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16 July 2021

HIGHLIGHTS

- **Latest developments on Pillars One and Two**
  - **G20 finance ministers meeting**
  - **Suspension of EU's proposed digital levy**
- **EU releases package of measures as part of "Green Deal"**
  - **Design features of CBAM (carbon border adjustment mechanism)**
- **Australia's draft guidance on software payments and the "royalties" definition: further comment**

HAPPY FRIDAY!

Texas Dems boondoggle; **Belarus** starts a travel agency; while **Oliver** and **Wally** find space to break records!

Meanwhile, in the tax world…

Brussels blinks; **Nike** stumbles at the first hurdle; **DEBRA** avoids bias; **Nigeria** runs out of zeroes; **Italy** rejects the benefit of **Dutch** certificates; **Colombia** tries again; **France** provides an 88% answer; **Oman** suspends, but only partially; while **Germany** runs down the clock in the **UAE**!

But at the end of the week, can you recall those innocent pre-COVID days when you thought that **"PPE"** stood for **"Property, Plant & Equipment"**?

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. Pillars One and Two
2. EU: Green Deal
3. Australia's draft guidance on software payments and the "royalties" definition: further comment
4. Trade & other global developments
5. Asia Pacific
   - Australia, China, India, Singapore, Thailand
6. Europe
   - EGC, EU, France, Germany, Italy, Luxembourg, Netherlands, Russia
7. Africa
   - Nigeria, South Africa
8. Middle East & Central Asia
   - Oman, Pakistan, UAE
9. Americas
   - Colombia
10. Treaties

ITB series on Pillar One

- **Scope (Parts 1, 2 & 3) – ITB (22, 29 Jan & 5 Feb 2021)**
- **Nexus – ITB (19 Feb 2021)**
- **Revenue sourcing rules (Parts 1 & 2) – ITB (26 Feb & 5 Mar 2021)**
- **Tax base determinations (Parts 1 & 2) – ITB (12 & 19 Mar 2021)**
- **Profit allocation (Parts 1 & 2) – ITB (26 Mar & 9 Apr 2021)**
- **Elimination of double taxation (Parts 1 & 2) – ITB (16 & 23 Apr 2021)**
- **Amount B (Parts 1 & 2) – ITB (30 Apr & 7 May 2021)**
- **Tax Certainty (Parts 1 to 4) – ITB (21, 28 May & 4, 11 Jun 2021)**
- **Implementation and administration – ITB (18 Jun 2021)**

ITB series on Pillar Two

1. **GloBE rules**
   - **Scope – ITB (9 Oct 2020)**
   - **Calculating the ETR (Parts 1 & 2) – ITB (16 & 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 (Parts 1 & 2) – ITB (20 & 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

Wei Cui
"What Does China Want From International Tax Reform?"
Tax Notes Today International, Tax Analysts, 12 July 2021 (subscription service)

Stéphane Celoudou
"The French Supreme Tax Court Secures Its Hold on the Tax Bases of Digital Enterprises by Reshaping the Dependent Agent PE Concept"
European Taxation, IBFD, 2021 (Volume 61), No. 7 (subscription service)

Eyal Gonen, Leonid Karasik and Michael McDonald
"Control Over Risk, DEMPE Functions, and the Remuneration of R&D Service Providers"
Tax Notes Today International, Tax Analysts, 6 July 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo is a publicly listed bank which is resident in A. ACo has a branch in B. The branch constitutes a PE under the A/B treaty.

A small percentage of ACo's shares are indirectly listed on the B stock exchange in the form of B Depository Receipts (BDRs). The BDRs are structured in this way: (1) some shares in ACo are owned by CCo, an unrelated bank resident in C, on bare trust (i.e., as nominee) for the B branch of ACo; and (2) the B branch of ACo issues BDRs (negotiable instruments listed on the B stock exchange), with the ACo shares held by CCo as the relevant underlying property.

