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ITB International Tax Bytes by Steve Towers

"International tax news, explained"

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17 September 2021

HIGHLIGHTS

- **US international tax changes**
    - **Draft bill from House Ways and Means Committee**
    - **3 sets of proposals from Democrats:**
        - **Biden administration**
        - **Senator Wyden and colleagues on Senate Finance Committee**
        - **House Ways and Means Committee**
    - **What are the common elements?**
- **Other US tax changes proposed this week by Democrats**
- **Molinos case from Argentina**
    - **Use of domestic law GAAR to deny treaty benefits**

HAPPY FRIDAY!

Milley needs to explain; and **AUKUS** creates a ruckus!

Meanwhile, in the tax world…

The **GILTI** tax rate will be rounded to **16.5625%**; **treaties** are not so superior in **Argentina**; **Margrethe** (sort of) wins at last; **Mexico** requires safe harbours; the **Netherlands** wants to reduce bias; and **Senator Wyden** doesn't like **share buybacks!**

And as we approach the **Mid-Autumn Festival**, the most important question is: **"What is your favourite type of Mooncake?"**

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. Other US tax changes
4. Molinos case – use of domestic-law GAAR to deny treaty benefits
5. Other global developments
6. Europe
    - ECJ, Finland, Germany, Ireland, Netherlands, Poland
7. Africa
    - Nigeria
8. Americas
    - 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

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

Andrés Báez Moreno
"How Do 'The Old' and 'The New' Live Together? The Principal Purpose Test and Other Anti-avoidance Instruments in Tax Treaties"
Intertax, Kluwer, 2021 (Volume 49), Issue 10 (subscription service)

Guillermo O. Teijeiro
"A Pre-BEPS, long-expected Landmark Argentine Supreme Court Decision on DTA interpretation and Domestic GAAR Application in a Treaty Setting"
Kluwer International Tax Blog (11 September 2021) (freely available)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, carries on a share trading business. For financial accounting purposes, XCo reports the shares it owns as inventory (i.e., trading stock).

As part of its share trading business, XCo purchased shares in YCo, a company resident in Y. YCo's shares are listed on the Y stock exchange. Over 95% of YCo's assets (by value) are buildings in Y.

Several weeks later, XCo sold all of its shares in YCo for a profit.

The share purchase and sale transactions were undertaken for XCo by ZCo, an independent stockbroker in Y.

XCo has never had any employees or office premises in Y.

Under Y domestic law, XCo's profit on the sale of the YCo shares is subject to income tax.

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

Does the treaty permit Y to levy income tax on XCo's profit?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

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?

LAST WEEK'S ANSWER

Note

This question is based on the Indonesian capital gains tax rules.

Art. 13(5)

Art. 13(5) permits B to levy tax on "gains … derived by [ACo] from the alienation of shares [in BCo]". Does ACo have a "gain derived", in the situation where it has incurred a loss of $4 million on the sale of the shares in BCo?

Para. 12 of the OECD Comm. on Art. 13 (which is incorporated in the UN Comm.) states:

> "The Article does not specify how to compute a capital gain, this being left to the domestic law applicable. As a rule, capital gains are calculated by deducting the cost from the selling price. … Some tax laws prescribe another base instead of cost, e.g. the value previously reported by the alienator of the asset for capital tax purposes."

Although it does not specifically refer to the calculation method used by B, the Comm. is quite clear that the calculation of a capital gain is solely a domestic law matter. Therefore, based on the Comm., I would conclude that Art. 13(5) permits B to levy $100,000 tax on ACo.

Art. 2

A possible issue arises under Art. 2: is B's tax on ACo's deemed "capital gain" a tax on income or a tax on capital? The argument in favour of it being a tax on capital is that ACo has actually derived a loss (not income). If it is a tax on capital, then Art. 22 would apply, instead of Art. 13: Art. 22 would not permit B to levy tax (i.e., there is no equivalent to Art. 13(5) in Art. 22).

However, B's taxation of ACo's deemed "capital gain" is part of B's income tax, which we can assume (according to its predominant character) is clearly a tax on income. Although the position might be different if B's taxation of ACo's deemed "capital gain" were pursuant to a separate tax, it is not: it is part of B's income tax. Therefore, IMHO: Art. 2 does not cause Art. 22 to apply, instead of Art. 13.

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