ITB International Tax Bytes by Steve Towers

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6 November 2020

HIGHLIGHTS

- **Pillar Two detailed analysis: GloBE rules – carve-out, and computation of the ETR and top-up tax**
- **Cases: Denmark, ECJ, France, Ireland**

HAPPY FRIDAY!

Ant is bitten, a **Dutch** tram is saved by a whale's tale, but the **US** still counts!

Singapore remits; **India** equalises; **Denmark** is not disposed; **France** is 2 days late; **Perrigo** expected something different; **Spain** trims; **Argentina** changes knowledge; while **Australia** and **Canada** object!

But at the end of the week, the most important question is this:**"If President Trump loses the election, will he run again in 2024?"**

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: GloBE Rules – Carve-out, and computation of the ETR and top-up tax
2. Asia Pacific
   - India, Indonesia, Singapore
3. Europe
   - Cyprus, Denmark, ECJ, Finland, France, Ireland, Italy, Spain
4. Americas
   - Argentina, US
5. Treaties
6. Worth reading

WORTH READING

Kruthika Prakash
"Permanent Establishments under the OECD Model (2017) Based on the Principal Role Leading to the Conclusion of Contracts – A Doctrinal and Policy Analysis"
Bulletin for International Taxation, IBFD, 2020 (Volume 74), No. 11 (subscription service)

Philippe Gamito and Gabrielle Galdino-Gläser
"Insurance and Financial Services VAT: Will a Reform Emerge by the End of 2021?"
Kluwer International Tax Blog, 3 November 2020 (freely available)

INTERNATIONAL TAX QUIZ

The X/Y treaty, which is identical to the 2010 OECD model, was signed and entered into force in 2011.

In 2012, Y changed its domestic law definition of "permanent establishment" to be identical to Art. 5 in the 2010 OECD model.

In 2019, Y changed its domestic law to introduce a provision which deems a non-resident to be carrying on business through a fixed place of business in Y, if the non-resident satisfies a "significant economic presence" (SEP) test. If that deeming provision applies to a non-resident, the non-resident therefore satisfies the domestic law definition of PE and is subject to Y income tax (on a net basis) on income which is derived from that SEP.

XCo, a company resident in X, derives income from online streaming services which are provided to Y residents. Although XCo has no assets or employees in Y, it satisfies the SEP test, and is therefore subject to Y income tax under domestic law.

Is XCo's Y income tax liability permitted under the X/Y treaty?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

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

Some years ago, ACo formed a 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 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 BCo's geographical area) 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 an amount equal to 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 A/B, B/C & A/C treaties are identical to the 2017 OECD model treaty – the rate in Art. 12 is 0% in the B/C treaty, and 10% in the other two treaties.

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?

LAST WEEK'S ANSWER

Relevance of A tax authorities' TP adjustment to ACo

The TP adjustment to ACo is irrelevant to the treatment of royalties under the B/C treaty: see OECD TPG, para. 6.13.

Beneficial owner (B/O) status

Even if the TP analysis in regard to ACo is that there is a deemed service fee which is paid by BCo to ACo, that deemed payment would not cause BCo to fail the B/O conditions in the OECD Comm.

IMHO, BCo is the B/O of the royalties.

Nevertheless, some tax authorities in the position of C (e.g., China) have taken the position that, if BCo does not perform the DEMPE functions, it is not entitled to the treaty benefit for royalties. As mentioned above, that view is not supported by the OECD TPG.

PPT (Art. 29(9))

Based on the facts (in particular, the differential royalty withholding tax rates), it is possible that the PPT might be triggered by the ACo / BCo arrangement. Even though CCo is not the only company to which BCo licenses the patents, the PPT might apply if it can be shown that a reduction in the royalty withholding tax rate was a principal purpose for BCo licensing the patents to those companies, instead of ACo.

If the PPT is triggered, 20% C withholding tax would apply.

In that case, economic / juridical triple taxation would likely occur between the 3 countries (B might not grant a foreign tax credit for the C 20% withholding tax, on the basis that BCo qualifies for the 0% treaty rate). That might possibly be resolved under a tripartite MAP.

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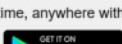

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