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4 November 2022



HIGHLIGHTS

- Latest developments on Pillar Two
 - Netherlands releases draft legislation to implement GloBE rules
 - Germany announces that it is preparing similar draft legislation
- Hong Kong releases bill to introduce "specified foreign-sourced income" rules
 - Significantly change Hong Kong's territorial tax system for certain passive income
- 2 recent transfer pricing cases from the Netherlands
 - ADM case on business restructuring
 - BAT case on guarantee fees and implicit support

HAPPY FRIDAY!

Taylor Swift is 10 for 10; Biden attacks oil companies (it must be election season!); and the heat is on in Sharm el-Sheikh!

Meanwhile, in the tax world...

Netherlands and Germany draft; Hong Kong loses territory; Dutch tax inspectors like to get retrospective with transfer pricing; Australia discovers EBITDA; Google clicks another win; Allianz Benelux makes an excess claim; Morocco seeks to simplify; and Chile plays good copper!

But at the end of the week, the most important question is this: "Will anything really be achieved at COP27?"

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 Two
2. Hong Kong's "specified foreign-sourced income" rules
3. International tax cases
4. Asia Pacific
 - Australia, India
5. Europe
 - Belgium, ECJ, Finland, Netherlands, Portugal, UK
6. Africa
 - Morocco
7. Americas
 - Canada, Chile, US
8. Treaty news

ITB series on Pillars One & Two

- **GloBE model rules:**
 - Art. 6.3 on transfers of assets and liabilities (ITB, 21 October 2022)
 - Art. 6.2.2 on deemed transfers of underlying assets and liabilities (ITB, 14 October 2022)
 - Art. 6.2.1 on Constituent Entities joining and leaving an MNE Group (ITB, 30 September; 7 October 2022)
 - Art. 6.1: application of consolidated revenue threshold to group mergers and demergers (ITB, 23 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

David Kamin
"The Ambition and Limits of the Global Minimum Tax"
Tax Notes Today International, Tax Analysts, 1 November 2022 (subscription service)

Benjamin Malek
"Beneficial Ownership and Income Receipt under Double Taxation Conventions: Considerations following the Planet Case"
Archives de droit fiscal Suisse (ASA), 81(4), pages 161-182 (subscription service).

Joachim Englisch
"VAT Goes Virtual: Security Tokens"
EC Tax Review, Kluwer, 2022, Issue 5 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo 1 is located in jurisdiction A, and is a Constituent Entity within MNE Group # 1. ACo 1 owns several businesses.

ACo 2 is also located in jurisdiction A, and is a Constituent Entity in MNE Group # 2.

ACo 1 sells the assets and liabilities in one of its businesses to ACo 2, for consideration in 2 parts: (1) shares issued by ACo 2 (80% of the value of the total consideration); and (2) cash (20% of the value of the total consideration). The issue of shares by ACo 2 does not cause it to leave MNE Group # 2 or to join MNE Group #1.

In ACo 1's financial statements, it reports a profit on the sale, and it records the cost of the ACo 2 shares according to their value.

In ACo 2's financial statements, it records the cost of the assets and liabilities according to the value of the consideration it provided to ACo 1.

However, under the jurisdiction A tax law: (i) ACo 1 does not recognize any gain or loss on the sale; (ii) ACo 1's basis in the ACo 2 shares is equal to its basis in the transferred assets; and (iii) ACo 2 inherits ACo 1's basis in the transferred assets.

How will this transaction be treated under the GloBE rules, for each of ACo 1 and ACo 2?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

XCo (located in jurisdiction X) is a Constituent Entity in an MNE Group, which is "within scope" of the GloBE rules. The MNE Group uses the calendar year as its fiscal year.

XCo owns 100% of the shares in YCo, which is located in jurisdiction Y.

On 30 June in year 1, XCo sells 100% of the shares in YCo to ZCo, which is an unrelated company located in jurisdiction Z. ZCo is a member of a group which is not an MNE Group "in scope" of the GloBE rules.

The consideration for the sale is in 2 parts: (1) the issue of new shares by ZCo to XCo (this represents 50% of the value of the total consideration), and (2) cash (this represents 10% of the value of the total consideration). The issue of shares does not cause ZCo to become a member of XCo's MNE Group – i.e., the MNE Group does not control ZCo.

