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International Tax Bytes
by Steve Towers

"International tax news, explained"

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10 September 2021

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Estonia's request for special treatment in Pillar Two**
  - **Growing support in US for 21% rate for GILTI – possible impact on minimum rate in Pillar Two**
- **Transfer pricing case from India**
  - **Should interest be imputed on outbound loan to special purpose vehicle?**
- **Interesting treaty provisions**
  - **Whether China / Russia treaty applies to Taiwan**
  - **Inclusion of VAT exemption in China / Qatar treaty**

HAPPY FRIDAY!

It's **teenager vs. teenager** at the **US Open!**

Meanwhile, in the "old" tax world…

Estonia asks for special treatment; in the **US**, it's **Democratic** to want **21%; Bennett Coleman** restricts and wins; **Russia** rules out **Taiwan**; **Qatar** lands easy in **China**; **New Zealand** is deductive; **Poland** goes for the minimum; companies are squeezed in **Nigeria**; and **Mexico** gives a third warning!

But at the end of the week, the most important question is this: **"Do you know that it's safer to move a rhinoceros upside down?"**

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. Transfer pricing case
3. Interesting treaty provisions
4. Trade & other global developments
5. Asia Pacific
   - India, Thailand
6. Europe
   - Denmark, ECJ, EU, Poland, Turkey, UK
7. Africa
   - Nigeria, Morocco, South Africa
8. Americas
   - Argentina, Colombia, Mexico
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

Harlow N. Higinbotham and Niraja Srinivasan
"'Coca-Cola' vs. §482: Is It Time to Refresh the Regulatory Guidance?"
Tax Management International Journal, Bloomberg BNA, 2021 (Volume 50), No. 9 (subscription service)

Gary Sprague
"Australian Taxation Office Proposes a New View on Software Revenue Characterization Departing From Prior Sensible Guidance"
Tax Management International Journal, Bloomberg BNA, 2021 (Volume 50), No. 9 (subscription service)

Christian Amand
"Disclosed / Undisclosed Agent in EU VAT: When Is an Intermediary Acting in Its Own Name?"
International VAT Monitor, IBFD, 2021 (Volume 32), No. 5 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo, a company resident in A, purchased 60% of the shares in BCo, a company resident in B.

ACo's purchase price was $6 million, and its purchase was from an unrelated party.

During ACo's ownership of the BCo shares, BCo paid no dividends or other distributions to its shareholders.

Several years later, ACo sold all of its BCo shares to another unrelated party, for a price of $2 million. ACo therefore incurred a loss of $4 million on the sale of the BCo shares.

Under the B domestic tax law, capital gains derived by non-residents on the sale of shares in B-resident companies are subject to income tax at a 25% rate. In computing such capital gains, the actual purchase price is ignored; instead, a capital gain equal to 20% of the sale price is deemed to be derived by the non-resident seller. Thus, in ACo's case, ACo is deemed to derive a capital gain of $400,000 (i.e., $2 million x 20%), and is therefore liable for B income tax of $100,000 (i.e., $400,000 x 25%).

The A/B treaty is identical to the 2017 UN model treaty. The percentage in Art. 13(5) is 10%.

Does the A/B treaty permit B to levy $100,000 income tax on ACo in regard to its sale of shares in BCo?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

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 a particular year, 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 that year 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?

LAST WEEK'S ANSWER

Art. 9(2):

Ignoring for the moment Art. 9(3) (see below), Art. 9(2) would require the X tax authorities to make a corresponding adjustment only if, and to the extent, they agree with the primary adjustment made by the Y tax authorities – i.e., the reduction of $20 million in the purchase price. Therefore, a preliminary issue is: do the X tax authorities agree with that $20 million reduction? If they don't agree with all or part that reduction, then economic double taxation will be the result, unless (i) YCo can achieve a more favourable assessment in Y, via the appeals process; and/or (ii) an agreement between the 2 competent authorities is achieved under Art. 25.

If the X tax authorities do agree with the primary adjustment, then Art. 9(2) would require them to "make an appropriate adjustment to the amount of [X] tax charged … on [the $20 million]". That adjustment might occur under Art. 9(2) itself – i.e., XCo's taxable profits would be reduced by $20 million, which (ironically) would cause a reduction of $5 million in X tax (cf. YCo's $4 million increase in Y tax). Under this mechanism, there would be no adjustment in X in regard to the $2 million penalty.

The OECD & UN Commentaries on Art. 9(2) suggest that an alternative mechanism for the "appropriate adjustment" would be for X to provide XCo with relief from double taxation under Art. 23. Again, under this mechanism, there would be no adjustment in X in regard to the $2 million penalty.

Art. 9(3):

However, according to Art. 9(3), Art. 9(2) shall not apply where "judicial, administrative or other legal proceedings have resulted in a final ruling" that YCo is liable to a penalty with respect to, inter alia, gross negligence.

In that situation, not only is there no corresponding adjustment in X for the $2 million penalty in Y, there would also be no requirement for X to provide a corresponding adjustment for Y's $20 million reduction of the purchase price – i.e., the full $6 million would not be relieved in X.

An open issue would be whether, in this present case, the "judicial, administrative or other legal proceedings have resulted in a final ruling" in regard to the penalty. If, for example, YCo still has time to appeal in regard to the penalty, the X tax authorities would probably wait for that appeal process to be completed or time-barred, so that they know whether Art. 9(3) will be triggered.

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