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**ITB International Tax Bytes** *by Steve Towers*

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## 23 July 2021

## HIGHLIGHTS

- **Latest developments on Pillars One and Two**
    - **How the US could ratify a multilateral convention on Pillar One**
    - **How jurisdictions are adjusting to Pillar Two**
    - **And does Pillar One signal the end of traditional transfer pricing?**
- **Further comments on EU's CBAM**
- **Review of major treaty developments in H1, 2021**

## HAPPY FRIDAY!

**Pegasus** hacks, **Jeff** soars for 10 minutes, while **Tokyo** crosses its fingers!

Meanwhile, in the tax world…

**Pascal** has "just a few numbers to firm up"; the **US** reverses claw-backs; **China** reforms Pudong; **Brazil** requires banks to contribute; **Gibraltar** raises its standard; **Hong Kong** carries on; while **Mexico** outsources tax deductions!

But at the end of the week, the most important question is this: **"If another country introduces a CBAM, would you call that a carbon copy?"**

**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. Review of major treaty developments in H1, 2021
3. Asia Pacific
    - Australia, China, Hong Kong, New Zealand
4. Europe
    - EU, Georgia, Germany, Ireland, Netherlands, UK
5. Americas
    - Brazil, Mexico, US
6. 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

Philippe Gamito
"*Danske Bank*: Will EU VAT Grouping Survive to Reverse *Skandia*?"
International VAT Monitor, IBFD, 2021 (Vol. 32), No. 4 (subscription service)

Reuven Avi-Yonah & Gianluca Mazzoni
"Stanley Surrey, the 1981 US Model, and the Single Tax Principle"
Intertax, Kluwer, 2021 (Vol. 49), Issue 8 & 9 (subscription service)

Mindy Herzfeld
"Pushing Pillar 1 Past Congress"
Tax Notes Today International, Tax Analysts, 19 July 2021 (subscription service)

## INTERNATIONAL TAX QUIZ

## THIS WEEK'S NEW QUIZ

XCo, a company incorporated and resident in X, owns some land in Y.

XCo sells the land to YCo, a related company incorporated and resident in Y, for a price of $Z. XCo does not own any shares in YCo.

Under the corporate income tax laws of both X and Y, a company is resident only if its central management and control is located in X or Y, respectively.

In accordance with Y stamp duty law, XCo pays 5% "sellers' stamp duty" on the price of $Z, and then transfers the balance of the sale price to its bank account in X. Under Y law, seller's stamp duty is imposed only on sellers which are foreign-incorporated companies.

Some months later, the Y tax authorities claim that the price of $Z was less than the arm's length price (ALP) of the land. They therefore claim that XCo owes additional stamp duty on the excess of the ALP over $Z.

XCo currently owns no assets in Y.

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

Will XCo be required to pay the additional stamp duty?

**Answer in next week's ITB email alert!**

## LAST WEEK'S QUESTION

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 Depositary 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 Depositary 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?

## LAST WEEK'S ANSWER

(1) ACo's A tax liability:

Under A domestic law, a liability for A dividend withholding tax would probably not arise, due to mutuality.

Nevertheless, the profit (if any) derived by ACo's B branch on the BDRs might be taxable under A domestic law (regardless of mutuality), unless that law exempts profits of foreign branches.

(2) ACo's B tax liability:

Art. 7 of the A/B treaty would likely allow a profit to be recognised (and taxed) on the BDRs, based on the "separate enterprise" assumption.

The actual profit (if any) derived by ACO's B branch might be taxable under B domestic law (regardless of mutuality).

(3) DCo's A tax liability:

Under domestic law, A imposes a 20% withholding tax on outbound dividends and "dividend equivalent payments" under Depositary Receipts.

Thus, under domestic law, the cash paid to DCo should be subject to 20% A tax, as either a dividend or a dividend equivalent payment.

Under the A/D treaty, if the cash retains the character as a dividend, Art. 10 should apply to permit A to levy tax according to the rate specified in Art. 10 – i.e., if the cash is a dividend, DCo should be the beneficial owner of the dividend.

However, if, under the A/D treaty, the cash does not retain its character as a dividend, then Art. 10 would not apply. Instead, Art. 7 should apply to exempt the cash (in the absence of a PE in A). There would be a risk that the A tax authorities would claim that Art. 7 does not apply, because DCo is a passive investor – and that Art. 21(3) would allow A tax (without limit).

(4) DCo's B tax liability:

Art. 10 does not apply, because the company paying the dividend is not a resident of B.

Art. 7 should apply to exempt the cash (in the absence of a PE in B). There would be a risk that the B tax authorities would claim that Art. 7 does not apply, because DCo is a passive investor – and that Art. 21(3) would allow B tax (without limit).

(5) Double tax relief in D:

Thus, it is possible that the cash is taxed in both A and B (in A, under Art. 10 or Art. 21(3); in B, under Art. 21(3)). In addition, the cash might be taxable under D domestic law. If the D tax authorities accept the applicability of the A and B tax in the 2 treaties, then D would be required to provide relief from double taxation under Art. 23A/B of the 2 treaties.

Note: The facts are based on the 2021 decision of the Mumbai ITAT in the Morgan Stanley case.

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