

Want to learn more about ITB? Sign up for a free trial by emailing us

[Free Trial](#)

Check out our suite of subscription plans: individual (standard), student, university faculty, young professional, and enterprise

[Subscribe](#)

3 December 2021



**HIGHLIGHTS**

- Latest developments on Pillars One & Two
  - OECD misses its own deadline
  - EU prepares Pillar Two directive
  - Is IIR really "a CFC rule on steroids"?
- Alta Energy case
  - Canadian Supreme Court holds that clear treaty shopping structure qualifies for treaty benefits, regardless of Canada's domestic law GAAR

**HAPPY FRIDAY!**

Angela farewells punk; Didi books a ride to Hong Kong; and Chris takes sibling support too far!

Meanwhile, in the tax world ...

The OECD misses its cue; treaty shopping wins in Canada; Papua New Guinea concentrates; advertising services are too expensive in Hungary; the EU writes a new code; and DAC allows a crowd!

But at the end of the week, the most important point to note is this: "It's the quality of the final Pillar Two product that matters, not compliance with deadlines!"

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. Alta Energy case
3. Other global developments
4. Asia Pacific
  - Australia, Papua New Guinea, Singapore
5. Europe
  - ECJ, EU, Germany
6. 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**

Robert J. Danon and Sebastian Wuschka  
["International Investment Agreements and the International Tax System: The Potential of Complementarity and Harmonious Interpretation"](#)  
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 11/12 (subscription service)

Kees van Raad  
["Proposal for a Reform of Article 21 of the OECD Model"](#)  
Bulletin for International Taxation, IBFD, 2021 (Volume 75), No. 11/12 (subscription service)

**INTERNATIONAL TAX QUIZ**

**THIS WEEK'S NEW QUIZ**

XCo, a company resident in X, carries on an investment consulting business.

YCo, a company resident in Y, enters into a contract with XCo for XCo to undertake a study of investment opportunities for YCo in several countries, including Z.

As XCo does not have any personnel in Z, XCo sends 2 of its X-based employees to Z to perform the Z part of the study. At the start, it was thought that the employees would be in Z for a continuous period of 4 months. However, due to their inefficiency, they actually spent a continuous period of 7 months in Z, working full-time on the study for YCo.

The X/Y, X/Z and Y/Z treaties are all identical to the 2017 UN model treaty, with Art. 23B.

After applying the 3 treaties:

1. which countries are permitted to impose income tax on the fees paid by YCo to XCo for the study?
2. which countries are permitted to impose income tax on the salaries paid to the 2 employees?

Answer in next ITB email alert!

**LAST WEEK'S QUESTION**

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 trade mark. 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?

**LAST WEEK'S ANSWER**

B/C treaty: beneficial ownership

To qualify for the 0% rate under Art. 12(1) of the B/C treaty, BCo must be the beneficial owner (B.O.) of the royalties. The 2014 OECD Comm. narrowed the circumstances in which a conduit company would fail the B.O. condition: BCo would fail the condition, only if its "right to use and enjoy the royalties is constrained by a contractual or legal obligation to pass on the payment received to another person [, provided the] contractual or legal obligation [is] dependent on the receipt of the payment by the direct recipient ...".

As BCo's contractual obligation to pay royalties to ACo is not contingent on BCo actually receiving royalties from CCo, it might be thought that BCo satisfies this narrowed B.O. condition. However, the 2014 OECD Comm. states that the contractual or legal obligation "will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person."

BCo's only source of funds to pay the royalties to ACo is the actual receipt of royalties from CCo. Thus, it can be argued that BCo's contractual obligation to pay royalties to ACo is contingent, in substance, on BCo actually receiving royalties from CCo.

If this argument is accepted, BCo would fail the B.O. condition.

B/C treaty: abuse

Even if BCo passes the B.O. condition, it is possible that a C court would take the view that the conduit arrangement was an abuse of the B/C treaty (based on the 2014 OECD Comm. on Art. 1), and deny the treaty benefit for that reason.

A/C treaty: beneficial ownership

If BCo fails the B.O. condition, can ACo claim the benefit of the 10% rate under Art. 12(2) of the A/C treaty?

The UN Comm. on Art. 12 allows a "look through" to the B.O. "when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer". However, there is no reference to an interposed conduit company. Also, Art. 12(2) applies to "such royalties" – i.e., the royalties referred to in Art. 12(1). Art. 12(1) refers to royalties "arising in a Contracting State [C] and paid to a resident of the other Contracting State [A]". In our case, there are 2 different royalty streams, neither of which satisfies the 2 conditions in Art. 12(1).

IMHO: ACo is not entitled to the 10% rate.

Conclusion

If BCo fails the B.O. condition or if the Art. 1 "abuse" rule is applied by a C court, then the 0% rate would be unavailable.

And, IMHO, ACo is not entitled to the 10% rate, even if BCo fails the B.O. condition.



If you have a friend or colleague who you think might find this email alert interesting, please forward it to them.

Watch ITB video podcasts anytime, anywhere with our App!



[HOME](#) [CONTACT US](#) [TERMS & CONDITIONS](#) [PRIVACY POLICY](#) [FAQS](#) [DISCLAIMER](#)

© 2021 International Insights Pty Ltd. All rights reserved.

**UNSUBSCRIBE**

If you no longer wish to receive emails from us, please click [here](#)