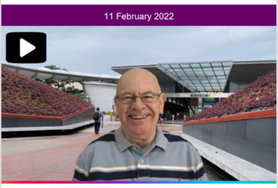
ITB International Tax Bytes by Steve Towers

**"International tax news, explained"**



11 February 2022



## HIGHLIGHTS

- **Review of draft model rules on nexus and revenue sourcing for Amount A in Pillar One**
  - **released for public comment**
- **Continuation of detailed review of GloBE model rules**
  - **Today, definition of Covered Taxes**
- **UAE announces introduction of general corporate income tax - for the first time**

## HAPPY FRIDAY!

**Ottawa** is locked down; **Putin** and **Macron** talk at a very long table; while **Ukraine** is looking like **Czechoslovakia** in September 1938!

Meanwhile, in the tax world…

The **ATO** provides natural love and affection; the **OECD** builds blocks; **Switzerland** abolishes duty; **Concentrix** is not most favoured in India; the **UAE** goes for 9%; while **Montenegro** is progressive!

But at the end of the week, the most important question is this: **"Is LinkedIn the best social network right now?"**

**Have a great weekend!**
**Steve**

## THIS WEEK'S PODCAST

***(For ITB video subscribers, please log in to access the video and documents/reports)***

1. Pillar One
2. GloBE model rules
3. Trade & other global developments
4. Review of tax cases in 2021
5. Asia Pacific
   - India, Singapore, Vietnam
6. Europe
   - Denmark, Italy, Montenegro
7. Middle East & Central Asia
   - UAE
8. Americas
   - Brazil
9. Treaty news

## ITB series on Pillars One & Two

- **GloBE model rules: Computation of Adjusted Covered Taxes (Part 1) (ITB, 11 February 2022)**
- **GloBE model rules: Computation of GloBE Income or Loss (Part 4) (ITB, 28 January 2022)**
- **GloBE model rules: Computation of GloBE Income or Loss (Part 3) (ITB, 21 January 2022)**
- **GloBE model rules: Computation of GloBE Income or Loss (Part 2) (ITB, 14 January 2022)**
- **GloBE model rules: Computation of GloBE Income or Loss (Part 1) (ITB, 7 January 2022)**
- **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

Tatiana Falcão
"Fragmentation of Contracts: Another Look at UN and OECD Model Provisions"
Tax Notes Today International, Tax Analysts, 3 February 2022 (subscription service)

Nupur Jalan, Gaetano Manzi and Gert Greve Arcil
"Most Favoured Nation Clauses in Tax Treaties: Comparative Analysis and Main Issues"
World Tax Journal, IBFD, 2022 (Vol. 14), No. 1 (subscription service)

## INTERNATIONAL TAX QUIZ

## THIS WEEK'S NEW QUIZ

XCo, a Constituent Entity resident in X, is liable for several taxes imposed in X:

1. Income tax of 25% imposed on XCo's taxable income. In computing taxable income, actual expenses are taken into account, but some expenses are denied deduction (e.g., entertainment expenses), and some other expenses qualify for a 200% deduction (e.g., R&D expenses). Also, XCo's taxable income includes (under the X CFC rules) its share of certain profits derived by XCo's foreign subsidiary.
2. Resource levy of 20% imposed on the value (determined according to a government schedule) of iron ore extracted in XCo's mining operations.
3. Withholding tax of 10% imposed on gross amount of rent received from leasing of X real estate owned by XCo. No deductions are available in calculating the withholding tax, which is a final tax.
4. A Qualified Domestic Minimum Top-Up Tax.
5. Wealth tax of 5% imposed on XCo's shareholders' equity as shown in its most recent balance sheet.
6. Capital duty of 1% imposed on the issue of new shares.
7. Top-up Tax imposed on XCo by X's "income inclusion rule", which is not a Qualified IIR.

**Which of these taxes qualify as Covered Taxes?**

**Answer in next ITB email alert!**

## LAST WEEK'S QUESTION

ACo 1, a company resident in A, is a Constituent Entity within an MNE Group, for the purposes of the GloBE rules.

