the treaty – if it has a meaning under country Z law, it would probably take that meaning: Art. 3(2)).
   iv. If Art. 7 does not apply, Art. 21 is relevant. The default position is Art. 21(1), which would provide exemption from country Z tax. The critical issue is whether the dividend is "arising in [country Z]", in which case Art. 21(3) would allow unlimited country Z tax. According to the UN Commentary, the "arising" issue is to be determined under the country Z domestic law – which would mean that there is a significant risk that a country Z court would conclude that Art. 21(3) applies.
3. Y/Z treaty:
   i. Subject to (ii) & (iii) below, Art. 10(5) would apply to prevent country Z tax.
   ii. On the facts, it appears that the dividend is paid from a common profit pool, consisting of profits derived from the country Z PE and the country Y operations. The exemption in Art. 10(5) should not be reduced to the extent that the dividend is paid from profits from the country Y operations.
   iii. But can XCO, which is not a resident of country Y or Z, claim the benefit of Art. 10(5) of the Y/Z treaty? Art. 1 would indicate that it cannot. However, numerous academic articles and books have stated that Art. 10(5) would apply in this situation, regardless of Art. 1. For example, see: Madeira & Neves, "Exploring the Boundaries of the Application of Article 10(5) of the OECD Model", Intertax, Vol. 35 (2007), Vol. 8/9.
4. What would happen if (a) Art. 21(3) of the X/Z treaty (country Z may tax), and (b) Art. 10(5) of the Y/Z treaty (country Z must exempt), BOTH apply? In my opinion, the exemption should prevail.

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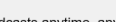

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