International Tax Bytes *by Steve Towers*

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30 October 2020

HIGHLIGHTS

- **Pillar Two detailed analysis: GloBE rules – carry-forwards**
- **Netherlands: Köln-Aktienfonds Deka case (EU free movement of capital)**

HAPPY FRIDAY!

Anonymous unmasks (and it's not **Kellyanne**!)

Meanwhile, in the tax world…

Pascal issues a wake-up call; **Boris** gets at least one trade agreement signed; the **Netherlands** refunds (or does it?); **Cambodia** delays; **Finland** finally loses; while the **EU** considers major VAT surgery!

But at the end of the week, the most important question is this: **"If Joe Biden wins next week's election, will the US be more or less likely to support Pillar One?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Global developments
2. Pillar Two: GloBE Rules – Carry-forwards
3. Asia Pacific
    - Cambodia, Korea, Singapore
4. Europe
    - ECJ, Finland, Netherlands
5. Treaties

WORTH READING

Mukesh Butani and Tarun Jain
"India's Dividend Distribution Tax: An Anomaly Outside the Treaties!"
Kluwer International Tax Blog, 23 October 2020 (freely available)

Adolfo Martín Jiménez
"The Apple Case: Who Wins? What's Next?"
Intertax, Kluwer, 2020 (Volume 48), Issue 11 (subscription service)

INTERNATIONAL TAX QUIZ

ACo, a company resident in A, is the parent of an MNE group.

Some years ago, ACo formed a new 100% subsidiary, BCo, in B. ACo injected substantial share capital into BCo.

B has a relatively low corporate income tax rate and a wide treaty network.

Since its formation, BCo has had 1 employee (a bookkeeper) and 2 non-executive directors (supplied by a corporate secretarial firm in B).

Shortly after B's formation, ACo and BCo entered into a cost contribution arrangement (CCA) to undertake R&D in regard to pharmaceuticals. Under the CCA:

- All R&D is performed by ACo's R&D centre in A
- BCo's obligation is to partially fund that R&D activity
- The 2 companies will share the output from the R&D activity (i.e., patent rights for specific geographical areas) proportionate to their relative contributions (cash and R&D activity)

The R&D activity has led to the registration of several patents. In accordance with the CCA, ACo granted to BCo an exclusive, royalty-free licence of those patents for their legal life.

BCo has licensed those patents, for arm's length royalties, to several related companies – including CCo, a related operating company resident in C.

Following a recent tax audit, the A tax authorities have issued assessments to ACo which include in ACo's taxable income the royalties received by BCo - on the basis that BCo is not a valid participant in the CCA, under the OECD TPG, and that all of the DEMPE functions are performed by ACo.

The B/C treaty is identical to the 2017 OECD model treaty. There is no A/B treaty and no A/C treaty.

Under domestic law, C levies a 20% withholding tax on outbound royalties.

Is C permitted to levy tax on the royalties paid by CCo to BCo?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo (a bank resident in A) enters into equity swaps with individual customers resident in C. The swaps track a portfolio of shares in companies resident in B (BCos), and cash balances held by the customers.

As a hedge, ACo purchases the share portfolio tracked in the swaps.

The swaps exchange the ownership economics of the share portfolio (e.g., dividends, price changes) and the cash balances (e.g., interest). A single payment is made under each swap (either from ACo to the customers, or vice versa) at every quarter end, calculated according to a formula. There is no contractual right to the components in the formula.

Each swap's "force majeure" clause does not cover the failure of BCos to pay dividends which have been declared (other than by virtue of B government action).

A and B each impose a 20% withholding tax on outbound dividends.

The A/B treaty (which was signed and entered into force in 2011), is identical to the 2010 OECD model, except that there is a single rate of 10% in Art. 10(2).

The A/C treaty is identical to the 2001 UN model, except that there is a single rate of 10% in Art. 10(2).

The MLI (including Art. 7(1)) applies to both treaties.

There is no B/C treaty.

Q1: Does the A/B treaty permit B tax on dividends paid to ACo?
Q2: Does the A/C treaty permit A tax on swap payments made by ACo?

LAST WEEK'S ANSWER

Q1

First issue: beneficial ownership

IMHO, the "contractual or legal obligation" requirement (in the 2014 OECD Comm. on beneficial ownership) should not apply to the A/B treaty, because it represents a change in meaning and not a mere elaboration on the previous meaning.

That previous meaning (reflected in the 2010 OECD Comm.) focuses on whether, in the present case, ACo is a conduit company acting as a fiduciary or administrator. The fact that there is no contractual right to the components in the payment formula, that only a single quarterly payment is made (in either direction), and that the payment reflects multiple elements besides dividends, suggests that ACo is the beneficial owner. However, note that the Swiss Supreme Court reached the opposite conclusion in a 2015 case.

On balance, IMHO, ACo is the beneficial owner.

Second issue: PPT

Based on the facts, the PPT would likely be triggered – this would cause the dividends to be subject to 20% B withholding tax.

Q2

Unless the A law deems equity swap payments to be dividends, Art. 10 should not apply.

Art. 21(3) might apply, if the individual customers are not carrying on "enterprises" , and thus Art. 7 does not apply. If Art. 21(3) applies, A can impose unlimited tax on the swap payments.

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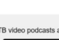

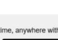

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