International Tax Bytes *by Steve Towers*

"International tax news, explained"

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5 March 2021

HIGHLIGHTS

- **A significant decision by the Indian Supreme Court in regard to payments for computer software and the definition of "royalties" in double tax treaties**
- **The UK Budget – and a major increase in the UK corporation tax rate**
- **The US abandons its safe harbour proposal for Pillar One**
- **Continuation of in-depth analysis of Pillar One – today: the revenue sourcing rules (Part 2)**

HAPPY FRIDAY!

Dolly trades **Jolene** for vaccine; **Texas** has done enough; and **Bolsonaro** tells everyone to stop whining!

Meanwhile, in the tax world…

India copies the **OECD**; **Pascal** detects a new dynamic; **Société Générale** loses credit; **BG** rules; **Japan** studies; the **Netherlands** meets its mismatch; and **London** no longer looks like **Singapore on the Thames!**

But at the end of the week, the most important question is this: **"Like Pascal, are your stars aligned?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Computer software case (Indian Supreme Court)
2. UK Budget
3. Digital taxation
4. Pillar One: Revenue sourcing rules (Part 2)
5. Asia Pacific
   - India, Japan, New Zealand, Singapore
6. Europe
   - ECJ, Ireland, Netherlands
7. Americas
   - UK / US
8. 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)**
- **Nexus – ITB (19 Feb 2021)**
- **Revenue sourcing rules (Part 1) – ITB (26 Feb 2021)**
- **Revenue sourcing rules (Part 2) – ITB (5 Mar 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

Ian F. Dykes and Louise H. Keegan
"The OECD Pillar 1 Blueprint: Why Amount B Matters"
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 3 (subscription service)

Alberto Gatto and Davide Attilio Rossetti
"An Italian Perspective on Beneficial Ownership and Financial Subholding Companies"
Tax Notes Today International, Tax Analysts, 4 March 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, owns some redeemable preference shares in YCo, a company resident in Y. The shares carry a preference right to a 5% per annum dividend and a preference right to a return of the face value of the shares (in a liquidation scenario), but they do not otherwise participate in YCo's profit distributions or surplus assets.

YCo has paid-up share capital of $10 million, a share premium reserve of $90 million, and retained earnings of $50 million.

Of the $10 million of paid-up share capital, $4 million represents the par value of common shares issued to numerous shareholders (not including XCo). The remaining $6 million represents the par value of the redeemable preference shares issued to XCo.

Under Y law, withholding tax of 25% is levied on outbound dividends, interest and royalties.

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

Does the X/Y treaty permit Y to levy tax on YCo's dividends paid to XCo? If yes, at what rate?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

XCo (a company resident in X) and YCo (an unrelated company resident in Y) are planning to form a 50/50 international joint venture.

One of the investments of the joint venture will be to acquire 100% of the shares in BCo, a company resident in B.

To hold the shares in BCo, XCo and YCo are currently planning to form a 50/50 general partnership under A law. The partnership will elect to be treated as a resident company for A tax law purposes. The reason for using a partnership is to allow surplus cash to be easily paid to XCo and YCo (i.e., without the restrictions of the A corporate law).

The A/B treaty is identical to the 2014 OECD model treaty. The MLI does not apply to the A/B treaty. There is no treaty between X and B, or between Y and B.

Under B law: (i) a 30% withholding tax is levied on outbound dividends; (ii) the A partnership is treated as transparent; and (iii) the GAAR does not apply to treaty benefits.

Under A law, foreign source income of residents is generally taxable. However, foreign dividends derived by resident companies are exempt.

After applying any treaty benefits, what rate of B withholding tax will apply to dividends paid by BCo?

LAST WEEK'S ANSWER

For the A/B treaty to apply to the partnership (p/s), it must be a "person" who is a "resident" of one or both of A and B.

The p/s is a "person", under the Art. 3(1) definition, as it is both a "company" (as defined in Art. 3(1)) and a "body of persons".

The p/s has elected to be treated as a resident company for A tax purposes. It is noted that, under A law, foreign source income of residents is generally taxable. The p/s should therefore be considered to be liable for comprehensive taxation in A, and thus should be a "resident" of A under the Art. 4(1) definition. The fact that the p/s has elected into this position should be irrelevant.

Under Art. 10(2), the 15% rate under para. (b) should apply instead of the 5% rate under para. (a), because the p/s does not satisfy the phrase, "company (other than a partnership)".

However, there are 2 possible risks with this outcome:

i. There is a risk that the p/s would be viewed as not being the "beneficial owner" of the dividends, due to the plan to distribute cash to the partners. However, under the 2014 OECD Comm., "beneficial ownership" status is denied only if the p/s is subject to a contractual or legal obligation to pass on the dividends to another person. Applying this rule in the context of a partnership is difficult!
ii. Although the B law GAAR does not apply to treaty benefits, it is possible that B is a country which views treaty shopping as an abuse of the treaty itself (see 2014 OECD Comm. on Art. 1). If this were the case, B might deny the treaty benefit.

If either of these risks is triggered, the withholding tax rate would be 30%.

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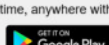

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