ITB International Tax Bytes by Steve Towers

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5 February 2021

HIGHLIGHTS

- **India's 2021 Budget**
- **Adams Challenge case: will a double tax treaty prevent the application of a domestic law rule which denies deductions for PEs if income tax returns are not filed on a timely basis?**
- **Continuation of in-depth analysis of Pillar One: Scope**

HAPPY FRIDAY!

Putin arrests half of Russia; **Myanmar's** military reverts to type; but **Jeff** is elevated!

Meanwhile, in the tax world...

Poland advertises a new tax; the **Philippines** finally creates; **Hong Kong** carries its interest; **Denmark** and **Luxembourg** cooperate; **Mauritius** provides partial guidance; **News Corp** goes offline; **Adams** loses its challenge; and **India** loses its goodwill!

But at the end of a troublesome week, the most important point to note is this: **all it takes is a coup for Suu Kyi's international popularity to increase!**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Indian Budget
2. PE Case: Adams Challenge
3. Pillar One: Scope (Part 3)
4. Asia Pacific
   - Hong Kong, Phillipines, Singapore
5. Europe
   - Denmark, EU, Luxembourg, Poland, UK
6. Africa
   - Mauritius
7. Treaties

ITB series on Pillar One

- **Scope (Part 1) – ITB (22 Jan 2021)**
- **Scope (Part 2) – ITB (29 Jan 2021)**
- **Scope (Part 3) – ITB (5 Feb 2021)**

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)**

WORTH READING

Jinyan Li
"The Legal Challenges of Creating a Global Tax Regime with the OECD Pillar One Blueprint"
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 2 (subscription service)

Reuven S. Avi-Yonah
"Is GILTI Constitutional?"
Tax Notes Today International, Tax Analysts, 27 January 2021 (subscription service)

Alexander Haller, Johannes Sultner and Leon Zimmermann
"Foreign-to-foreign licensing subject to withholding tax in Germany?"
Kluwer International Tax Blog (25 January 2021) (freely available)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

YCo, a company resident in Y, has been granted an oil & gas production licence by the Y government. The licence entitles YCo to produce oil & gas from a specific field in Y.

XCo, a company resident in X, has provided YCo with $50 million of finance, in return for annual payments (for 25 years) equal to 1.5% of the value of oil & gas YCo produces from the field. The finance is not in the form of a loan.

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

Does the X/Y treaty permit the Y tax authorities to levy income tax on the annual payments made by YCo to XCo?

Answer in next ITB email alert on 19 February 2021!

LAST WEEK'S QUESTION

ACo, a company resident in A, has conducted business with customers in B for 10 years.

ACo has always taken the position that it does not have a PE in B under the A/B treaty, and that therefore it is exempt from B tax on its profits. For that reason, ACo has never filed a B income tax return.

Following a recent tax audit, the B tax authorities have claimed that ACo has had a PE in B for all of the 10 years. The tax authorities have therefore issued a tax assessment to ACo (reflecting item (ii) below for 8 of the years) in regard to the 10 years.

Under B income tax law: (i) the "statute of limitations" (i.e. the time period in which the tax authorities may issue assessments for an income year) only starts to run from the time that the taxpayer files an income tax return for the relevant income year; and (ii) a non-resident taxpayer which fails to file an income tax return within 24 months after the relevant income year, is denied all deductions in calculating its taxable profits for that year. Item (i) applies to both residents and non-residents, but item (ii) applies to non-residents only.

Both items (i) and (ii) were introduced into the B law in 1970.

The A/B treaty, which was signed in 2005 (this is the first treaty between A and B), is identical to the 2000 OECD model treaty.

Does the treaty permit the tax assessment to reflect item (ii)?

LAST WEEK'S ANSWER

Art. 7(3) (2000 OECD model) states that all of the expenses incurred for the purposes of the PE shall be deducted in determining the profits attributable to the PE.

However, in the 2008 Update, para. 30 was added to the OECD Comm.: Art. 7(3) does not deal with whether expenses, after being attributed to the PE by Art. 7(3), are deductible under domestic law – that is "a matter to be determined by domestic law, subject to [Art. 24]." The interesting issue is whether para. 30 (added in 2008) should be taken into account in interpreting the 2005 A/B treaty.

If it is taken into account, the conclusion would be that Art. 7 would not prevent the disallowance of the deductions.

However, Art. 24(3) requires that B's tax on ACo's PE shall not be less favourably levied than the tax levied on B-resident enterprises carrying on the same activities. Item (ii) under the B law appears to breach this requirement. That view is supported by para. 24(a) of the 2000 OECD Comm., which states that PEs must be accorded the same right as resident companies to deduct trading expenses.

Nevertheless, the US Tax Court has recently held (Adams Challenge case) that a similar rule to item (ii) does not breach either Art. 7(3) or Art. 24(3). Key to the court's decision is that the relevant rule was included in US domestic law many years before the treaty was signed – thus, the treaty partner was "on notice", and did not object. Also, the US does not accord supremacy to treaty provisions.

If B does accord supremacy to treaty provisions, IMHO: Art. 7(3) might not be breached, but Art. 24(3) should be breached.

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