ITB International Tax Bytes by Steve Towers

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HAPPY FRIDAY!

Fowler dives and wins, but **cricketers** have to appeal for treaty benefits; **Denmark** banks on a new procedure, but there's still **collateral damage**; the **Netherlands** is perpetually deductible; and the **European Court of Justice** reminds the **UK** why it wanted **Brexit** in the first place!

Names don't matter in the **US**; **Saudi Arabia** transitions; **Coca-Cola** tastes better in **Kenya**; **ATMs** deposit success in the **UK**; **content** is not king in **India**; and **France & Germany** get very close, but still practise social distancing!

But at the end of another **WFH** week, the most important question is this: **when you're no longer required to WFH, will you still choose to do so?**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Fowler's case
2. Asia Pacific
    - Australia, Cambodia, India, Indonesia, Philippines, Thailand
3. Europe
    - Denmark, ECJ, EU, France, Netherlands, Norway, UK
4. Africa
    - Kenya, Nigeria
5. Middle East & Central Asia
    - Bahrain, Saudi Arabia
6. Americas
    - Costa Rica, Mexico, US
7. Worth reading

WORTH READING

Reuven S. Avi-Yonah
"COVID-19 and US Tax Policy: What Needs to Change?"
www.ssrn.com (free service)

Markus Greinert, Susann Karnath and Theresa Siebing
"Germany's License Barrier Rule and its Application of the Nexus Approach for Preferential Tax Regimes"
Tax Notes Today International, Tax Analysts, 7 May 2020 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, carries on a business of manufacturing and selling electronic devices. XCo is considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs and tax incentives.

After a review, XCo identifies possible locations in 3 different countries. Each of those locations would provide low manufacturing costs and a tax holiday for 10 years. All 3 countries provide similar economic and political environments. And all 3 countries impose 20% dividend withholding tax on outbound dividends, even though the profits of the dividend-paying company are exempt under the tax holiday.

The only material difference between the 3 countries is that country Y has entered into a double tax treaty with X, and the other 2 countries have not. The X/Y treaty is identical to the 2017 OECD model treaty.

Based on that material difference, XCo decides that Y will be the location for the new manufacturing plant. XCo therefore forms a 100% Y-resident subsidiary (YCo) and it subscribes for significant share capital in YCo (due to the tax holiday in Y, XCo structures its funding of YCo in the form of 100% equity). YCo has no other funding. YCo builds and operates the plant. Some years later, YCo pays dividends to XCo. Under X domestic law, resident companies are taxable on global profits; however, the dividends received from YCo are tax-exempt under a participation exemption.

Q1: Under the X/Y treaty, what rate of dividend withholding tax is Y permitted to levy on YCo's dividends which are paid to XCo?
Q2: Does the X/Y treaty permit the X tax authorities to deny all or part of the exemption for XCo's dividend income?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo (a company resident in A) and BCo (a company resident in B) are sister subsidiaries in the global XYZ group.

ACo is the group's in-house finance company and BCo carries on a manufacturing business.

ACo lends money to BCo at an interest rate of 4% per annum.

The B tax authorities determine that the arm's length interest rate is 3% p.a. (please assume that that is the correct determination).

Under B domestic law, a final withholding tax of 20% (on gross) is levied on outbound payments of dividends, interest and royalties. The corporate income tax rate in B is 25%.

The A/B treaty is identical to the 2014 OECD model treaty.

What actions does the treaty permit the B tax authorities to take in regard to the 1% of excessive interest?

LAST WEEK'S ANSWER

- BCo's interest deduction:
    - Art. 9(1) permits the B tax authorities to use domestic law TP rules to disallow a deduction for the 1% excessive interest.
- ACo's interest income:
    - Art. 11(6) applies to the 1% excessive interest – with three effects: (i) Art. 11(2) 10% limit on B tax does not apply to the 1%; (ii) the 1% "shall remain taxable according to the laws of each Contracting State"; and (iii) "due regard being had to the other provisions of this Convention".
    - Effect (ii) indicates that the 1% would be subject to 20% B tax.
    - However, what is the impact of effect (iii)? Unless the B tax authorities make a secondary adjustment (see below), it seems that Art. 7(1) should apply to the 1% - in which case, the 1% would be exempt from B tax (assuming that ACo does not have a PE in B).
- Secondary adjustment:
    - According to the OECD Comm., Art. 9 does not prevent B from applying a secondary adjustment, if permitted to do so under its tax law.
    - 2017 OECD TPG, paras. 4.68 – 4.78: A secondary adjustment might take the form of a deemed dividend (which would trigger dividend withholding tax) or a deemed loan to ACo (with deemed arm's length interest). If a deemed dividend, then the fact that ACo and BCo are sister subsidiaries might cause hypothetical dividends and capital contributions up and down the ownership chain. Alternatively, the B law might allow ACo a time period in which to repay the cash to BCo.

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