International Tax Bytes *by Steve Towers*

"International tax news, explained"

18 November 2022

HIGHLIGHTS

- **UK's Autumn Statement**
  - **GloBE rules will be implemented, including a QDMTT**
- **Interesting case on tax sparing credit in France / Tunisia treaty**
- **Hong Kong amends proposed "specified foreign-sourced income" rules, after feedback from EU**
- **Continuation of detailed review of GloBE model rules**
  - **Today: Art. 6.4 on joint ventures**

HAPPY FRIDAY!

Nancy bows out; **Xi** scolds **Trudeau** at the **G19**; **Qatar** gets ready to be grilled by the foreign press; and **Moët Hennessy** is running out of champagne! Mon Dieu!

Meanwhile, in the tax world…

The **UK** doubles down on **GloBE**; **Hong Kong** excludes the excluded; **France** spares a credit for **Somfy**; the **OECD** measures **BEPS**; **Taiwan** drafts its own **CHIPS Act**; **Mozambique** slices; **Jeremy Hunt** tilts at windfalls; and **VP Capital** relocates into a tax problem!

But at the end of the week, the most important question is this: **"Should the World Cup teams follow FIFA's request, and focus only on the football?"**

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. Hong Kong's "specified foreign-sourced income" rules
3. International tax cases
4. Other global developments
5. GloBE model rules: detailed review
6. Asia Pacific
   - Taiwan
7. Europe
   - ECJ, Spain, UK
8. Africa
   - Mozambique
9. Treaty news

ITB series on Pillars One & Two

- **GloBE model rules:**
  - **Art. 6.4 on joint ventures (ITB, 18 November 2022)**
  - **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, 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

Vikram Chand
"The interaction between the Arm's Length Principle and Pillar II Global Minimum Tax Rules: A technical and policy-oriented analysis"
IFF Forum für Steuerrecht 2022, IFF-HSG, Universität St. Gallen (subscription service)

Mindy Herzfeld
"Do GILTI + BEAT + BMT = GloBE?"
Intertax, Kluwer, Volume 50 (2022), Issue 12 (subscription service)

Caroline Silberztein and Manon Guillaume
"Does Intangible Ownership Move with the People That Perform the DEMPE Functions?"
International Transfer Pricing Journal, 2022 (Volume 29), No. 7 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo 1 is a company located in jurisdiction X. It has 3 shareholders: UPE 1, UPE 2, and UPE 3 (each of which is a UPE of an MNE Group "in scope" of the GloBE Rules).

XCo 1 has only 1 class of issued shares, which are owned in these percentages: UPE 1 (50%), UPE 2 (25%), and UPE 3 (25%).

All 3 of the UPEs include XCo 1's financial results in their consolidated financial statements under the equity method.

XCo 1 owns 80% of the shares in YCo, a company located in jurisdiction Y. The other 20% is owned by third parties.

UPE 1 owns 100% of the shares in XCo 2, a Constituent Entity located in jurisdiction X. UPE 1 does not own any other subsidiaries in X, and UPE 2 & 3 own no subsidiaries in X.

In the current Fiscal Year:

1. XCo 1 has GloBE Income of 100, and Adjusted Covered Taxes of 10
2. XCo 2 has GloBE Income of 100, and Adjusted Covered Taxes of 25
3. YCo has GloBE Income of 100, and Adjusted Covered Taxes of 5

Based on this information, what will be the impact, under the GloBE rules, on UPE 1, UPE 2, and UPE 3? Please ignore any Additional Current Top-up Tax, Substance-based Income Exclusion, and/or Qualified Domestic Minimum Top-up Tax.

Answer in next ITB email alert!

LAST WEEK'S QUESTION

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.

The change in legal form does not trigger the recognition of a gain or loss, or any adjustment to the carrying value of assets and liabilities, in XCo's financial statements.

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?

LAST WEEK'S ANSWER

1. GloBE Reorganisation:

A threshold issue is whether the change in legal form is a "GloBE Reorganisation", as defined in Art. 10.1.1. If it is not a "GloBE Reorganisation", then Arts. 6.3.2 & 6.3.3 can be ignored.

The opening words and para. (a) in the definition should be satisfied: the change in legal form is a "transformation", and no consideration is provided.

In applying para. (b) to a transformation, the "disposing Constituent Entity" presumably means XCo (LLC). Para. (b) seems to assume that the disposing Constituent Entity has a "gain or loss". However, it's not clear what the "gain or loss" in para. (b) is referring to, in the context of a transformation (where no consideration is provided). As noted in the question, XCo does not record a gain or loss in its financial statements. Moreover, if XCo does have a "gain", the whole of that gain is subject to tax, albeit at a reduced tax rate (10%). For these reasons, para. (b) is probably not satisfied.

Para. (c) is also probably not satisfied. Although XCo derives a taxable gain on the transformation, that taxable gain is not a "Non-qualifying Gain or Loss", as defined in Art. 10.1.1 – because XCo's financial accounting gain or loss arising on the transformation is nil.

Thus, IMHO: the change in legal form is not a "GloBE Reorganisation".

2. XCo: continuity of identity for GloBE rules

The jurisdiction X corporate law deems XCo (LLC) and XCo (corporation) as the same legal entity.

The GloBE rules, as implemented in the various jurisdictions where XCo's MNE Group has Constituent Entities, should accept that jurisdiction X corporate law treatment.

3. Adjusted Covered Taxes:

XCo's Adjusted Covered Taxes will increase (ceteris paribus) in the Fiscal Year it changes legal form (due to the taxable gain); and will reduce (ceteris paribus) in subsequent Fiscal Years, due to tax depreciation on a higher tax basis.

4. GloBE Income:

The impact on GloBE Income will depend on whether an election is made under Art. 6.3.4:

i. If election is not made, then the transformation will have no impact on XCo's GloBE Income. Thus, XCo's ETR will be higher (ceteris paribus) in the Fiscal Year it changes legal form, and will be lower (ceteris paribus) in subsequent Fiscal Years.
ii. If election is made: (a) a gain is recognised in the Fiscal Year it changes legal form (equal to the difference between fair value and carrying value immediately before the change in legal form); and (b) higher amounts of depreciation will be recognised in subsequent Fiscal Years, due to using fair value as the new base for depreciation. In regard to (a), the MNE Group can choose to spread the gain over 5 Fiscal Years.

Do you agree?