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ITB International Tax Bytes *by Steve Towers*

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20 November 2020

HIGHLIGHTS

- **Pillar Two detailed analysis: GloBE rules – Switch-Over Rule, and Undertaxed Payments Rule (Part 1)**
- **Coca-Cola TP case**

ITB series on GloBE rules

- **Scope – ITB (9 Oct 2020)**
- **Calculating the ETR (Part 1) – ITB (16 Oct 2020)**
- **Calculating the ETR (Part 2) – ITB (23 Oct 2020)**
- **Carry-forwards – ITB (30 Oct 2020)**
- **Carve-out, and computation of the ETR and top-up tax – ITB (6 Nov 2020)**
- **Income Inclusion Rule – ITB (13 Nov 2020)**
- **Switch-Over Rule, and Undertaxed Payments Rule (Part 1) (20 Nov 2020)**

HAPPY FRIDAY!

Some folks complain about anything…**"The Rockefeller Christmas tree is bald"! So what's wrong with bald?**

Meanwhile, in the tax world

RCEP flexes its biceps; **IFA** talks; **India** misses the boat; there's no cigar for **5th Avenue**; the **UK** invents a new PPT; **Coca-Cola** goes flat; **Mexico** outsources common sense; **Kenya** holds all the cards; and **ITB** is 100 not out!

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Trade & other global developments
2. Pillar Two: GloBE Rules – Switch-Over Rule, and Undertaxed Payments Rule (Part 1)
3. Asia Pacific
   - India, Indonesia
4. Europe
   - Denmark, ECJ, Italy, Turkey, UK
5. Africa
   - Kenya, South Africa
6. Americas
   - Mexico, US

WORTH READING

Richard S. Collier and Ian F. Dykes
"The Virus in the ALP: Critique of the Transfer Pricing Guidance on Risk and Capital in the Light of the COVID-19 Pandemic"
Bulletin for International Taxation, IBFD, 2020 (Volume 74), No. 12 (subscription service)

Jeroen J. M. Janssen and Mónica Sada Garibay
"What Should Be the Scope of the Beneficial Owner Concept?"
Intertax, Kluwer, 2020 (Volume 48), Issue 12 (subscription service)

INTERNATIONAL TAX QUIZ

ACo (a company resident in A) carries on a business of collecting, organising and maintaining various databases, to which it sells access.

ACo has 2 clients in B.

The first client (BCo 1) pays a fee to ACo to access its various databases.

The second client (BCo 2) pays a fee to ACo for ACo to create a specialised database customised for BCo 2's use only. Some of the information in the database is provided by BCo 2, and the remainder is collected by ACo.

The A/B treaty is identical to the 2017 UN model treaty.

ACo has no tangible assets, employees or agents in B.

Does the A/B treaty permit B to levy income tax on the fees paid by BCo 1 and BCo 2 to ACo?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

The A/B treaty, which was signed and entered into force in 2005, is identical to the 2001 UN model treaty, with the rate specified in Art. 12(2) being 10%. A 10% rate is used in the royalties article in most of A's double tax treaties.

At the time the treaty was signed, A domestic law did not levy a withholding tax on outbound payments of equipment rentals, although it did levy a 15% withholding tax on all other outbound payments described in the definition of "royalties" in Art. 12(3) of the UN model.

In 2010, A changed its domestic law to levy a 10% withholding tax on outbound payments of equipment rentals which are paid to residents of jurisdictions with which A has a comprehensive double tax treaty - that would include residents of B. However, under A domestic law, the withholding tax does not apply to outbound payments of equipment rentals to recipients which are not resident in such jurisdictions.

In other words, a non-treaty resident is exempt from the withholding tax on equipment rentals.

BCo (a company resident in B) has leased an item of equipment to a resident of A, for use in A.

Does the A/B treaty permit the 10% withholding tax to apply to the equipment rentals which are paid to BCo?

LAST WEEK'S ANSWER

1. Non-discrimination

   A's withholding tax discriminates against residents of treaty countries, in favour of residents of non-treaty countries. However, none of the paragraphs in Art. 24 applies to this situation. In particular, it should be noted that Art. 24 is not a "most favoured nation" provision.

   Thus, A's withholding tax on equipment rentals does not breach Art. 24.

2. General principle that treaties cannot increase tax liabilities

   Some people assert that there is a general principle that double tax treaties cannot increase tax liabilities.

   It is arguable whether there is such a general principle. However, even if there is, there is no breach of that principle here: A's withholding tax on BCo is levied by the A domestic law, not by the A/B treaty.

3. "Good faith" under Art. 26, Vienna Convention on the Law of Treaties

   Art. 26 requires the parties to a treaty to perform it "in good faith".

   Does A's withholding tax on residents of treaty countries, but not on residents of non-treaty countries, breach Art. 26?

   IMHO: No – The A/B treaty permits A to levy a tax of up to 10% on residents of B in receipt of equipment rentals, and that is exactly what A's domestic law has done. The treaty has been performed in good faith.

4. Example and policy

   Korea provides a good example of this type of withholding tax which discriminates against residents of treaty countries, in favour of non-treaty countries.

   The policy for such a tax is this: the A/B treaty is the result of "horse-trading" by both countries. A's rights under the treaty were obtained by A for the "price" of it relinquishing some tax rights to B. Having so "purchased" its treaty rights, it would be foolish for A not to levy taxes up to those treaty rights.

   In contrast, with a non-treaty country, there is no "purchase" element.

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