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16 September 2022



HIGHLIGHTS

- Latest developments on Pillars One & Two
 - 5 major EU Member States commit to implement GloBE rules "in 2023 and by any possible legal means"
 - Public consultation meeting on Amount A of Pillar One
- Treaty characterisation of payments under time charter of vessel:
 - Art. 8 on shipping profits?
 - Art. 12 (JUN model form) on royalties?
- Continuation of detailed review of GloBE model rules
 - Today: deferred tax transition rules in Art. 9.1

HAPPY FRIDAY!

Squid wins the game; Roger follows Serena to the exit; and Janet Yellen does not collect stamp!

Meanwhile, in the tax world...

Withholding tax could be a dealbreaker; Norway charts murky waters; the EU wants a mandatory contribution (but don't call it a tax!); Italy keeps capital moving; and Ethiopia puts a premium on exemption!

But at the end of the week, the most important question is this: "Will the joint statement on the implementation of the GloBE rules by Germany and its 4 friends cause Hungary to change its position?"

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. Significant international tax rulings
3. Other global developments
4. GloBE model rules: detailed review
5. Asia Pacific
 - Korea, Sri Lanka
6. Europe
 - ECJ, EU, France, Ireland, Italy
7. Africa
 - Ethiopia
8. Middle East & Central Asia
 - Oman
9. Treaty news

ITB series on Pillars One & Two

- **GloBE model rules:**
 - Art. 9.1: transitional rules regarding deferred tax attributes (ITB: 16 September 2022)
 - Art. 4.6.1 on carry back of tax losses, and Arts. 4.6.2 to 4.6.4 (ITB: 26 August 2022)
 - Art. 4.6.1: Post-filing adjustments (ITB: 19 August 2022)
 - GloBE Loss Election in Art. 4.5 (ITB: 12 August 2022)
 - Deferred tax liability recapture rules in Arts. 4.4.4 and 4.4.5 (ITB: 5 August 2022)
 - Art. 4.4: mechanism to address temporary differences (ITB: 29 July 2022)
 - Scope: Art. 1.5 (definition of "Excluded Entity") (ITB: 1 July 2022)
 - Scope: Arts. 1.1 to 1.4 (ITB: 24 June 2022)
 - Charging Provisions (parts 1 to 5) (ITB: 6, 13 & 20 May; 10 & 17 June 2022)
 - Computation of Effective Tax Rate and Top-up Tax (Parts 1 to 6) (ITB, 18 & 25 March; 1, 8, 22 & 29 April 2022)
 - Flow-through Entities and Hybrid Entities (ITB, 4 March 2022)
 - Computation of Adjusted Covered Taxes (Parts 1 to 3) (ITB, 11, 18 & 25 February 2022)
 - Computation of GloBE Income or Loss (Parts 1 to 4) (ITB, 7, 14, 21 & 28 January 2022)
- Progress Report on Amount A in Pillar One (ITB, 22 July 2022)
- Draft model rules for Amount A in Pillar One:
 - Tax certainty (ITB, 10 June 2022)
 - Regulated Financial Services exclusion from scope (ITB, 13 May 2022)
 - Extractives exclusion (ITB, 22 April 2022)
 - Scope (ITB, 8 April 2022)
 - Tax base determination (ITB, 25 February 2022)
 - Nexus and revenue sourcing (ITB, 11 February 2022)
- Inclusive Framework's final agreement on Pillars One & Two (ITB, 15 October 2021)

WORTH READING

Noam Noked

"Designing Domestic Minimum Taxes in Response to the Global Minimum Tax"

Intertax, Kluwer, Volume 50 (2022), Issue 10 (subscription service)

Reuven S. Avi-Yonah

"Medtronic II and the Profit-Shifting Problem"

Tax Notes Today International, Tax Analysts, 14 September 2022 (subscription service)

J. Harold McClure

"Medtronic II: Bizarre Application of the Unspecified Method"

Tax Notes Today International, Tax Analysts, 14 September 2022 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo is the only Constituent Entity (within an in-scope MNE Group) which is located in jurisdiction A. The Fiscal Year for the MNE Group is the calendar year. The MNE Group has Constituent Entities which are located in 10 jurisdictions.

Jurisdiction A imposes a corporate income tax with a 10% rate.

