ITB International Tax Bytes *by Steve Towers*

"International tax news, explained"

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29 October 2021

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Closer look at likely start dates for 2 pillars**
- **President Biden's new framework for US corporate tax changes**
- **Review of recent international tax cases**
  - **Determining arm's length interest rate**
  - **Application of PE definition to employee's home office**
  - **Interpretation of tax sparing credit provision**
  - **"Income vs. capital" character of merger fees**

HAPPY FRIDAY!

Facebook makes a **metaphysical change**, **Cavallo** enjoys freedom; and **Australia** relies on the future to get to zero!

Meanwhile, in the tax world…

Biden creates a framework, but keeps the **BEAT**; **Spain** goes for the minimum; **carbon** has multiple prices; **Germany** remains comparable; **Denmark** works from home, while **China** starts trials at home; **Belgium** does not spare credits; the **UK** changes domicile; and **Glencore's** fees are all mine!

But as the world gets ready for the start of **COP26**, the most question is this: **"Do your kids think Halloween is scarier than climate change?"**

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 corporate tax changes
3. Carbon pricing
4. International tax cases
5. Asia Pacific
   - China, Singapore
6. Europe
   - Finland, Ireland, Spain, UK

ITB series on Pillars One & Two

- **Inclusive Framework's final agreement on Pillars One & Two (ITB, 15 October 2021)**

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)**

Pillar Two

- **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)**
- **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

Jan de Goede
"The Future of the Taxation of Software Payments: Reflections on the Proposal to Amend Article 12 of the UN Model as Discussed by the UN Tax Committee in April 2021"
Bulletin for International Taxation, 2021 (Volume 75), No. 11/12 (subscription service)

Ailtor Navarro
"Jurisdiction Not to Tax, Tax Sparing Clauses, and the OECD Minimum Taxation (GloBE) Proposal"
Nordic Tax Journal, Nordic Tax Research Council, 2021 (freely available at https://sciendo.com/issue/NTAX/2021/1)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, is in the business of generating electricity through wind turbines.

As part of its business, it purchased land in Y, on which wind turbines and related assets ("wind farm") were constructed.

All of the decision-making in regard to the establishment of the wind farm was made by XCo's employees in X. In fact, XCo has no employees who are based in Y, and XCo's employees do not regularly visit Y.

To construct the wind farm, XCo engaged YCo 1, an unrelated company resident in Y, to construct the wind farm as a service for it. The components for the construction were purchased by XCo and physically transferred to YCo 1. Ongoing maintenance of the wind farm is also performed by YCo 1, as a service for XCo. Legal and administrative arrangements for the sale of the electricity into the Y electricity grid, are performed by YCo 2, another unrelated company resident in Y, as a service for XCo – however, YCo 2 does not conclude contracts on behalf of XCo.

The X/Y treaty is identical to the 2014 OECD model treaty.

Questions: (1) Does XCo have a PE in Y?; (2) If XCo does have a PE in Y: in determining the profits attributable to the PE under Art. 7, what functions, assets and risks would be allocated to the PE, on the assumption that it is a "separate and independent enterprise"?

Answer in next ITB email alert on 12 November 2021!

LAST WEEK'S QUESTION

ACo, a company resident in A, carries on a logistics business on a global basis.

ACo owns a warehouse in B. ACo uses the warehouse to provide logistics services in B.

Under the B domestic tax law, fees paid for logistics services are subject to a withholding tax of 5% on the gross fees. The withholding tax is a final tax – i.e., no deductions are allowed. This final withholding tax regime applies to all logistics services provided in B, regardless of whether they are provided by residents or non-residents.

The A/B treaty is identical to the 2017 OECD model treaty.

In the current year, ACo's logistics business in B has incurred losses.

Does the treaty allow ACo to be exempt from B withholding tax, on the basis that it incurs losses?

LAST WEEK'S ANSWER

1. Art. 5:

The warehouse would constitute an Art. 5(1) PE for ACo in B. All of the Art. 5(1) tests would be satisfied. Also, the exceptions in Art. 5(4)(a), (b) & (e) would not be satisfied, because: (i) the goods stored in the warehouse do not belong to ACo; and (ii) the provision of logistics services in the warehouse is a direct income-producing activity for ACo – they are not "preparatory or auxiliary".

2. Art. 7:

Art. 7 therefore allows B to impose tax on ACo's profits which are attributable to the PE.

This raises 2 issues.

2.1 The first issue is whether Art. 7 allows B to impose tax on ACo only on a "net" basis – i.e., after deducting expenses. In other words, does gross-basis taxation satisfy Art. 7's reference to "profits"?

The answer is that "gross-basis" taxation is not prohibited by Art. 7 – see paragraph 30 of the 2017 OECD Comm. on Art. 7: "[Art. 7(2)] does not deal with the issue of whether expenses are deductible when computing the taxable income of the enterprise in either Contracting State."

However, Art. 24(3), which requires that the taxation on a PE is "not less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities", must be considered. Art. 24(3) might be triggered if the gross-basis taxation applied only to non-resident companies. But that's not the case here: the gross-basis taxation applies to all logistics services provided in B, regardless of whether they are provided by residents or non-residents.

Thus, the B withholding tax levied on ACo would not breach Art. 7 (even though it is gross-basis taxation) or Art. 24(3).

2.2 The second issue is determining how much of the fees received by ACo are attributable to the B PE.

Art. 7 allows B to tax ACo only on its profits which are attributable to the B PE. If the logistics fees are consideration for a freight service which commences in A (or some other country) and finishes in B, it is quite likely that not all of the fees should be attributed to the B PE.

Thus, IMHO: The mere fact that ACo's logistics business in B incurs losses, does not cause the A/B treaty to prevent the imposition of the B withholding tax. However, there might be an opportunity for ACo to reduce the quantum of the withholding tax, on the basis that not all of the fees are attributable to the B PE.

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