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11 November 2022



**HIGHLIGHTS**

- Latest developments on Pillar Two
  - Will UTPR breach customary international law or double tax treaties?
- European Court of Justice decides Fiat case on State aid and transfer pricing rulings
  - Major defeat for European Commission
- Continuation of detailed review of GloBE model rules
  - Today: Art. 6.3.4 on GloBE election regarding adjustment of tax basis of assets

**HAPPY FRIDAY!**

A red ripple, but Ron DeSanctimonious wins big; and red lines will be drawn in Bali next week!

Meanwhile, in the tax world...

UTPR conflicts; the European Commission loses its Fiat; EV tax credits cause tension; Sunsmart forgets the treaty; Thailand counts on the Substance-based Income Exclusion; Rwanda finds interest in exchange losses; and Puerto Rico concludes that the US 15% minimum tax is not a 15% minimum tax!

But at the end of the week, the most important question is this: "Should the world admit that 1.5°C will not be achieved?"

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. Trade & other global developments
3. GloBE model rules: detailed review
4. Asia Pacific
  - India, Singapore, Thailand
5. Europe
  - Bulgaria, ECJ, EU
6. Africa
  - Rwanda
7. Americas
  - Puerto Rico, US
8. Treaty news

**ITB series on Pillars One & Two**

- **GloBE model rules:**
  - Art. 6.3.4 on GloBE election regarding adjustment of tax basis of assets (ITB, 11 November 2022)
  - 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, 19 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**

Heydon Wardell-Burnus  
"Four Questions for UTPR Sceptics"  
Tax Notes Today International, Tax Analysts, 11 November 2022 (subscription service)

Kasper Dziurdz and Christoph Marchgraber  
"GloBE: Why a Nominal Tax Rate of More Than 15% Might Not Be Enough"  
Bulletin for International Taxation, IBFD, 2022 (Vol. 76), No. 11 (subscription service)

Jonathan Schwarz  
"What is the main purpose of a transaction?"  
Kluwer International Tax Blog, 3 November 2022 (freely available)

**INTERNATIONAL TAX QUIZ**

**THIS WEEK'S NEW QUIZ**

XCo is a Constituent Entity located in jurisdiction X, which imposes a corporate income tax with a 20% rate.

100% of the shares in XCo are owned by X Holdco, which is also located in jurisdiction X.

XCo is a limited liability company (LLC) formed under jurisdiction X corporate law.

XCo changes its legal form to a corporation, also under jurisdiction X corporate law.

LLCs and corporations are both taxable entities for the purposes of the jurisdiction X corporate income tax, and they are both subject to the 20% rate.

Under the jurisdiction X corporate law, the change in legal form: (1) automatically causes all of the assets and liabilities of XCo (LLC) to be the assets and liabilities of XCo (corporation), for no consideration; (2) the issued shares of XCo (LLC) are automatically treated as the issued shares of XCo (corporation); and (3) XCo (LLC) and XCo (corporation) are deemed to be the same legal entity.

Under the jurisdiction X tax law, the excess of (1) the fair value of XCo's assets and liabilities, over (2) the tax basis of the assets and the amount of the liabilities, at the time of the change in legal form, is treated as a taxable gain for XCo. That gain is subject to a special tax rate of 10%. Also, under the jurisdiction X tax law, after the change in legal form, the tax basis of the assets and the amount of the liabilities, are treated as equal to that fair value.

What will be impact, under the GloBE rules, of XCo's change in legal form?

Answer in next ITB email alert!

**LAST WEEK'S QUESTION**

ACo 1 is located in jurisdiction A, and is a Constituent Entity in 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 (70% of the value of the total consideration); and (2) cash (30% 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 ACo 2 shares according to their value.

In ACo 2's financial statements, it records 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 (minus the amount of transferred liabilities); 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?

**LAST WEEK'S ANSWER**

The key question is whether the transaction constitutes a "GloBE Reorganisation", as defined in Art. 10.1.1.

There are 2 issues:

(1) First issue

Is the transaction "a transformation or transfer of assets and liabilities such as in a merger, demerger, liquidation, or similar transaction" (the opening words in the "GloBE Reorganisation" definition)?

It is not a "transformation", which (according to the Commentary) refers to a change in the form of an Entity.

It is a "transfer of assets and liabilities" – but what about "such as in a merger, demerger, liquidation, or similar transaction"?

As ACo 2 does not change its MNE Group from #2 to #1 (i.e., control does not change), I think the transaction is not a "merger". And it's obviously not a "liquidation".

The transaction is possibly a "demerger" of the transferred assets or liabilities, or a "similar transaction" to such a demerger. Nevertheless, there is a risk that the opening words are not satisfied.

(2) Second issue

Is "the consideration for the transfer ... in whole or in significant part, equity interests issued by [ACo 2]" (para. (a) in definition of "GloBE Reorganisation")?

Does 70% of the value of the total consideration satisfy the "significant part" condition? The Commentary provides no guidance on the meaning of "significant part".

My personal view is that 70% should satisfy that condition.

(3) Conclusion on "GloBE Reorganisation"

The definition will be satisfied, if the transaction is a "demerger, ... or similar transaction".

If the transaction is a "GloBE Reorganisation": (i) ACo 1 will exclude the gain from its GloBE Income or Loss; and (ii) ACo 2 will use ACo 1's carrying value of the transferred assets and liabilities in computing its future GloBE Income or Loss (Art. 6.3.2).

If the transaction is not a "GloBE Reorganisation": (i) ACo 1 will include the gain (generally as reported in its financial statements) in its GloBE Income or Loss; and (ii) ACo 2 will use the value determined under the relevant accounting standard, or the carrying value of the transferred assets and liabilities in computing its future GloBE Income or Loss (Art. 6.3.1).

In both situations: ACo 1 will use the value in its financial statements, as the carrying value of the shares in ACo 2 in computing its future GloBE Income or Loss.

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