ITB International Tax Bytes
by Steve Towers

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13 August 2021

HIGHLIGHTS

- Pillars One & Two
  - Will EU Member States be able to effectively implement Pillar Two, due to the restrictions under EU law?
- Latest update on Brazil's proposed corporate tax reform
- Interesting double tax treaty provisions

HAPPY FRIDAY!

Messi learns French, the **US** builds bridges in Congress, while the **UN** says the world is melting away!

Meanwhile, in the tax world...

Barbados joins the club: **Brazil** races to the bottom; **Canada** consults on a carbon copy; **Colombia** goes sailing; **Israel** drip-feeds proposals; **Hong Kong** provides guidance, but not on the most important issue; while **Sri Lanka** just wants to see the dollars!

But at the end of the week, the most important question is this: **"How would you feel if someone else lit your Olympic gold medal?"**

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 & Two
2. Brazil's corporate tax reform
3. Carbon border adjustments
4. Interesting treaty provisions
5. Other global developments
6. Asia Pacific
   - Hong Kong, India, Singapore, Sri Lanka, Taiwan
7. Europe
   - Romania
8. Middle East & Central Asia
   - Israel, Qatar
9. Americas
   - Colombia

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 (4 Dec 2020)
   - Implementation and Rule Co-ordination – ITB (11 Dec 2020)
   - Unresolved issues, GILTI & hub jurisdictions – ITB (18 Dec 2020)

WORTH READING

Oliver R. Hoor & Keith O'Donnell
"The New EU Initiative on Fighting Shell Entities: Tackling a Nonissue?"
Tax Notes Today International, Tax Analysts, 11 August 2021 (subscription service)

Kim Blanchard
"Practical Roadblocks to U.S. Adoption of a Global Minimum Tax"
Tax Management International Journal, Bloomberg BNA, 6 August 2021 (subscription service)

Yariv Brauner
"Serenity Now! The (Not So) Inclusive Framework and the Multilateral Instrument"
1 July 2021 (freely available at www.ssrn.com)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo, a company incorporated in A, has a branch in B.

The branch, which has 10 employees, operates solely to purchase goods for ACo.

B imposes a payroll tax on the total payroll of companies operating in B. For B-incorporated companies, the payroll tax rate is 4%; for foreign-incorporated companies, the payroll tax rate is 10%.

Under the respective income tax laws of A and B, a company's residence status is determined by incorporation.

The A/B treaty is identical to the 2014 OECD model treaty.

Is ACo liable for the 10% payroll tax?

Answer in next ITB email alert on 27 August 2021!

LAST WEEK'S QUESTION

XCo (a company resident in X) has valuable technical knowledge.

YCo (a related company resident in Y) carries on a technical consulting business.

XCo and YCo enter into a contract, under which XCo agrees to provide its technical knowledge to YCo, in consideration for a payment equal to 10% of YCo's gross technical consulting fees.

YCo's consulting business includes the provision of consulting services to clients in Z. YCo does not have an office, or any employees who are based, in Z.

In particular year, YCo provided consulting services to 20 different clients in Z. The services were mainly provided by YCo's Y-based employees being present at the Z business premises of those clients: planning and conducting interviews, writing reports, presenting findings, etc. YCo's employees were present at the Z business premises for an aggregate of 200 business days during the year. However, at no single business premises were they present for more than 50 business days during the year.

All the contracts for the consulting services are negotiated and entered into by the senior management of YCo in Y.

The X/Z treaty is identical to the 2017 UN model (with a 10% rate limit in both Art. 12 and Art. 12A), and the Y/Z treaty is identical to the 2017 OECD model.

Do those treaties permit Z to levy income tax on YCo and/or XCo?

LAST WEEK'S ANSWER

1. Y/Z treaty
   1. XCo:
      The Y/Z treaty is not relevant to Z's taxation of XCo.
   2. YCo:
      No Art. 5(1) PE, as YCo did not have any of the clients' premises at its disposal for a sufficiently long period.

      Thus, Art. 7(1) would provide YCo with an exemption from Z tax on its profits.

      No other provision in the treaty is relevant – thus, YCo would be exempt from Z tax.

2. X/Z treaty
   1. XCo:
      XCo would not have a PE in Z under Art. 5.

      However, the payments made by YCo to XCo should satisfy the definition of "royalties" in Art. 12(3): payments "for information concerning industrial, commercial or scientific experience". Under Art. 12(5), the royalties would be deemed to arise in Z if (1) the payer (YCo) is resident in Z (which it is not), or (2) the royalties have a relevant nexus with a PE of the payer (YCo) in Z.

      Note that the PE status of YCo for the purposes of Art. 12(5), will be determined under Art. 5 of the X/Z treaty. It is irrelevant that YCo does not have a PE in Z under the Y/Z treaty (see above).

      YCo would not have an Art. 5(1) PE in Z, as none of the client business premises was at its disposal for a sufficiently long period. However, the furnishing of services in Z would satisfy the requirements for an Art. 5(3)(b) PE – note that the words, "for the same or a connected project", which appeared in earlier versions of Art. 5(3)(b), were deleted in the 2017 UN model.

      A relevant nexus with the PE will exist under Art. 12(5) if 2 tests are satisfied: (i) the liability to pay the royalties was incurred in connection with the PE, and (ii) the royalties are borne by the PE.

      Test (i): This test is not explained in the Comm. on Art. 12. However, a similar test exists in Art. 11, and the UN Comm. on Art. 11 incorporates the OECD Comm. on Art. 11 – which says that the test is satisfied only where the relevant contract (i.e., the provision of knowledge contract, in our case) was entered into solely for the purposes of the relevant PE. That is unlikely to be the situation here – e.g., XCo's knowledge is probably also intended to be used in YCo's operation in Y, if not other countries. Thus, it is likely that test (i) is failed.

      Test (ii): This test is not explained in either Comm. on Art. 11 or 12. However, as YCo does not have an office, or employees who are based, in Z, it is likely that YCo does not produce any financial statements for its operations in Z. If that is the case, it is unlikely that the royalties, or any part of the royalties, are borne by the PE.

      Thus, Art. 12 should not apply. Also, Art. 12A would not apply, as XCo does not provide "services" to YCo – it provides information (i.e., knowhow); see para. 62 of UN Comm. on Art. 12A.

      That would mean that Art. 7(1) should exempt XCo from Z tax.

      However, if XCo does not carry on an active business, it is possible that the Z tax authorities could claim that it does not carry on an "enterprise" (defined in Art. 3(1)), thus Art. 7 does not apply, and thus Art. 21(3) allows unlimited taxation of the "royalties" by Z. Note that, according to the UN Comm. on Art. 21, "arising" takes its meaning under Z law. In the circumstances of this case, it is possible that a proportion of the royalties could be considered to "arise" in Z under Z law.

   2. YCo:
      The X/Z treaty is not relevant to Z's taxation of YCo.

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