ITB International Tax Bytes by Steve Towers

"International tax news, explained"

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20 December 2019

HAPPY FRIDAY!

They should have put **Baby Yoda** in the **Skywalker film!**

Meanwhile, **Chip** widens and narrows; **Pascal** sets out a plan; **Boris** is bullish; but **Greta** is lost in translation!

Australia gives new meaning to **Google Pay**; **New Zealand** takes sides with leases; **Sweden** slips a **DISC**; **Germany** rules on **lonely PEs**; but don't buy foreign currency in **Argentina!**

Broadcom wins in **Israel**; services are free in **France**; the ECJ sets priorities in **Belgium**; and **Italy** is full of **sardines!**

But at the end of the week, we're left with this question: if you fall out of a boat and into a **North African river**, are you **in denial?**

Merry Christmas and Happy New Year!
Steve

Curious about ITB? Watch this video!

#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 and other global developments
3. Asia Pacific
   - Australia, India, Indonesia, Japan, Malaysia, New Zealand, Singapore
4. Europe
   - Denmark, ECJ, EU, France, Germany, Italy, Serbia, Sweden, Switzerland, UK
5. Africa
   - Algeria
6. Middle East & Central Asia
   - Israel, Qatar
7. Americas
   - Argentina, Brazil, Canada, US
8. Treaties
9. Worth reading

WORTH READING

Gary Lambert, Amanda Pletz and Georg Dettmann
"Implicit Support and Its Implications on Guarantee Fee Pricing: Fact or Fiction"
Intertax, Kluwer, Volume 47 (2019), Issue 12 (subscription service)

George Salis
"It's Time to Update the Laffer Curve for the 21st Century"
Tax Notes Today International, Tax Analysts, 13 December 2019 (subscription service)

Guillermo Teijeiro and Juan Manuel Vázquez
"Taxation of the Ride-Sharing Economy: Source Taxation through Service Permanent Establishment Provisions Revisited – The Case under the Argentine Treaty Network"
Bulletin for International Taxation, IBFD, 2019 (Volume 73), No. 12 (subscription service)

INTERNATIONAL TAX QUIZ

XCO is a company resident in country X.

XCO owns 100% of the shares in YCO, a company resident in country Y.

XCO has made an interest-bearing loan to YCO.

Country Y tax law includes a thin capitalisation rule, which uses a 2:1 related party debt to equity limit. XCO's loan to YCO exceeds that 2:1 limit. Accordingly, under the thin capitalisation rule, the interest on the excess amount of loan is disallowed as a deduction for YCO, and it is treated as a dividend for country Y tax purposes.

Country Y levies a 25% withholding tax on outbound dividends, but outbound interest is tax-exempt.

The X/Y double tax treaty is identical to the 2014 OECD model treaty.

Based on these facts, what is the tax treatment of each of XCO and YCO in countries X and Y?

Answer in next ITB email alert on 10 January 2020!

Last week's question & solution

ACO is a company resident in country A.

3 years ago, ACO purchased, from an unrelated 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.

Several other parties own "special securities" issued by Entity B.

During the last 3 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, no entity characterisation rules, and no instrument characterisation rules. Partnerships are tax-transparent. 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?

This question raises 2 characterisation issues: (1) what is the characterisation of Entity B?; and (2) what is the characterisation of the "special security"?

Regarding (1):

As country A law recognises only 3 legal forms (individuals, companies and partnerships), it is necessary to characterise Entity B as one of those 3 forms. In the absence of specific rules, most countries adopt a so-called "similarity approach" – i.e., identify the rights and obligations of the foreign entity under the law where it is formed, and then (based on those rights and obligations) identify the local country legal form which it most closely resembles (see: OECD Report: "The Application of the OECD Model Tax Convention to Partnerships", 1999).

Based on this approach, Entity B would be characterised as either a company or a partnership for country A tax law purposes.

Regarding (2):

As country A tax law has no instrument characterisation rules, a "similarity approach" would probably also be used: based on the rights and obligations of the "special security" under country B law, what characterisation would be given to the "special security"?

The 2 likely alternatives are: an ownership interest (either shares in a company or a partner's interest in a partnership) or a debt interest.

Thus:

The possibilities are: (a) company + shares (no country A tax); (b) company + debt (country A tax on payments received, on basis that they are "interest"); and (c) partnership (country A tax on Entity B's profits; possibly 2 taxable items, if "special security" is characterised as debt).

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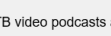

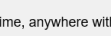

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