ITB International Tax Bytes
by Steve Towers

"International tax news, explained"

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HAPPY FRIDAY!

Boris roars back in, **Donald** saves Christmas, while **Greta** marks **time** and works on her **anger management!**

But I'm afraid that **Pillar Two** is underwhelming, compared with **Mnuchin's safe harbour!**

HSBC uses **barter trade** to avoid **TP**; **Australia** and **Malaysia** fixate on **residence**; **USMCA** makes a comeback, like a **1970s disco hit**; and in the **EU**, **quick fixes** are slow and the **definitive VAT system** is, hmm, not definitive!

We're told that **aviation taxes** don't reduce **carbon emissions** (huh?); in **Helsinki**, a company can contribute to the **Finnish**; **Poland** gets cold feet (again!); and, in **Germany**, **State aid** is a **gamble!**

But at the end of the week, the most important thing we've learnt is that **Brexit really does mean Brexit!**

Have a great weekend!
Steve

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#AskSteve

Episode 9
What big changes have you seen in international tax law over your career?

Episode 8
What are your favorite topics in international tax?

IN TODAY'S VIDEO PODCAST

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

1. Digital taxation
2. Trade
3. Asia Pacific
    - Australia, China, Hong Kong, India, Malaysia, New Zealand
4. Europe
    - Austria, EU, Finland, Norway, Poland
5. Africa
    - Nigeria
6. Middle East & Central Asia
    - Saudi Arabia
7. Americas
    - Costa Rica, Mexico, US
8. Treaties
9. Worth reading

WORTH READING

Ian Zahra
"The Principal Purpose Test: A Critical Analysis of its Substantive and Procedural Aspects – Parts 1 & 2"
Bulletin for International Taxation, IBFD (subscription service)

- Part 1: 2019 (Volume 73), No. 11
- Part 2: 2019 (Volume 73), No. 12

Finn Martensen
"Rethinking Interquartile Ranges"
International Transfer Pricing Journal, IBFD, 2020 (Volume 27), No. 1 (subscription service)

INTERNATIONAL TAX QUIZ

ACO is a company resident in country A.

Three years ago, ACO purchased, from a third party, a "special security" which had been issued by Entity B, which was formed under country B law. Entity B is a "qualifying cooperative foundation" (QCF), a legal form which is found in country B law, but not in country A law. Under country A law, the only legal forms which exist are individuals, companies and partnerships.

ACO is not the only party to own "special securities" issued by Entity B.

During the last three years, Entity B has derived significant profits from business operations in country B. However, during that period, it has made only a series of relatively small payments to ACO.

Under country A tax law, ACO is taxable on global profits, although an exemption is given for foreign source dividends. Country A has no CFC or similar rules. There is no double tax treaty between countries A and B.

In calculating ACO's country A income tax liability: (i) should ACO be taxable on the series of relatively small payments made to ACO by Entity B?; and (ii) should ACO be taxable on all or part of the profits derived by Entity B?

Answer in next week's ITB email alert!

Last week's question & solution

XCO, a company resident in country X, owns 24% of the shares in YCO, a company resident in country Y. YCO's shares are listed on a stock exchange in country Y. The X/Y treaty is identical to the 2014 OECD model treaty. Also, the MLI applies to the X/Y treaty – in particular, Arts. 6(1) & 7(1) of the MLI apply, but Art. 8(1) of the MLI does not apply.

Under country Y domestic law, a 30% dividend withholding tax (DWT) is levied on outbound dividends.

XCO expects YCO to soon declare a large dividend. In order to reduce the rate of country Y DWT, XCO purchases (on the stock exchange) additional shares in YCO equal to 1% of YCO's total shares. A few weeks later, YCO declares and pays a large dividend. Shortly after its dividend was received, XCO sells (on the stock exchange) shares equal to 1% of YCO's total shares.

Under the X/Y treaty, what DWT rate should apply to the dividend paid to XCO? Please ignore country Y domestic law anti-avoidance rules.

5%, under Art. 10(2)(a) – reasons:

1. Without the 12-month rule in Art. 8(1) (MLI), Art. 10(2)(a) applies a "point in time" test: does the dividend-receiving company hold directly at least 25% of the capital of the company paying the dividends, at the time the dividends are paid? See para. 16 of 2014 OECD Comm. on Art. 10.
2. XCO directly holds 25% of YCO's share capital at the time the dividend is paid.
3. The principal purpose test (PPT) in Art. 7(1) (MLI) is relevant. The first limb ("obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit") is clearly satisfied. The issue is whether the exception in the second limb ("unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the [treaty]") is satisfied.
4. The facts are based on Example E in the BEPS Action 6 2015 Final Report (page 61), which is stated to satisfy the exception in the second limb. However, there's one important difference in the facts: XCO sells the extra 1% shortly after the dividend is received. Does that make a difference to the analysis, particularly as Example E refers to "a taxpayer who genuinely increases its participation in a company in order to satisfy [the 25% requirement]"?
5. On balance, I think XCO should still fall within the scope of Example E. Although it presumably had a plan (at the time it acquired the 1%) to sell the 1% shortly after the dividend receipt, it did not enter into any form of forward sale or put option transaction to remove its risk – at the time of dividend receipt, it was fully exposed to the ownership risks of the 1%. Also, the fact that X and Y chose not to apply Art. 8(1) (MLI), arguably indicates their acceptance of such "bed and breakfast" strategies.
6. Final point: should the examples in the Action 6 Report influence the interpretation of the PPT? I will leave that issue for a later time!

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