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ITB International Tax Bytes *by Steve Towers*

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7 October 2022

HIGHLIGHTS

- **Latest developments on Pillars One & Two**
  - **Progress report on administration and tax certainty aspects of Amount A in Pillar One**
  - **Report on tax incentives and GloBE rules**
  - **Belgium announces that it will proceed with implementation of GloBE rules, even without Hungary's agreement**
- **Interesting international tax cases and rulings**
  - **UK case on unilateral foreign tax credits**
  - **Spanish ruling on application of GAAR to chain of transactions**
- **Continuation of detailed review of GloBE model rules**
  - **Today: paras. (f) to (h) in Art. 6.2.1, on Constituent Entities joining and leaving an MNE Group**

HAPPY FRIDAY!

Liz Truss does a **screeching U-turn**; **Twitter** "won't take yes for an answer"; and **Putin** turns 70!

Meanwhile, in the tax world…

Aozora triumphs with form over substance; **Spain** breaks the chain; the **OECD** provides incentives for the GloBE rules; **Belgium** makes 6; **Suntory** goes flat in **New Zealand**; and the **EU** picks on more **Caribbean islands**!

But at the end of the week, the most important question is this: **"Do you think that awarding the 2022 Nobel Peace Prize to peace activists in Russia, Belarus and Ukraine is the perfect 70th birthday present for Vladimir Putin?"**

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. Other global developments
3. International tax cases
4. Significant international tax rulings
5. GloBE model rules: detailed review
6. Asia Pacific
   - China, Malaysia, Maldives, New Zealand
7. Europe
   - EU, Spain
8. Treaty news

ITB series on Pillars One & Two

- **GloBE model rules:**
  - **Art. 6.2.1(f) to (h) on Constituent Entities joining and leaving MNE Group (ITB, 7 October 2022)**
  - **Corporate Restructurings and Holding Structures (parts 1 & 2) (ITB, 23 & 30 September 2022)**
  - **Scope (parts 1 & 2) (ITB, 24 June; 1 July 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 9) (ITB, 11, 18 & 25 February; 29 July; 5,12,19 & 26 August; 16 September 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

Andrew Hickman & Marcelo Henrique Barbosa Moura
"Transfer Pricing of Financial Guarantees: The Limits of Arm's Length and a Practical Solution"
Intertax, Kluwer, Volume 51 (2023), Issue No. 1 (subscription service)

Alistair Pepper, Jessie Coleman & Thomas D. Bettge
"In Defense of the Arm's-Length Principle"
Tax Notes Today International, Tax Analysts, 5 October 2022 (subscription service)

Philippe G. Penelle & Stefanie Perrella
"Derivative Nature of Certain Delineated Controlled Transactions"
Daily Tax Report: International, Bloomberg BNA, 28 September 2022 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

A Group

ACo is the UPE of an MNE Group ("A Group"), which includes XCo (100% subsidiary of ACo).

ACo is located in jurisdiction A, and XCo is located in jurisdiction X. Jurisdiction X has implemented the GloBE rules, but jurisdiction A has not.

XCo is the parent of a 100% subsdiary, YCo, which is located in jurisdiction Y. YCo is the only member of the A Group which is located in Y.

A Group uses the calendar year as its fiscal year.

B Group

BCo is the UPE of another MNE Group ("B Group"), which includes YCo 2 (100% subsidiary of BCo).

BCo is located in jurisdiction B, which has implemented the GloBE rules.

YCo 2 is located in jurisdiction Y – it is the only member of the B Group which is located in Y.

B Group uses the calendar year as its fiscal year.

Sale of XCo

On 30 September in Year 1, ACo sells 100% of the shares in XCo to BCo.

In the 12 months ending 31 December in Year 1, YCo's financial accounting net income is 100 and its Adjusted Covered Taxes are 5. Please assume that there are no differences between the computation of YCo's financial accounting net income and GloBE Income.

In the 12 months ending 31 December in Year 1, YCO 2's financial accounting net income is 100 and its Adjusted Covered Taxes are 30. Again, please assume that there are no differences between the computation of YCo 2's financial accounting net income and GloBE Income.

Question

For Year 1, will there be one or more tax liabilities under the GloBE rules in regard to jurisdiction Y? If yes, which entity or entities will be subject to the liability or liabilities?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

X Group sells 100% of the shares in ZCo (a Constituent Entity located in jurisdiction Z) to Y Group. ZCo is not an Investment Entity.

Both groups are MNE Groups "within scope" of the GloBE rules, and both use the calendar year as the fiscal year.

The sale is effective on 31 May of Year 2.

In its consolidated financial statements for Year 2, X Group reports these 2 items in regard to ZCo: (1) 200 of payroll costs incurred in the 5 months to 31 May; and (2) 50 of depreciation incurred in the 5 months to 31 May. The depreciation relates to a tangible asset ("asset A") which has a carrying value (net of accumulated depreciation) at the start of Year 2 of 240.

In its consolidated financial statements for Year 2, Y Group reports these items in regard to ZCo: (1) 300 of payroll costs incurred in the 7 months to 31 December; and (2) carrying value of asset A (net of accumulated depreciation for Y Group's 7 months of ownership of ZCo) of 350 – this reflects the fair value of asset A, net of Y Group's 7 months' depreciation.

Please assume that: (i) ZCo is the only Constituent Entity in jurisdiction Z for both groups; (ii) the jurisdiction Z corporate income tax law does not treat the transfer of shares in ZCo as a transfer of ZCo's assets and liabilities; (iii) the payroll costs satisfy the conditions for the payroll carve-out in Art. 5.3.3; and (iv) asset A is an Eligible Tangible Asset and it satisfies the conditions for the tangible asset carve-out in Art. 5.3.4.

For each of X Group and Y Group, what will be the amount of Substance-based Income Exclusion for Year 2 for jurisdiction Z?

LAST WEEK'S ANSWER

1. X Group:
1.1 Payroll carve-out (Art. 5.3.3 & Art. 6.2.1(d)):
5% x 200 = 10

1.2 Tangible asset carve-out (Art. 5.3.4 & Art. 6.2.1(e)):
Carrying value at start of Year 2 (net of accumulated depreciation): 240
Carrying value at end of Year 2 (for X Group) (net of accumulated depreciation): 240 – 50 =190 (see Example 6.2.1-1 in IF's Examples document)
Thus, carrying value for Year 2 = (240 + 190) / 2 = 215 (Art. 5.3.5)
Adjusted carrying value under Art. 6.2.1(e): 215 x 5/12 = 89.5833
Tangible asset carve-out: 5% x 89.5833 = 4.4792

1.3 Substance-based Income Exclusion for jurisdiction Z:
10 + 4.4792 = 14.4792

2. Y Group:
2.1 Payroll carve-out (Art. 5.3.3 & Art. 6.2.1(d)):
5% x 300 = 15

2.2 Tangible asset carve-out (Art. 5.3.4 & Art. 6.2.1(e)):
Carrying value at start of Year 2 (for Y Group) (net of accumulated depreciation): 0
Carrying value at end of Year 2 (net of accumulated depreciation): 350 (step-up to fair value – see Commentary on Art. 6.2.1(e) and Example 6.2.1-1 in IF's Examples document)
Thus, carrying value for Year 2 = (0 + 350) / 2 = 175 (Art. 5.3.5)
Adjusted carrying value under Art. 6.2.1(e): 175 x 7/12 = 102.0833
Tangible asset carve-out: 5% x 102.0833 = 5.1042

2.3 Substance-based Income Exclusion for jurisdiction Z:
15 + 5.1042 = 20.1042

Do you agree?

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