Some of the BDRs are acquired by DCo, an investment company resident in D.

ACo pays dividends on its shares. In regard to the shares held by CCo, the dividends are received by CCo, which transfers the cash (less its expenses and fees) to the B branch of ACo, which in turn transfers the cash (less its expenses and fees) to the holders of the BDRs (including DCo).

Under the domestic law of each of A and B, a 20% withholding tax is imposed on outbound dividends and on outbound "dividend equivalent payments" under Depository Receipts.

All 6 bilateral treaties (i.e., A/B, A/C, A/D, B/C, B/D and C/D) are identical to the 2017 UN model treaty.

After applying those treaties, will ACo or DCo have an income tax liability in A or B on the dividends and the resulting flow of cash?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

XCo, a company resident in X, owns some IP.

Some years ago, XCo licensed the IP to YCo (a related company resident in Y), for use in Y.

The royalties paid by YCo to XCo are (1) tax deductible to YCo, (2) subject to 10% Y royalty withholding tax (in accordance with the X/Y treaty), and (3) taxable to XCo under X income tax law (with a foreign tax credit for the Y royalty withholding tax). However, due to the calculation of credits under X law (i.e., allocation of deductions), XCo does not obtain a full credit for the Y withholding tax.

YCo entered into a unilateral APA with the Y tax authorities. Under the APA, the royalty rate was reduced. Also, the APA was "rolled back" for 2 years.

YCo has filed amended Y income tax returns covering the last 2 years, to reflect reduced deductions for royalties, as agreed in the APA.

The APA does not cover the Y royalty withholding tax which has been incurred by XCo – and, being unilateral, it also does not cover XCo's X income tax liability on the royalty income.

The X/Y treaty is identical to the 2017 OECD model treaty, with Art. 23B – except that Art. 12 permits 10% source country tax on royalties.

What steps can be taken to properly adjust XCo's tax position (in both X and Y), to reflect the APA's reduced royalty rate for the last 2 years?

LAST WEEK'S ANSWER

(1) XCo's tax position in Y:

Although the reduction in YCo's royalty deductions ("excess royalties") is pursuant to Art. 9(1), XCo cannot claim the benefit of Art. 9(2), which is directed at the X tax authorities making a corresponding adjustment (see below).

However, Art. 12(4) should apply, with the result that the 10% Y tax does not apply to the excess royalties. Instead, under the 2nd sentence in Art. 12(4), the excess royalties "shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention". If the Y tax law does not allow secondary TP adjustments, then the excess royalties should be exempt from Y tax under Art. 7 or 21 (assuming that XCo does not have a PE in Y). However, if the Y tax law does allow secondary TP adjustments, then the excess royalties might be treated as a deemed dividend to YCo's shareholder, or as a deemed interest-bearing loan to XCo – both of which might cause further Y tax (wholly or partly compensating for the 10% royalty withholding tax on the excess royalties).

If the net result would be an amount of reduced Y tax for XCo, XCo could institute the MAP process under Art. 25 to try to secure the reduction. Alternatively, the Y domestic law might allow XCo to secure the reduction.

(2) XCo's tax position in X:

Threshold issue: The X tax authorities are not required to make any corresponding adjustment except to the extent that they agree with the primary adjustment made by the Y tax authorities in the APA.

Assuming they do fully agree with the primary adjustment…

Art. 9(2) requires the X tax authorities to "make an appropriate adjustment to the amount of the tax charged" on XCo's profits. Art. 9(2) and the OECD Comm. do not mandate the form of that adjustment – but a common way would be for XCo's royalty income from YCo to be reduced. XCo could institute the MAP process under Art. 25 to try to secure the consequential reduction in X tax.

The amount (if any) of the reduction in X tax should take into account the amended Y withholding tax position. Also, as XCo is not entitled to a full foreign tax credit, the impact on XCo's credit position would need to be calculated.

Tax Quiz Archives

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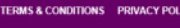

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