ITB International Tax Bytes by Steve Towers

"International tax news, explained"

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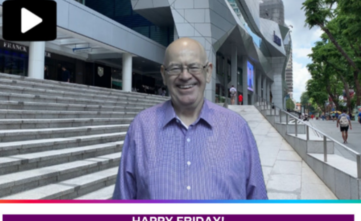

HAPPY FRIDAY!

The **OECD** drops its **C**, while the **UN** creates a **B**!

Meanwhile…**Australia** is indiscriminate; **Myanmar** offsets; **Korea** extends; **Amazon** charges; but **India** invoices!

Russia gives **Cyprus** a **red card** (or is it really just **yellow?**); the **Philippines** seeks to create; **Angola** changes; **Costa Rica** delays; while the **US** plays the "national security" card against its long-time enemy, **Canada**!

But at the end of another long COVID-19 week, the most important question is this: **"After several months of WFH, are you still baking bread?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Digital taxation
2. Trade & other global tax developments
3. Asia Pacific
   - Australia, China, India, Korea, Malaysia, Myanmar, Philippines, Singapore
4. Europe
   - EU, France / Italy, France, Russia, Spain, UK
5. Africa
   - Angola, Kenya, South Africa, Uganda
6. Americas
   - Costa Rica, US
7. Treaties
8. Worth reading

WORTH READING

Jeffery M. Kadet
"BEPS Primer: Past, Present, and Future (Part 2)"
Tax Notes Today International, Tax Analysts, 28 July 2020 (subscription service)

João Félix Pinto Nogueira
"GloBe and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market"
World Tax Journal, IBFD, 2020 (Volume 12), No. 3 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company incorporated in X, is a buy-sell distributor of motor vehicle spare parts. XCo buys the spare parts from several third party suppliers and sells them to repair shops in X. XCo's annual sales revenue from this activity is $50 million.

XCo also acts as a contract-concluding sales agent for 2 non-resident motor vehicle spare parts suppliers. The 2 suppliers are resident in Y and Z, respectively. YCo, the supplier resident in Y, is a member of the same multinational group as XCo. ZCo, the supplier resident in Z, is a third party. XCo enters into sales contracts, on behalf of YCo and ZCo (respectively), with repair shops in X. The annual sales revenue from this activity is $5 million (i.e., this is the aggregate of YCo's and ZCo's revenue from sales concluded by XCo). 95% of that sales revenue is on behalf of YCo, with 5% on behalf of ZCo. XCo is paid a sales commission by each of YCo and ZCo.

XCo's agency contracts require it to also perform another service for each of YCo and ZCo – it is required to identify new business opportunities in X for those 2 suppliers. This service, which is not commonly performed by similar agents in X, is not separately remunerated by YCo or ZCo (i.e., it's covered by the sales commissions) – and, for that reason, XCo spends only a minor amount of time in performing this service.

The X/Y treaty and the X/Z treaty are both identical to the 2017 OECD model treaty.

Does YCo have a PE in X? Does ZCo have a PE in X?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo, a company resident in A, owns a patent which is registered in B.

BCo, a company resident in B, wants to use that patent to manufacture certain goods in B.

ACo and BCo are related parties.

ACo sells the patent to BCo, in consideration for an annual fee which is set at 5% of BCo's annual gross revenue from the sale of the goods manufactured by using the patent. The contractual obligation to pay the annual fee is for 10 years. The sale contract calls the annual fee a "royalty".

Under B tax law:

- BCo is able to claim tax depreciation on the 10 years aggregate of the annual fee (which is initially estimated, and then "trued up" each year)
- Outbound royalties are subject to 20% royalty withholding tax on gross (final tax)

The A/B treaty is identical to the 2017 OECD model treaty, except that the source country tax on outbound royalties is limited by Art. 12 to 10% on gross.

ACo is (and is expected to remain) in an excess foreign tax credit position in A, which means that it cannot obtain an effective credit for the B withholding tax.

Does the A/B treaty permit B to impose tax on the annual fee payments?

LAST WEEK'S ANSWER

1. Art. 12
   i. The key issue is whether the annual fee payments fall within the definition of "royalties" in Art. 12(2): "consideration for the use of, or the right to use, any…patent"
   ii. The answer is no. The annual fee payments are consideration for the acquisition of the patent, not for its use: see OECD Comm., para. 8.2 (first sentence). The form of consideration (i.e., a percentage of annual sales revenue for 10 years) and the name given to the consideration (i.e., "royalties") are irrelevant.
   iii. Note, however, that some bilateral and model treaties include in the definition of "royalties" in Art. 12, gains on the disposal of IP where the consideration is contingent on the use of the IP – for example, see the 2006 US model treaty.
2. Art. 13
   i. The gain derived by ACo on the sale of the patent should be exempt from B tax under Art. 13(5) – subject to Art. 29(9) (see below). The fact that the patent is registered in B is irrelevant.
   ii. If Art. 12 applies (see 1(iii) above), then an interesting conflict would arise between Art. 12 (which would allow B tax of 10% on the gross annual fee payments) and Art. 13(5) (which would exempt the gain from B tax).
3. Art. 11
   It is conceivable that B domestic law "carves out" implicit interest from the series of annual fee payments – despite the fact that the quantum of each annual fee payment is uncertain at the start. If it does so, the B tax authorities might claim that that interest is taxable in accordance with Art. 11. The OECD Comm. probably supports that approach: see "conflicts of qualification" in regard to Art. 23A/B.
4. Art. 29(9)
   i. Based on the facts (in particular, that ACo is in an excess foreign tax credit position), it is conceivable that Art. 29(9) (the PPT) could be triggered by this transaction.
   ii. Art. 29(9) would probably not apply if there were merely a "plain vanilla" sale of the patent to BCo for a lump sum price – it's the contingent consideration which makes the transaction unusual and therefore raises the risk that, viewed objectively, the avoidance of B withholding tax under Art. 12 is seen to be a dominant purpose. Nevertheless, no B tax advantage seems to be achieved from structuring the consideration in contingent form, rather than a lump sum.
   iii. On balance, IMHO: Art. 29(9) should not apply.

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