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ITB International Tax Bytes *by Steve Towers*

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8 October 2021

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Inclusive Framework seeks to finalise both agreement and detailed implementation plan before next week's G20 finance ministers' meeting**
- **EU's new lists of non-cooperative jurisdictions**
  - **Impact on Hong Kong's exemption of foreign source income**
- **Interesting treaty provisions**

HAPPY FRIDAY!

Facebook faces outrage and outage; **Netflix** mistranslates **Squid Game** into dollars; and **Captain Kirk** (at last!) will go to the final frontier!

Meanwhile, in the tax world…

Ireland achieves the least, but **Bruno** measures by the millimetre; **Hong Kong** is listed in **Europe**; **Australia** is privileged; **Spain** loses goodwill; **Brazil** favours **Portugal**; and **Argentina** does its duty!

But at the end of the week, the most important question is this: **"If you are not mentioned in the Pandora Papers, are you disappointed or relieved?"**

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. EU: non-cooperative jurisdictions
3. Trade & other global developments
4. Interesting treaty provisions
5. Asia Pacifc
   - Australia, Cambodia, India, Indonesia, Malaysia, Philippines, Singapore
6. Europe
   - Austria, EU, ECJ, France, Germany, Netherlands, Poland, Spain
7. Africa
   - Egypt
8. Middle East & Central Asia
   - Bahrain
9. Americas
   - Argentina, Brazil, Canada, US
10. 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

Bodil Tolstrup and Nikolaj Bjørnholm
"First Danish Decisions on Beneficial Ownership following the ECJ Decisions in the *'Danish Cases'* "
European Taxation, IBFD, 2021 (Volume 61), No. 10 (subscription service)

Reuven Avi-Yonah
"Is the Net Investment Income Tax a Treaty Override? Reflections on *Toulouse*"
Tax Notes Today International, Tax Analysts, 4 October 2021 (subscription service)

Kees van Raad
"A Blueprint for Restructuring the OECD Model's Distributive Rules"
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 10 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, carries on an insurance business. XCo has no employees or offices in Y.

XCo owns 100% of the shares in YCo, a company resident in Y, which also carries on an insurance business.

XCo provides insurance for many types of risks, including some types of risks which YCo does not insure.

Occasionally, an existing customer of YCo wishes to buy insurance of a type which is provided by XCo, but not by YCo. YCo will act as a communication channel between the customer and XCo. However, it will be clear (including to the customer) that any resulting insurance contract is between XCo and the customer, and that YCo has no authority to conclude that contract on behalf of XCo.

YCo does not provide this "communication service" for any other insurance companies.

YCo charges XCo an arm's length fee for the "communication service", but only if an insurance contract is entered into between XCo and the customer.

Premiums are paid directly by the customer to XCo.

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

Does the X/Y treaty permit Y to levy income tax on the insurance premiums paid to XCo?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo, a company resident in A, has a branch in B. The branch has office premises in B and there are 10 employees who are based at the branch.

The branch conducts an investment business – it holds equity and debt instruments issued by numerous companies which are resident in B. In regard to several of those companies, 100% of the issued shares are held by the branch.

The branch wanted to acquire all of the shares in BCo, a company resident in B. Most of BCo's shareholders were resident in A. The transaction was structured as a "share for share" exchange – i.e., ACo issued new shares to the BCo shareholders, in return for 100% of the shares in BCo. After this transaction, the shares in BCo were held by ACo's branch in B.

ACo incurred significant costs in the "share for share" exchange (e.g., time of head office and branch employees, and external costs for capital duty, lawyers, accountants, valuers, etc.). Those costs are tax deductible under the A income tax law.

The A/B treaty is identical to the 2008 OECD model treaty.

In determining the profits attributable to the PE under Art. 7 of the treaty, how should the costs be treated?

LAST WEEK'S ANSWER

The profits attributable to the PE should be determined using the "authorised OECD approach" which is described in the 2008 OECD report on attribution of profits to PEs. That approach requires the assumption that the PE is an independent and separate enterprise from the remainder of ACo, and the use of a 2-step analysis.

The starting point is the identification of the signficant people functions in regard to the "share for share" transaction. The question indicates that the branch management made the decision to acquire all of the shares in BCo, but there was also some head office employee time spent on the transaction. This suggests that the branch management took primary responsibility for the transaction, but some support was provided by the head office employees – this would need to be confirmed by a functional analysis.

Assuming it is confirmed, then that would probably lead to a conclusion that the PE would notionally be considered to have issued all of the ACo shares and to have incurred all of the costs which relate the transaction. It would also mean that the PE should pay a service fee to the head office to reward the head office for its employee time. Due to the fact that the relevant treaty is identical to the 2008 OECD model treaty (which includes the "old" Art. 7(3) in regard to expenses), and also due to the fact that the head office (I assume) is not in the business of providing such services, the service fee should be at cost.

An important point to note is that there is nothing in the 2008 or 2010 OECD reports on attribution of profits to PEs, which suggests that the usual approach for attributing profits to a PE does not apply to so-called "organ costs" – i.e., costs which relate to the legal entity, such as costs incurred in the legal entity issuing new shares.

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AskSteve

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