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ITB International Tax Bytes *by Steve Towers*

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26 November 2021

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Agreements to remove DSTs in 2 more countries**
  - **Use of accounting planning to "manage" ETR calculation in GloBE rules**
- **Review of recent international tax cases**
  - **Foreign tax credit provision in treaty**
  - **Beneficial ownership of royalties**

HAPPY FRIDAY!

The Beatles get back; **Adele** stops shuffling; and **NASA** aims for an asteroid!

Meanwhile, in the tax world …

India keeps 6%; **Labuan** adds substance; **Velcro** might stick, but it does not repeat; the **UK** QAHCs; in the **US**, BBB is a pass; **Nigeria** wants 1% of everything; **Sweden** provides no aid; and **Dutch conduits** really do have risk!

But at the end of the week, the most important question is this: **"Will the model GloBE rules, which are scheduled to be released next week, be interesting or a disappointment?"**

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. International tax cases
3. Trade & other global developments
4. Asia Pacifc
   - Malaysia
5. Europe
   - EU, Netherlands, Sweden, UK
6. Africa
   - Ghana, Nigeria
7. Americas
   - US
8. 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

John F. Avery Jones
"What Can We Learn from the History of Article 21 of the OECD Model?"
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 11/12 (subscription service)

Vikram Chand, Alessandro Turina and Kinga Romanovska
"Tax Treaty Obstacles in Implementing the Pillar Two Global Minimum Tax Rules and a Possible Solution for Eliminating the various challenges"
19 November 2021 (freely available at www.ssrn.com)

Lucas de Lima Carvalho and Larissa Falkowski
"The 'Principal Role' of Social Media Influencers as PEs"
Tax Notes Today International, Tax Analysts, 22 November 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo, a company resident in A, owns a valuable trade mark.

ACo licenses the trade mark to BCo, a related company resident in B, in return for annual royalties which are set at 93% of the gross amount of royalty income to which BCo is contractually entitled to receive from sub-licensing the IP. However, BCo's contractual obligation to pay the royalties to ACo is not dependent on BCo actually receiving the royalty income from sub-licensing.

BCo sub-licenses the trade mark to CCo, an unrelated company resident in C, in return for annual royalties which are calculated as a percentage of CCo's gross revenue from using the trade mark in its business.

These 2 transactions are the only transactions which are entered into by BCo. BCo has no other operations, assets, liabilities or employees.

BCo pays royalties to ACo 3 days after receiving royalties from CCo. BCo uses its 7% "spread" to pay its administrative expenses and B income tax on its taxable profits, and the balance is paid as a dividend to the group parent company.

Withholding tax rates on outbound royalties under domestic law are: 0% (B) and 20% (C).

The B/C treaty is identical to the 2014 OECD model treaty, and was signed and entered into in 2016. The MLI does not apply to the B/C treaty.

The A/C treaty is identical to the 2011 UN model treaty, with a 10% rate specified in Art. 12(2). The MLI (including the PPT) applies to the A/C treaty.

There is no A/B treaty.

After applying all treaty benefits, what rate of withholding tax (if any) should apply to the royalties paid by CCo to BCo?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

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 to levy tax on XCo in regard to the taxable capital gain which (they say) XCo derives?

LAST WEEK'S ANSWER

Art. 13

If the actual facts are respected (i.e., X Sub, not XCo, owns and sells the shares in YCo), none of Art. 13(1)-(5) would apply. Thus, Art. 13(6) would provide XCo with an exemption from Y tax.

If, however, XCo is treated as the owner and seller of the shares in YCo, Art. 13(5) would allow Y to tax XCo on the gain it derives.

GAAR / Treaty abuse

As treaties have superior force over Y domestic law (including GAAR), it might be thought that the Y tax authorities would not be permitted to apply GAAR to change the facts, by disregarding X Sub's existence.

However, the 2011 UN Comm. on Art. 1 would allow that to occur if the use of X Sub is considered to be an "abuse" of the treaty: see paras. 20-27, and 38-39. At paras. 25 & 27, the Comm. states that 2 elements must be present for transactions or arrangements to be found to be an abuse of the treaty: (1) a main purpose (determined objectively, based on all relevant facts and circumstances) for entering into the transactions or arrangements was to secure a more favourable tax outcome; and (2) obtaining that more favourable treatment would be contrary to the object and purpose of the relevant provisions. [Yes, this is very similar to the PPT!]

Applying those 2 elements to this case:

Element (1): The fact that X Sub lacks substance is suggestive that this structure was put in place to allow Art. 13(6) to apply on eventual sale. However, it is possible that the use of X Sub could be explained for non-tax reasons – e.g., (a) to enable a sale of YCo without requiring approval from Y regulatory authorities; and/or (b) to protect XCo from non-tax legal liabilities in Y. Such possible reasons would need to be investigated, to determine whether they are credible or not.

Element (2): The scope of the "second limb" in the PPT is very difficult to identify. However, if the result in element (1) is that a main purpose of the use of X Sub was to allow Art. 13(6) to apply on eventual sale, it is likely that that would be considered to be contrary to the object and purpose of the relevant provisions.

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