"International tax news, explained"

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18 December 2020

HIGHLIGHTS

- **Landmark PE case (Valueclick): "contract-concluding agent" PE definition in France / Ireland treaty**
- **Latest developments on digital taxation**
- **Pillar Two detailed analysis: unresolved issues, interaction of GloBE rules with US GILTI regime, and likely impact of Pillar Two on hub jurisdictions**

ITB series on Pillar Two

1. **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) – 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)**
2. **Other topics**
    - **Subject to Tax Rule – ITB (2 Oct 2020)**
    - **Implementation and Rule Co-ordination – ITB (11 Dec 2020)**
    - **Unresolved issues, GILTI & hub jurisdictions – ITB (18 Dec 2020)**

HAPPY FRIDAY!

SolarWinds blows ill; **Macron** has too many lunches; and the **OECD** turns 60 (but is not retiring!)

Meanwhile, in the tax world…

Valueclick is too formal; **DSTs** get granular; everyone complains about **Pillars One & Two** (but has the ship sailed?); the **Netherlands** liquidates foreign losses; **China** caps and incentivises; **Spain** manufactures an establishment; while a **Bengal Tiger** finds relief!

But at the end of a traumatic year, there's only one thing to say: **"Merry Christmas! And a Happy Covid-free New Year!"**

Have a great weekend!
Steve

P.S. ITB will return on 8 January 2021

THIS WEEK'S PODCAST

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

1. Valueclick PE case
2. Digital taxation
3. Other global developments
4. Pillar Two: unresolved issues, GILTI & hub jurisdictions
5. Asia Pacific
    - Australia, China, India, Japan, Singapore
6. Europe
    - Netherlands, Spain
7. Treaties

WORTH READING

Massimo Bellini, Raffaele Iervolino and Maria Cristina Latino
"Transfer pricing valuation methodologies in times of economic downturn, differences between market and income approaches"
International Transfer Pricing Journal, IBFD, 2021 (Volume 28), No. 1 (subscription service)

Alfredo Guerrero Mackinlay and Carlos Wisniowski
"*BMW*: should the development costs for free software be added to the transaction value?"
Tax Notes Today International, Tax Analysts (17 December 2020) (subscription service)

INTERNATIONAL TAX QUIZ

ACo, a company resident in A, conducts a manufacturing business in A, using patents and knowhow which ACo owns.

ACo wants to sell its goods in the B market. However, due to the significant customs duties which would be imposed on imports into B, ACo is planning to start a manufacturing operation in B, with the finished goods being sold to consumers in B.

ACo would like your advice on whether the B manufacturing operation should be structured as a B-resident subsidiary of ACo or as a branch of ACo.

ACo has told you the following:

- ACo currently has significant tax losses in A. These losses are available for indefinite carry-forward.
- ACo plans to use its existing cash resources to finance the B manufacturing operation – i.e., no borrowing will be done.
- ACo wants to minimise B tax.
- ACo wants to retain, in A, the legal and economic ownership of its IP.
- The B market does not discriminate against branches of companies incorporated in A.

The B corporate income tax law levies the same tax rate (25%) on resident companies and branches of non-resident companies.

B does not impose tax on outbound dividends or on branch profit remittances. However, B imposes a 10% withholding tax on outbound interest and royalties.

The B tax law does not recognise intra-entity "transactions".

The A/B treaty is identical to the 2017 OECD model, except that Arts. 11 & 12 allow 10% source country tax (on gross payments) to be levied.

What is your advice?

Answer in next ITB email alert on 8 January 2021!

LAST WEEK'S QUESTION

Under the X domestic tax law, a resident company which makes income tax deductible payments to a related company which is resident in a designated low-tax jurisdiction, is subject to an adjustment. The adjustment is in the form of deemed income, calculated by a formula which has regard to the amount of deductible payments to the related company. The designation of a jurisdiction as low-tax is made annually in respect of a particular MNE Group, based on the effective tax rate (in that year) of the Group's members which are resident in that jurisdiction.

XCo, a company resident in X, makes income tax deductible payments to YCo, a company resident in Y. Both XCo and YCo are members of an MNE Group. For the relevant year, Y is designated as a low-tax jurisdiction in regard to the MNE Group. Accordingly, an amount of deemed income is included in XCo's taxable profits for that year.

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

Does the treaty permit the inclusion of the deemed income in XCo's taxable profits?

LAST WEEK'S ANSWER

This question raises issues under Art. 24 (non-discrimination). Although XCo is a resident of X, Art. 24 can apply to restrict X's taxation of XCo: Art. 1(3).

I should note that I'm assuming that the amount of the payments satisfy the arm's length principle.

If the X law operated to disallow XCo income tax deductions for the payments to YCo, then (IMHO) Art. 24(4) would likely be breached. The disallowance of the deductions would be because the payments are made to YCo, a resident of Y – and the deductions would not be disallowed if the recipient were not a resident of Y. That would seem to me to be a clear breach of Art. 24(4).

However, such a provision in the X tax law would be based on the undertaxed payments rule (UTPR) in Pillar Two, in the context where the adjustment is in the form of disallowance of deductions. The Pillar Two blueprint report surprisingly concludes that there would be no breach of Art. 24(4), because the disallowance is not based on the residence of the recipient (YCo), but instead on the designation of YCo's residence jurisdiction (Y) as low-tax. IMHO: that view has no basis in either the text of Art. 24(4) or the OECD Comm.

But, in our question, the form of the adjustment is deemed income, not disallowance of deductions. Does that make a difference? Art. 24(4) requires that "disbursements…shall, for the purpose of determining the taxable profits…, be deductible under the same conditions…". That would seem not to cover deemed income, although (in our question) the deemed income is calculated by a formula which has regard to the amount of deductible payments to the related company.

The link provided by that formula might be sufficient for a court in X to conclude, particularly having regard to the requirement of "good faith" in the Vienna Convention on the Law of Treaties, that the deemed income is a breach of Art. 24(4). However, on balance, I think that the deemed income form is probably sufficient to avoid the application of Art. 24(4).

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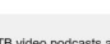

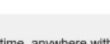

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