ITB International Tax Bytes
by Steve Towers

"International tax news, explained"

4 December 2020

HIGHLIGHTS

- **Royal Bank of Canada case:** payments received by bank, in satisfaction of interest and principal – Art. 6?
- **Digital taxation:** latest developments
- **Pillar Two detailed analysis:** GloBE rules – Associates, joint ventures and orphan entities; and Simplification options

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 (6 Nov 2020)
- Income Inclusion Rule – ITB (13 Nov 2020)
- Switch-Over Rule, and Undertaxed Payments Rule (Part 1) – ITB (20 Nov 2020)
- Undertaxed Payments Rule (Part 2) – ITB (27 Nov 2020)
- Associates, joint ventures and orphan entities; and Simplification options – ITB (4 Dec 2020)

HAPPY FRIDAY!

Atlas loses his way; **kimchi** ferments a feud; and **BTS** has dynamite, but no soldiers!

Meanwhile, in the tax world…

Canada goes digital; **China** stops drinking **Australian** wine; the **UKFTT** loses perspective; **Hong Kong** singles out commercial property; the **Philippines** creates history; **Kokott** rejects; **Ukraine** limits royalties; while **Skandia** branches out in **France**!

But at the end of the week, the most important question is this: **"Has the Grünten statue moved to Utah?"**

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 & trade
2. Royal Bank of Canada case
3. Pillar Two: GloBE Rules – Associates, joint ventures and orphan entities; and Simplification options
4. Asia Pacific
   - Australia, Hong Kong, Philippines
5. Europe
   - EU, EU State aid, France, Ukraine
6. Americas
   - US
7. Treaties

WORTH READING

Raffaele Petruzzi and Argyro Myzithra
"Substance in Transfer Pricing in a Post-BEPS World and Beyond…"
International Transfer Pricing Journal, IBFD, 2020 (Volume 27), No. 6

INTERNATIONAL TAX QUIZ

ACo, a company resident in A, has manufacturing and trading branches in a number of other countries.

ACo, through its branch in B, owns inventory (goods) and fixed assets.

Those goods and fixed assets are physically transferred to ACo's branch in C.

Both the goods and the fixed assets have an arm's length value which exceeds their cost.

The A/B treaty, the A/C treaty and the B/C treaty are identical to the 2017 OECD model treaty.

Under those treaties, is B permitted to levy income tax on ACo in regard to the 2 physical transfers?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

XCo (a company resident in X) makes a loan to YCo (an unrelated company resident in Y).

YCo uses the borrowed money to acquire commercial real estate (in Y), from which it receives rent under a long-term lease to ZCo (another unrelated company resident in Y).

YCo gets into financial difficulties – it defaults on some interest payments and principal repayments.

YCo assigns to XCo its right to receive rent under the lease, in satisfaction of its obligations to make overdue and future interest payments and principal repayments. Please assume that the assignment is legally effective.

The X/Y treaty is identical to the 2010 OECD model treaty, except that Art. 11 provides an exemption from source country tax on interest (provided the conditions in Art. 11 are satisfied).

Does the X/Y treaty permit Y to levy tax on the rent payments made by ZCo to XCo?

LAST WEEK'S ANSWER

Overdue interest

The assignment of the right to receive rent is, in part, in satisfaction for YCo's overdue interest payments and principal repayments.

It would need to be determined, under the law governing the loan, the extent to which the debt for the overdue interest payments has been satisfied. To that extent, the assignment should constitute a payment of interest from YCo to XCo, if the payment has not already arisen under the relevant law: see OECD Comm. on Art. 11. That interest payment should be exempt under Art. 11.

Future interest

The issue is the character of the payment by ZCo to XCo: is it "income from immovable property" (and therefore covered by Art. 6) or is it "interest" (and therefore covered by Art. 11)? This issue is critical, because Art. 6 allows unlimited Y tax, whereas Art. 11 provides an exemption from Y tax.

The OECD Comm. on Art. 6 states that Art. 6 applies "where, in the case of an enterprise, income is only indirectly derived from immovable property".

From the payer's (ZCo's) perspective, the payments are income from immovable property. However, from the recipient's (XCo's) perspective, the payments are interest.

There is very little authority on this issue. The UK First-tier Tribunal, in a similar 2020 case concerning the Royal Bank of Canada, reached a decision which effectively accepted that the Art. 6 characterisation prevailed. However, the tribunal's decision was not based on existing authority, and it did not focus on the characterisation issue: the parties in the case accepted that the Art. 6 characterisation prevailed.

If Art. 6 applies, there is an issue whether the amount of Y tax (under domestic law) is limited to the tax on the future interest, or whether it effectively also applies to the future principal repayments. Art. 6 itself would allow the full amount of rent to be taxed, without distinguishing between the "interest" component and the "principal" component.

Conclusion

I don't know the answer! While I'm sympathetic to XCo's position, both the OECD Comm. and the Royal Bank of Canada case suggest that Art. 6 might prevail. Banks beware!