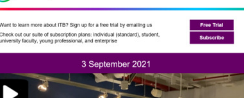

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3 September 2021

HIGHLIGHTS

- **Wyden draft bill for US international tax changes**
  - **Criticism of "high-tax exclusion" and other proposals in bill**
- **3 interesting treaty provisions**
  - **Ireland / Kenya**
  - **Serbia / Singapore**
  - **Indonesia / Singapore**

HAPPY FRIDAY!

Biden is incredible; **Suga** is not sweet enough; and **Mamma Mia! Abba's back!**

Meanwhile, in the tax world…

IF is ready **Togo**; **Wyden** doesn't exclude interest; **Australia** launches a protected cell; **Norway** turns to cash; **Centrica** manages to win; **Nigeria** throws out VAT (again); and the **EU** doesn't know when to say nothing!

And my cynical thought for this week is this: **"The secret to success in life is sincerity … If you can fake that, you've got it made!"**

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. US international tax changes
3. Interesting treaty provisions
4. Other global developments
5. Asia Pacific
   - Australia, India, Singapore, Thailand
6. Europe
   - France, Norway, UK
7. Africa
   - Nigeria, South Africa
8. Americas
   - Brazil, Canada
9. 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

Stephen L. Curtis and David G. Chamberlain
"Apple's Cost-Sharing Arrangement: Frankenstein's Monster"
Tax Notes Today International, Tax Analysts, 31 August 2021 (subscription service)

Wolfgang Schön
"Is There Finally an International Tax System?"
World Tax Journal, IBFD, 2021 (Volume 13), No. 3 (subscription service)

Bob Stack
"US Tax Policy and Attribution of Profits to Permanent Establishments"
World Tax Journal, IBFD, 2021 (Volume 13), No. 3 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, sells goods to YCo, a related company resident in Y.

The income tax rates are 25% (in X) and 20% (in Y).

The X/Y treaty is identical to the 2011 UN model treaty.

In year A, XCo derived $100 million of revenue from sales to YCo.

Under the Y transfer pricing rules, the Y tax authorities reduced YCo's aggregate consideration for purchases in year A from XCo to $80 million – i.e., a reduction of $20 million. The Y tax authorities therefore issued an assessment to YCo for tax of $4 million (i.e., $20 million x 20%). In addition, the Y tax authorities imposed a 50% "gross negligence" penalty of $2 million on YCo (i.e., $4 million x 50%). Thus, in total, YCo is required to pay $6 million in additional Y tax and penalties.

Will the X/Y treaty allow the group to obtain any relief in X for that $6 million?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

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 not 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 (or alternatively, 0% 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 X government provides a grant to XCo, equal to the X income tax on its gross royalty income.

LAST WEEK'S ANSWER

For XCo to qualify for the 5% rate, Art. 12(2) includes a condition that "the beneficial owner of the royalties … is subject to tax in [X] in respect thereof" – i.e., in respect of the royalties.

This "subject to tax" (STT) condition is not included in either the OECD or UN model treaty, and it is relatively unusual in the dividends, interest and royalties articles in bilateral treaties. There is very little authority on its meaning.

Note that the STT condition refers to the royalties – in contrast to, say, the "liable to tax" condition in Art. 4, which refers to the taxpayer.

Based on the limited authority, IMHO: the STT condition means that the relevant income is included in the tax base for the tax (i.e., included in the gross taxable income) – it does not mean that tax is actually paid. This distinction is critical to my answers below:

(1) 5%.

(2) 5%.

(3) 5%.

(4) This scenario is difficult, because of the 0% tax band. If XCo's taxable profits were sufficiently high to move into higher tax bands, XCo would pay current year income tax. As the STT condition relates to the royalty income, it would seem strange if that condition depended on whether XCo derived sufficient other income. Therefore, on balance, I think that the STT condition should be satisfied here – i.e., 5%.

(5) 5%.

(6) (i) If 2% rate: 5% wht applies. (ii) If 0% rate: I think it would be difficult to argue that the royalties are subject to tax. Thus, IMHO: 20%.

(7) Unless it is remitted, 20%. If it is remitted at a later time, then a refund of the excess Y tax might be possible at that time, subject to the time limits under Y law.

(8) 20% - the STT condition refers to taxation in X, not in third countries.

(9) 5% - the STT condition refers to taxation of XCo – the treatment of other entities should be irrelevant.

(10) This scenario is difficult. Do you split the royalties into 2 groups (90%) and (10%), and then Y levies 20% wht on the 90% group and 5% wht on the 10% group? Or do you say that 100% of the royalties are subject to an effective X tax rate of 2.5% (10% x 25%), and thus 100% of the royalties satisfy the STT condition? On balance, I think the latter is the better approach – i.e., 5% wht on 100% of the royalties.

(11) 5%.

(12) 5%. However, query whether the Y government would be considered to breach Art. 28, VCLT, to perform the treaty "in good faith".

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