In XCo's financial statements, it reports a gain of 100 on the sale of the shares in YCo. The gain is computed as: value of consideration (300) minus carrying value of shares in YCo (200) = 100. XCo's carrying value of the shares is equal to its tax basis in the shares, for X tax law purposes.

Under the jurisdiction X tax law, XCo recognizes a gain of 10, which represents the gain referable to the cash component of the consideration. XCo is liable for jurisdiction X Covered Tax of 2.5 on that gain. The remainder of the gain is exempt.

Under the jurisdiction Y tax law, the sale of the 100% shares in YCo is treated as a sale, and re-acquisition, of YCo's assets and liabilities. The deemed sale price and the deemed re-acquisition price of the assets are both equal to the value of the consideration paid to XCo (i.e., 300), plus the value of the liabilities deemed to be transferred and re-acquired (200) – i.e., total consideration of 500. At the date of the transaction, YCo has assets with a carrying value (and tax basis) of 250. The jurisdiction Y corporate income tax rate of 20% applies to any gain deemed to be derived by YCo.

The jurisdiction Y tax law does not impose any tax on XCo in regard to the sale.

Based on these facts, what are the consequences, under the GloBE rules, for XCo's MNE Group? Please assume that XCo's MNE Group does not make an election under Art. 6.3.4 in regard to YCo.

LAST WEEK'S ANSWER

1. XCo:

XCo's gain of 100 is excluded from its GloBE Income: Art. 3.2.1(c) (Excluded Equity Gain or Loss), regardless of the cash element of the consideration.

XCo's jurisdiction X tax of 2.5 is excluded from its Adjusted Covered Taxes: Art. 4.1.3(a) (current tax) & Art. 4.4.1(a) (deferred tax).

2. YCo:

A threshold issue is whether Art. 6.2.2 applies to the transfer of shares in YCo. In particular, who is "the seller" referred to the provision – XCo or YCo? Strangely, para. 64 in the Commentary suggests that "the seller" (i.e., the entity on which the jurisdiction Y Covered Tax is imposed) is YCo; but para. 68 in the Commentary suggests that "the seller" is XCo.

If "the seller" is XCo:

1. Art. 6.2.2 will not apply, as jurisdiction Y does not impose a Covered Tax on XCo.
2. There will be no further impact on XCo's GloBE rules position.
3. For jurisdiction Y tax purposes, YCo incurs a tax liability of 50 on its deemed gain of 250. That 50 will likely qualify as Adjusted Covered Taxes. As there should be no impact in YCo's financial statements (which are used for the group consolidation), there should be no impact on YCo's GloBE Income. Thus, YCo's ETR in year 1 will be increased.

If "the seller" is YCo:

1. Art. 6.2.2 will potentially apply, as the jurisdiction Y Covered Tax is imposed on YCo.
2. But there is another issue with Art. 6.2.2: is it correct that the Covered Tax of 50 which is imposed on YCo is "based on the difference between the tax basis and the consideration paid in exchange for the Controlling Interest or the fair value of the assets and liabilities"? The consideration paid in exchange for the Controlling Interest is 300, reflecting the value of the assets minus the liabilities. In contrast, the Covered Tax imposed on YCo uses total consideration equal to (i) the value of consideration paid to XCo (300), plus (ii) the value of liabilities deemed to be transferred and re-acquired (200). Possibly, the total consideration of 500 can be accepted as corresponding to "the fair value of the assets and liabilities".
3. Assuming Art. 6.2.2 applies: for purposes of the GloBE rules, the share transfer will be treated as a disposal and acquisition of YCo's assets and liabilities.
4. YCo's GloBE Income: (i) deemed gain of 250 included in GloBE Income (Art. 6.3.1); (ii) carrying value of assets and liabilities based on 500: para. 72 of Commentary.
5. YCo's Adjusted Covered Taxes: 50 included.

Regardless of whether Art. 6.2.2 applies: The allocation of YCo's GloBE Income and Covered Taxes for year 1 to XCo's MNE Group must be determined, as the share transfer will cause YCo to leave the MNE Group during the year. I will leave that issue for another day!



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