ITB International Tax Bytes by Steve Towers

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19 November 2021

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Planning in regard to GloBE rules and Subject To Tax Rule (STTR) in Pillar Two**
- **Royal Dutch Shell's proposal to move its tax residence from the Netherlands to the UK**

HAPPY FRIDAY!

Modi blinks; **Hong Kong** is full of boars; and the **Olympics** should introduce a new sport: **political football!**

Meanwhile, in the tax world…

IF does not consult; **Pascal** says withholding taxes are safe; **Shell** leaves town; **Clough** coughs up 15 million; **Spain** must deduct; **Ecuador** raises taxes; and the **US** finally enacts some legislation!

But at the end of the week, the most important question is this: **"Was COP26 a cop-out?"**

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. Royal Dutch Shell
3. Asia Pacifc
   - Australia, Malaysia, Singapore, Sri Lanka
4. Europe
   - EU, Netherlands, Poland
5. Africa
   - South Africa
6. Americas
   - Ecuador, Mexico, US
7. Treaty news

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

Jinyan Li
"China's Rising (and the United States' Declining) Influence in Global Tax Governance? Some Observations"
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 11/12 (subscription service)

Adam Zalasiński
"35 Years of ECJ Direct Tax Case Law: An Historical Overview on the Occasion of the 60th Anniversary of European Taxation"
European Taxation, IBFD, 2021 (Volume 61), No. 12 (subscription service)

Mindy Herzfeld
"Can the United States Make Good on Its International Tax Commitments?"
Tax Notes Today International, Tax Analysts, 15 November 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, owns 100% of the shares in X Sub, another company resident in X.

X Sub owns 100% of the shares in YCo, a company resident in Y. YCo operates a very profitable business in Y, but it owns very little real estate in Y.

X Sub is a pure holding company, which was established by XCo to hold the shares in YCo – those shares in YCo were acquired by X Sub from third parties many years ago. X Sub has no other assets, and it has no employees or business premises.

XCo now sells 100% of the shares in X Sub to a third party purchaser, and derives a significant profit on the sale.

The X/Y treaty is identical to the 2011 UN model treaty. The MLI does not apply to the X/Y treaty.

The Y domestic tax law contains a GAAR provision. Applying that GAAR, the Y tax authorities disregard X Sub's existence (on the basis that it lacks substance), and treats XCo as owning and selling the shares in YCo – which causes XCo to derive a taxable capital gain under Y tax law.

Under the Y law, treaties have superior force over domestic law (including GAAR).

Does the X/Y treaty allow the Y tax authorities levy tax on XCo in regard to the taxable capital gain which (they say) XCo derives?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

For the last 5 years, ACo, a company resident in A, has owned 24% of the shares in BCo, a publicly listed company resident in B.

Under B domestic law, a 20% dividend withholding tax is levied on all outbound dividends, regardless of the level of shareholding.

The A/B treaty, which is the first double tax treaty between A and B, recently entered into force. The A/B treaty is identical to the 2017 OECD model treaty.

For the purpose of qualifying for the 5% dividend withholding tax rate under Art. 10 of the treaty, ACo has recently purchased an additional 1% of shares (giving ACo a total of 25% of BCo's shares).

B introduced into its domestic tax law a GAAR provision (based on the taxpayer's principal purpose) 10 years ago.

BCo will soon pay dividends to all its shareholders. Questions:

1. What dividend withholding tax rate should apply to the dividend to be paid to ACo?
2. Are the B tax authorities permitted to apply the PPT (Art. 29(9)) to this situation?
3. Are the B tax authorities permitted to apply GAAR to this situation?
4. If the B tax authorities chose to apply GAAR, but not the PPT, to this situation, and therefore they claim that a higher dividend withholding tax rate applies, is ACo entitled to request MAP discussions between the A and B tax authorities?

LAST WEEK'S ANSWER

Dividend withholding tax (DWT) rate

Subject to the possible application of Art. 29(9) and/or GAAR (see below), the DWT rate should be 5% under Art. 10(2)(a), provided ACo holds the 25% shareholding throughout the required 365 day period.

Note that Art. 10(2)(a) does not require the 365 day period to be satisfied before the dividend is paid. However, the provision does not prevent B from requiring that either 15% (Art. 10(2)(b)) or 20% (domestic law) DWT is withheld by BCo, and allowing ACo to seek a refund of the difference after it has satisfied the 365 day period.

PPT (Art. 29(9))

These facts are drawn from Example E in para. 182 of the 2017 OECD Comm. on Art. 29.

According to that example, the "first limb" of Art. 29(9) (i.e., "one of the principal purposes of any arrangement or transaction") would be satisfied by ACo's purchase of the additional 1% of the shares in BCo; however, the exception in the "second limb" (i.e., "granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention") would also be satisfied.

Therefore, based on that example, the result is that the 5% DWT would not be denied by Art. 29(9).

GAAR

The question suggests that B's GAAR would be applicable in this situation – e.g., because it is based on the taxpayer's principal purpose, and it does not include an exception similar to the "second limb" of Art. 29(9).

It would therefore lead to a different outcome than Art. 29(9).

The issue is how that conflict between GAAR and Art. 29(9) should be resolved.

There is support for the view that the conflict should be decided in favour of ACo – i.e., that the B tax authorities cannot apply GAAR to deny a treaty benefit, if Art. 29(9) does not do so: (1) see paras. 68 to 77 of the 2017 OECD Comm. on Art. 1; and (2) the A/B treaty does not include a provision which expressly allows the 2 parties to apply domestic law anti-avoidance rules (despite the fact that B's GAAR was in existence for many years before the treaty was signed). If the A/B treaty has superior status under B domestic law (vs. domestic legislation), then, IMHO, GAAR should not apply.

However, the legal status of treaties in the B domestic law might be such that they do not have automatic superior status over domestic legislation. It is possible that the B legal position is that the GAAR has paramount force over the A/B treaty – in which case, GAAR would apply.

MAP

If the B tax authorities apply GAAR, but not Art. 29(9), to deny the 5% rate to ACo, is ACo entitled to request MAP discussions?

The answer is "yes". ACo's taxation would not be "in accordance with the provisions of this Convention" (Art. 25(1)). Thus, ACO would be entitled to present its case to the competent authority (CA) of either A or B.

Under Art. 25(2), the obligation on the 2 CAs is to "endeavour … to resolve the case by mutual agreement". This is an obligation to negotiate, not an obligation to reach an agreement. That being the case, although the CA for A might be supportive of ACo's position that the GAAR should not deny ACo the 5% rate, the CA for B might not agree.

In that case, ACo might (after 2 years) initiate the arbitration process (Art. 25(5)). However, if the arbitration decision is in favour of A and ACo (i.e., GAAR should not be applied), it is still conceivable that, due to its domestic legal position in regard to GAAR's paramount force, the B tax authorities might still insist on applying GAAR – although this would suggest that the B CA entered into the arbitration process in bad faith.

Note that the 2017 OECD Comm. on Art. 25 indicates that some States deny the taxpayer the ability to initiate MAP in cases where the transactions are regarded as abusive. Also, Australia has made a reservation that it reserves the right to exclude from Art. 25(5) cases involving the application of Australia's GAAR.

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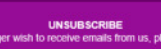

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