ITB International Tax Bytes by Steve Towers

"International tax news, explained"

2 October 2020

HIGHLIGHTS

- **Pillar Two: Subject to Tax Rule – detailed analysis**
- **Vodafone's win**
- **US denies credits for DSTs and other "unilateral" taxes**

HAPPY FRIDAY!

Chris Wallace needs a mute button; **Subway** serves sweetbreads; and mushrooms kidnap people in Russia!

Meanwhile, in the tax world…

The **OECD** starts moving goalposts, but **Vodafone** scores a goal; **Australia** advises purposefully; the **US** discredits foreign taxes; **Denmark** is remote; the **Netherlands** is embarrassed; and **notional interest** gets an **STTR** nod!

But the most important question asked this week was this: **"Will you shut up, man?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Pillar Two: Subject to Tax Rule
2. Asia Pacific
   - Australia, India
3. Europe
   - Denmark, ECJ, EU, Netherlands
4. Americas
   - US
5. Treaties

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company incorporated and resident in X, owns 100% of the shares in YCo, a company incorporated and resident in Y.

XCo makes a loan (with an arm's length interest rate) to YCo.

YCo uses the borrowed money in its business in Y.

YCo fails to deduct and remit withholding tax from the interest it pays to XCo.

As a result of the non-payment of withholding tax, the Y tax authorities (acting in accordance with the Y tax law): (i) impose penalties on XCo and YCo; and (ii) deny an income tax deduction to YCo for the interest payments.

Under Y law, no withholding tax is imposed on interest payments to resident lenders.

The X/Y treaty is identical to the 2017 OECD model treaty.

Are the 2 actions taken by the Y tax authorities, permitted under the treaty?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo, a company resident in A, owns 100% of the shares in BCo, a company resident in B.

BCo owns land in B, with a market value equal to 35% of the aggregate market value of all of BCo's assets.

In September 2020, ACo sold all its shares in BCo to CCo (an unrelated company resident in C).

The A/B treaty, which was signed and entered into force in 2012, is identical to the 2010 OECD model treaty.

The MLI, which applies to the A/B treaty, entered into effect, for both A and B, on 1 January 2020.

Both A and B: (i) reserved against Art. 9(1)&(4) for all covered tax agreements ("CTAs"); but (ii) did not reserve against Art. 11(1) for any CTAs.

In early 2020, B changed its tax law, in regard to the imposition of capital gains tax on sales of shares in "land-rich" companies. Prior law applied a "more than 50%" valuation threshold – i.e., the value of land in B had to be more than 50% of the aggregate value of the company's assets. There were 2 changes : (i) the valuation threshold was reduced to "more than 25%"; and (ii) the tax liability was removed from the seller and imposed on the "land-rich" company. These changes are effective for sales after 30 June 2020.

Does the treaty permit B to levy tax in regard to ACo's sale of shares in BCo?

LAST WEEK'S ANSWER

Art. 11(1), MLI

Art. 11(1), MLI effectively adds, to the A/B treaty, the so-called "saving clause" in Art. 1(3) of the 2017 OECD model treaty.

Subject to one qualification, this would mean that B's taxing rights in regard to BCo are unrestricted by the A/B treaty.

As the B tax liability in regard to ACo's sale of shares in BCo is imposed on BCo (and not ACo), this would indicate that the treaty would not impact that liability.

However, a possible argument under the Vienna Convention on the Law of Treaties (VCLT) should be considered (see below).

The possible qualification concerns Art. 24(5), which is effectively included in an exception in Art. 11(1), MLI. Art. 24(5) could be relevant if the B tax law imposed the tax liability on "land-rich" companies only if their share capital is wholly or partly owned or controlled by non-residents. I will assume that that is not the case here.

VCLT

Despite that assumption, it is possible to view the B law change as a device to avoid the application of Art. 13(5), which would give the exclusive tax right to A.

That would likely breach Arts. 26 & 27, VCLT.

Depending on the status of legislation in B vs. treaty obligations, a court in B might conclude that the breach is sufficient to not enforce the tax liability against BCo. It could possibly do so by interpreting the B tax law change as not applying in situations where B's treaty obligations would be avoided (on the basis that, if the B parliament had intended to avoid the treaty obligations, it would have expressed that intention clearly).

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