In 2023:

- ACo incurs a tax loss (for jurisdiction A corporate income tax purposes) of 100, which it can carry forward indefinitely
- If the GloBE rules were applicable to ACo in 2023, ACo would have incurred a GloBE Loss of 70 in 2023. The difference between the tax loss (100) and the notional GloBE Loss (70) is due to a "double deduction" for certain expenditure, which is allowed under the jurisdiction A corporate income tax law
- The GloBE rules are not effective, in 2023, in any jurisdiction where the MNE Group operates

In 2024:

- ACo derives taxable income (for jurisdiction A corporate income tax purposes) of 100, before deducting (in full) the carry-forward tax loss
- If the GloBE rules were applicable to ACo in 2024, ACo would have derived GloBE Income of 100 in 2024
- The GloBE rules are effective in jurisdiction B, from the start of 2024. The MNE Group includes BCo, a Constituent Entity which is located in jurisdiction B (BCo does not own any shares in ACo)
- The GloBE rules are not effective, in 2024, in any other jurisdiction where the MNE Group operates

In 2025:

- ACo derives taxable income (for jurisdiction A corporate income tax purposes) of 100
- If the GloBE rules were applicable to ACo in 2025, ACo would have derived GloBE Income of 100 in 2025
- The GloBE rules are effective in jurisdiction U (where the UPE is located), from the start of 2025.
- The GloBE rules are not effective, in 2025, in any jurisdiction where the MNE Group operates, other than jurisdictions B and U

Based on these facts, and ignoring the Substance-based Income Exclusion and Qualified Domestic Minimum Top-up Tax, does ACo have Top-up Tax in 2023, 2024 or 2025?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

XCo is a Constituent Entity in an MNE Group, which is "within scope" of the GloBE rules.

XCo is located in jurisdiction X, which levies a corporate income tax. XCo is the only Constituent Entity located in jurisdiction X.

In Year 1:

1. XCo purchases (at the start of Year 1) a fixed asset for 150, which it depreciates for financial accounting purposes at 10% per annum, and which it depreciates for X corporate income tax purposes at 20% per annum
2. XCo has GloBE Income of 100, after expensing 15 of depreciation for the fixed asset
3. XCo has taxable income (for the purposes of X corporate income tax) of 50, after deducting 30 of depreciation for the fixed asset
4. XCo has no other temporary differences between its financial accounting pretax profit and taxable income
5. The X corporate income tax rate is 25%

In Year 2:

1. XCo has GloBE Income of 220, after expensing 15 of depreciation for the fixed asset
2. XCo has taxable income of 80, after deducting 30 of depreciation for the fixed asset
3. XCo has no other temporary differences between its financial accounting pretax profit and taxable income
4. Jurisdiction X increases its corporate income tax rate to 30% (effective in Year 2)

Based on these facts, what amounts of Top-up Tax (if any) does XCo have in each of Years 1 and 2?

Please assume that jurisdiction X has no Substance-based Income Exclusion and no Qualified Domestic Minimum Top-up Tax.

LAST WEEK'S ANSWER

Year 1:

1. Current tax expense: 50 x 25% = 12.5
2. Total Deferred Tax Adjustment Amount: 15 x 15% = 2.25 (i.e., recast at 15%, no adjustments or exclusions are relevant) (Art. 4.4.1)
3. Adjusted Covered Taxes: 12.5 + 2.25 = 14.75 (Art. 4.1.1)
4. ETR: 14.75 / 100 = 14.75% (Art. 5.1.1)
5. Top-up Tax: 0.25% x 100 = 0.25 (Art. 5.2.3)

Year 2:

1. Current tax expense: 80 x 30% = 24
2. Total Deferred Tax Adjustment Amount: 15 x 15% = 2.25 (again, recast at 15%, no adjustments or exclusions are relevant) (Art. 4.4.1)
3. Adjusted Covered Taxes: 24 + 2.25 = 26.25 (Art. 4.1.1)
4. ETR: 26.25 / 220 = 11.9318% (Art. 5.1.1)
5. Top-up Tax: 3.0682% x 220 = 6.75 (Art. 5.2.3)

Final answer:

Top-up tax: 0.25 (Year 1) and 6.75 (Year 2), despite fact that jurisdiction X's corporate income tax rate is 25% in Year 1 and 30% in Year 2 – the power of permanent differences!



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