ACo 1 has the following financial information for the current fiscal year:

1. Profit or loss: **negative EUR 20 million**
2. Income tax expense: **EUR 7 million**
3. Profit on sale of 8% shareholding in XCo, an unrelated company: **EUR 3 million**
   a. The shares were sold to ACo 2 (another Constituent Entity resident in A)
   b. ACo 1 and ACo 2 are members of a tax consolidation group in A
   c. MNE Group's UPE makes an election under Art. 3.2.8 to apply its consolidated accounting treatment to all Constituent Entities resident in A
4. Charter fee revenue: **EUR 4 million**
   a. The revenue is from the lease of a ship for 2 years, on a bare boat charter basis, to BCo (unrelated shipping company resident in B)
   b. BCo uses the ship to transport passengers in international traffic
   c. ACo 1 incurs **EUR 1.5 million** of costs directly or indirectly attributable to this revenue
   d. ACo 1 has no other shipping activities. With the exception of ACo 2 (see below), no other Constituent Entity resident in A has any shipping activities.
   e. ACo 2 has **EUR 6 million** of charter fee revenue from leasing a ship (to be used to transport cargo in international traffic) on charter fully equipped, crewed and supplied; ACo 2 incurs **EUR 2 million** of costs directly or indirectly attributable to this revenue
5. ACo 1 has a sales agent in C
   a. The sales agent causes ACo 1 to have a **"contract-concluding agency" PE in C**, under the A/C double tax treaty (which is identical to the 2017 UN model treaty)
   b. ACo 1 does not prepare separate financial accounts for the PE in C
   c. However, if ACo 1 did prepare separate financial accounts for the PE in C on a standalone basis in accordance with the accounting standard used in the preparation of the UPE's consolidated financial accounts, those separate financial accounts would show a profit of **EUR 0.5 million**. That profit of **EUR 0.5 million** is equal to the profit attributable to the PE, under Art. 7 of the A/C treaty
   d. **EUR 0.2 million** of ACo 1's income tax expense relates to the C income tax for the PE

**Based on those numbers, what is the GloBE Income or Loss of ACo 1 (Main Entity) and the C PE, respectively?**

## LAST WEEK'S ANSWER

The threshold issue is whether the "contract-concluding agency" PE in C (under the A/C treaty) qualifies as a "permanent establishment" under the Art. 10.1.1 definition.

Under para. (a) of that definition, 2 questions arise: (1) Does the phrase, "deemed place of business", apply to a "contract-concluding agency" PE? Note that Art. 5 of the 2017 UN model merely deems there to be a PE – it does not deem there to be a place of business. (2) Is Art. 7 of the 2017 UN model similar to Art. 7 of the OECD model? Note that Art. 7 of the UN model includes both an attribution rule and a modified force of attraction rule.

If para. (a) does not apply, the only other paragraph which could apply is para. (d) – but para. (d) will not apply if A does not exempt the profits attributable to the agency PE.

I suspect that the IF intends that para. (a) should apply in this case – but, if so, the drafting of para. (a) is loose!

The following assumes that there is an Art. 10.1.1 PE …

1. We need to separate the Main Entity (ME) and the C PE.
2. C PE: (i) Financial Accounting Net Income or Loss (FANIL) = **0.5**; (ii) Income tax expense = **0.2**; (iii) thus, **C PE's GloBE Income = EUR 0.7m**.
3. ME: profit or loss: **negative 20**.
4. ME: C PE's FANIL: **deduct 0.5**.
5. ME: Income tax expense (after removing C PE's income tax expense): **add 6.8**.
6. ME: profit on sale of 8% shareholding: **deduct 3**: Art. 3.2.8
7. ME: charter fee revenue.
   a. Not "International Shipping Income" (ISI), as lease is to an unrelated party: Art. 3.3.2
   b. Prima facie, the revenue satisfies "Qualified Ancillary International Shipping Income" (QAISI): Art. 3.3.3
   c. However, the **50% cap** in Art. 3.3.4 applies: ACo 2's ISI is **4** (after deducting costs) – the cap is therefore **2**.
   d. ACo 1's QAISI is (prima facie) **2.5** (after deducting costs), but is capped at **2**.

      Thus, **deduct 2.**

8. **Thus, ME's GloBE Loss = (20) – 0.5 + 6.8 – 3 – 2 = EUR 18.7m**