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ITB International Tax Bytes by Steve Towers

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14 October 2022

HIGHLIGHTS

- **Malaysia announces implementation of GloBE rules, effective in 2024**
- **Spanish Supreme Court case on "royalties" definition in Germany / Spain treaty**
- **Continuation of detailed review of GloBE model rules**
  - **Today: Art. 6.2.2 on deemed transfers of underlying assets and liabilities**

HAPPY FRIDAY!

Trump is ordered to talk; but it's **New Zealand** which has decided to **tax hot air**!

Meanwhile, in the tax world…

G24 communicates friction; the **OECD** needs better acronyms; **Argentina** drives incentives; **Nintendo** wins its game; **Belgium** is at a loss with a 15% minimum tax; the **ECJ** participates in a win; the **EU** wants to **BEFIT**; and the **IRS** codifies, but does not supplant!

But at the end of the week, the most important question is this: **"Will the GloBE rules be an election issue in Malaysia?"**

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. GloBE model rules: detailed review
5. Asia Pacific
   - Malaysia, Singapore
6. Europe
   - Belgium, Czech Republic, ECJ, EU, Luxembourg, UK
7. Americas
   - Argentina, US
8. Treaty news

ITB series on Pillars One & Two

- **GloBE model rules:**
  - **Art. 6.2.2 on deemed transfers of underlying assets and liabilities (ITB, 14 October 2022)**
  - **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

Bret Wells
"Foreign Tax Credit Redux"
Chapman Law Review, forthcoming, freely available on www.ssrn.com

Joachim Englisch
"GloBE Rules and Tax Competition"
Intertax, Kluwer, Volume 50 (2022), Issue 12 (subscription service)

Ryan Finley
"Do Periodic Adjustments Violate U.S. Treaty Commitments?"
Tax Notes Today International, Tax Analysts, 11 October 2022 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo is the UPE of an MNE Group which is "within scope" of the GloBE rules. XCo and most of the subsidiaries within the group, are located in jurisdiction X. Jurisdiction X has implemented the GloBE rules, but it does not have a QDMTT. No other jurisdiction where the group operates has implemented the GloBE rules.

X Sub is one of the subsidiaries located in jurisdiction X. X Sub owns IP, which it licenses to third parties in return for royalties. X Sub has no employees (it receives services from other subsidiaries located in jurisdiction X), and it owns no assets other than the IP. X Sub is not an Investment Entity.

In year 1, X Sub derives 100 of royalties, and incurs an IP amortisation expense of 20, resulting in a pre-tax profit of 80. X Sub qualifies for a tax incentive in jurisdiction X, which is a corporate income tax rate of 5%. X Sub is not subject to any royalty withholding tax in other jurisdictions.

Ignoring any permanent or timing differences between financial accounting net income, GloBE Income, and taxable profits in jurisdiction X, X Sub has GloBE Income of 80 in year 1, and Adjusted Covered Taxes of 4 in year 1.

On 30 September in year 2, XCo sells 100% of the shares in X Sub to YCo, which is the UPE of another MNE Group which is "within scope" of the GloBE rules. YCo is located in jurisdiction Y. Although jurisdiction Y has not implemented the GloBE rules, several jurisdictions where the YCo group has subsidiaries have done so.

YCo records X Sub's IP at fair value in its consolidated financial statements for year 2. That fair value is significantly higher than the carrying value of the IP in X Sub's financial statements.

Assume that, in year 2, X Sub's financial statements report the same financial information as in year 1 – i.e., royalty income of 100, amortisation expense of 20, pre-tax profits of 80, no royalty withholding tax, jurisdiction X corporate income tax rate of 5%. Please ignore any permanent or timing differences between financial accounting net income, GloBE Income, and taxable profits in jurisdiction X. Also assume that both XCo and YCo use the calendar year as the fiscal year.

Based on this information, will X Sub have a tax liability under the GloBE rules in year 1 and/or year 2?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

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% subsidiary, YCo, which is located in jurisdiction Y. YCo is the only member of the A Group which is located in Y. Jurisdiction Y has not implemented the GloBE rules.

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?

LAST WEEK'S ANSWER

Preliminary point

XCo and YCo will be members of both the A Group and the B Group in Year 1: Art. 6.2.1(a).

A Group

In computing the ETR and Top-up Tax for jurisdiction Y in Year 1, A Group will take into account only the Financial Accounting Net Income or Loss and Adjusted Covered Taxes of YCo that are taken into account in ACo's consolidated financial statements for Year 1: Art. 6.2.1(b).

Accordingly, YCo's GloBE Income should be 75 (i.e., 100 x 9/12) and its Adjusted Covered Taxes should be 3.75 (i.e., 5 x 9/12).

Jurisdiction Y's ETR should be 3.75 / 75 = 5%.

If we ignore the Substance-based Income Exclusion and Additional Current Top-up Tax, the jurisdictional Top-up Tax for jurisdiction Y should be: 10% x 75 = 7.5.

Jurisdiction A has not implemented the GloBE rules. Thus, the IIR will not be imposed on ACo.

Assuming XCo is not an Investment Entity, it will qualify as an Intermediate Parent Entity in regard to YCo: Art. 10.1.1 definition. In accordance with Art. 6.2.1(h) and Art. 2.1.2, an IIR of 7.5 will be imposed on XCo.

B Group

In computing the ETR and Top-up Tax for jurisdiction Y in Year 1, B Group will take into account only the Financial Accounting Net Income or Loss and Adjusted Covered Taxes of YCo that are taken into account in BCo's consolidated financial statements for Year 1: Art. 6.2.1(b).

Accordingly, YCo's GloBE Income should be 25 (i.e., 100 x 3/12) and its Adjusted Covered Taxes should be 1.25 (i.e., 5 x 3/12).

Jurisdiction Y's Net GloBE Income, aggregate Adjusted Covered Taxes, ETR and Top-up Tax will need to take into account both YCo and YCo 2.

Net GloBE Income: 25 + 100 = 125

Adjusted Covered Taxes: 1.25 + 30 = 31.25

ETR: 31.25 / 125 = 25%

Thus, if we ignore Additional Current Top-up Tax, jurisdiction Y will have no Top-up Tax in Year 1.

Final answer

A Group: IIR of 7.5 imposed on XCo.

B Group: no IIR.

2 points to note: (i) For B Group, YCo 2's high ETR shelters YCo's low-taxed profits; and (2) B Group should do its tax due diligence carefully: XCo (which it purchases) has an IIR liability in regard to A Group.

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