ITB International Tax Bytes
by Steve Towers

"International tax news, explained"

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HAPPY FRIDAY!

The OECD's "Unified Approach" looks suspiciously like **proposal 2** on marketing intangibles – but, shh, **don't tell India!**

"Trust us": despite a projected significant increase in global tax revenues, the OECD assures us that **Pillars One & Two will not adversely affect the investment environment!**

Meanwhile, the **IRS** tells us that a **hard fork** is not always followed by an **airdrop**…huh?; the **European Commission** sends a letter (on paper!) which scolds **Germany** for requiring paper, not electronic, certificates; **Malawi** changes its mind; **Ireland** gets tough on debt loading; and the EU continues to pick on **poor Pacific and Caribbean islands** – and gives the **US** a free pass!

But at the end of the week we're left with this question: how will **India's** secondary transfer pricing adjustments deal with **negative interest rates?**

Have a great weekend!
Steve

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#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: "Unified Approach" under Pillar One
2. Digital taxation: other topics
3. Asia Pacific
   - Australia, India, Malaysia, Taiwan
4. Europe
   - EGC, ECJ, EU, Ireland, UK
5. Africa
   - Malawi
6. Americas
   - Argentina, Brazil, US
7. Treaties
8. Worth reading

WORTH READING

Giandomenico Petronella
"Valuations for Transfer Pricing of Intangibles: A Comparative Analysis of the Excess Earnings Method and Residual Profit Split"
International Transfer Pricing Journal, IBFD, 2019 (Volume 26), No. 6 (subscription service)

INTERNATIONAL TAX QUIZ

XCO is a company resident in country X.

XCO places money on a term deposit with an unrelated Bank, which is resident in country Y.

The deposit carries a fixed negative interest rate – i.e., XCO pays interest to the Bank.

The X/Y treaty is identical to the 2014 OECD model treaty. Assume that the Bank is the beneficial owner of the interest, and that it does not have a PE in country X.

Question 1: What is the treatment of the interest (which is paid by XCO to the Bank) under the X/Y treaty?

Due to further negative movements in market interest rates, the Bank decides to terminate the deposit before its maturity date. This triggers a penalty fee (imposed on the Bank) under the terms of the deposit.

Question 2: What is the treatment of the penalty fee (which is paid by the Bank to XCO) under the X/Y treaty?

Answer in next week's ITB email alert!

Last week's question & solution

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?

This is a "conflict of attribution of income" case: under domestic law, X attributes the $50,000 income to XCO, and Y attributes the $50,000 income to Mr A, resulting in economic double taxation.

This type of case is controversial – it is discussed in depth in: J.Wheeler, "The Missing Keystone of Income Tax Treaties", IBFD, World Tax Journal, 2011 (Volume 3), No. 2. It was also one of the main subjects at the 2007 IFA Congress – see, in particular, the general report (also written by Wheeler) in Cahiers de droit fiscal international, Volume 92b.

The better view is that the X/Y treaty cannot resolve the economic double taxation, for these reasons:

1. In accordance with the domestic law income attributions: (i) X would view the treaty as applicable (Art. 7 would apply to the $50,000 income derived by XCO), but (ii) Y would view the treaty as not applicable (the $50,000 income is derived by a resident of Y from a source in Y – in Y's view, there is no connection with X).
2. The OECD model treaty and Commentary deal with one form of "conflict of attribution of income" case – i.e., involving partnerships and other types of fiscal transparency. However, this present case is not due to fiscal transparency.
3. It could be argued that the OECD Commentary provides some limited support for Y's view. The 2017 Commentary on Art. 1 states (at paragraph 79): "… to the extent that the application of a general anti-abuse rule or a judicial doctrine such as 'substance over form' or 'economic substance' results in a recharacterization of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied taking into account these changes." However, the particular anti-avoidance provision in this case is probably not a "general anti-abuse rule", and thus this statement can be argued to be not applicable.
4. The facts in this case are taken from an Australian case, Russell v Commissioner of Taxation. The Federal Court held that the economic double taxation cannot be resolved by the treaty. However, there is some other case law (e.g., the Padmore case in the UK) which would support a different view: see Wheeler's article cited above.
5. Art. 9 of the X/Y treaty does not apply, for several reasons, including: (i) Mr A does not carry on an enterprise; and (ii) the anti-avoidance provision in Y is not based on the arm's length principle.
6. For completeness, it should be noted that Mr A's presence would not cause XCO to have a PE in Y.

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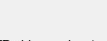

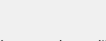

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