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27 August 2021

HIGHLIGHTS

- **US international tax changes**
  - **Democrat leaders in Senate Finance Committee release draft bill – proposes major changes to US international tax**
  - **Draft bill builds on international tax "framework" released in April – big questions remain unanswered**
- **Recent international tax cases**
  - **US case on foreign tax credits**
  - **Spanish and Indian cases on PE definitions**
- **Interesting double tax treaty provisions**
  - **"Most favoured nation" clause in India / Switzerland treaty**
  - **Several unusual provisions in pending Botswana / Kenya treaty**

HAPPY FRIDAY!

The baby sues **Nirvana**; **Abba** plans a voyage next week; and **Kanye** is now **Ye**, but **"nah he tweakin"!**

Meanwhile, in the tax world…

Ron Wyden is unsure about haircuts; **Mondelez** is part of the establishment in **Spain**; **Telenor** makes connections in **India**; **Australia** discusses **IBOR**; **South Africa** guides on the brightline; **Switzerland** reads **Indian** tax cases; interest deductibility is uncertain in **South America**; and in the **US**, a taxpayer claims a foreign tax credit, because she had nothing **Toulouse!**

But my thought for the week is this: **"If you ate a really, really bad sausage, would you say it was the wurst?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

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

1. US international tax changes
2. International tax cases
3. Interesting treaty provisions
4. Asia Pacific
   - Australia, India
5. Europe
   - Denmark, UK
6. Africa
   - South Africa
7. Americas
   - Argentina, Colombia, US
8. Treaty news

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

J. Scott Wilkie
"Canada – Transfer Pricing Rules Past Cameco and Digital Tax on Tech Giants"
International Transfer Pricing Journal, IBFD, 2021 (Volume 28), No. 5 (subscription service)

Jeffrey Owens and Gabriela Capristano Cardoso
"The Future of International Tax"
Tax Notes Today International, Tax Analysts, 26 August 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo (a company resident in X) has licensed IP to YCo (a company resident in Y), in return for arm's length royalties.

Subject to exceptions mentioned in some scenarios below: (i) X levies income tax at a flat rate of 25% on resident companies; (ii) XCo's royalty income is treated as taxable income for X income tax purposes; and (iii) X does levy an "alternative minimum tax".

The Y domestic tax law levies a final withholding tax of 20% on the gross amount of outbound royalties.

The X/Y treaty is identical to the 2011 UN model treaty, except that Art. 12(2) says this:

"However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State and is subject to tax in that other Contracting State in respect thereof, the tax so charged shall not exceed 5 per cent of the gross amount of the royalties."

The MLI does not apply to the X/Y treaty.

After applying Art. 12(2), what rate of Y withholding tax would apply to the royalties paid by YCo to XCo in the current year, in each of these scenarios (which deal with XCo's income tax treatment in X):

(1) XCo incurs a tax loss in the current year

(2) XCo derives a taxable profit in the current year, but it reduces that taxable profit to nil by deducting its carried forward tax losses

(3) XCo derives a taxable profit in the current year, but it reduces that taxable profit to nil by deducting tax losses which are transferred to it by related X-resident companies

(4) X income tax is levied on a progressive rate scale starting at 0%, and (in the current year) XCo is in the 0% band

(5) XCo derives a taxable profit in the current year, but it reduces its X income tax payable to nil by claiming foreign tax credits

(6) XCo derives a taxable profit in the current year, but it is subject to a 2% rate because it is based in a "technology zone" in X

(7) X levies income tax on foreign sourced income only if and when it is remitted to X; XCo's royalty income in the current year is unremitted foreign sourced income

(8) XCo derives the royalty income through a PE in Z; XCo pays 30% Z income tax on the royalty income; the X/Z treaty is identical to the 2011 UN model, with Art. 23A

(9) XCo derives a taxable profit in the current year, and it pays X income tax at the 25% rate on that taxable profit; however, when XCo pays dividends, the full amount of XCo's income tax is credited to the shareholders in XCo, under the X dividend imputation system

(10) XCo derives a taxable profit in the current year, and it pays X income tax at the 25% rate on that taxable profit; however, 90% of XCo's royalty income is excluded from its gross taxable income

(11) XCo derives a taxable profit in the current year, and it pays X income tax at the 25% rate on that taxable profit; however, in computing the taxable profit, XCo is allowed a 250% deduction (for IP amortisation), which exceeds the amount of royalty income

(12) XCo derives a taxable profit in the current year, and it pays X income tax at the 25% rate on that taxable profit; however, the Y government provides a grant to XCo, equal to the X income tax on its gross royalty income

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

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?

LAST WEEK'S ANSWER

Art. 2:

B's payroll tax is levied on the total payroll of companies operating in B. Thus, it would fall within the list of covered taxes in Art. 2(2): "taxes on the total amount of wages or salaries paid by enterprises".

Note that if the payroll tax were levied only on some of the payroll, it would not fall within this description (see below).

Art. 2(2) does not state whether payroll taxes are taxes on income or on capital. If on income, Arts. 6 to 21 should apply; if on capital, Art. 22 should apply. Payroll taxes don't fit neatly into either category! See Michael Lang, " 'Taxes Covered' – What is a 'Tax' according to Article 2 of the OECD Model?", Bulletin on International Taxation, IBFD, June 2005.

Arts. 6 to 21:

If B's payroll tax is a tax on income, then ACo should be exempt from the payroll tax under either Art. 7 or Art. 21. The Art. 7 exemption should apply if ACo does not have a PE in B – ACo's branch should be excluded from PE status under Art. 5(4)(d).

Art. 22:

If B's payroll tax is a tax on capital, then ACo should be exempt under Art. 22(4).

If B's payroll tax is not a covered tax in Art. 2(2):

If B's payroll tax is not a covered tax in Art. 2(2) (e.g., because it is levied on only some of the payroll), then Arts. 6 to 21 (income) and 22 (capital) should not apply to the tax.

However, Art. 24 would be applicable: Art. 24(6).

Art. 24(3) should not apply, on the basis that ACo does not have a PE in B (see above).

Art. 24(1) is relevant. ACo is a "national" of A, under the Art. 3(1) definition. The 10% vs. 4% rate differential is due to the nationality difference between ACo and B-incorp. companies. However, Art. 24(1) requires the comparison to be made against B-incorp. companies "in the same circumstances": does that mean that, for the B-incorp. companies to be validly compared with ACo, the B-incorp. companies and ACo need to have the same tax residence status (which they don't)?

According to the OECD Comm, the answer (surprisingly) is "no": see Example 4 in para. 23.

Thus, if B's payroll tax is not a covered tax in Art. 2(2), ACo should be able to secure the 4% rate by virtue of Art. 24(1).

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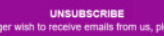

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