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24 March 2023



HIGHLIGHTS

- Latest developments on Pillar Two
o UK: GloBE rules included in Finance Bill introduced into parliament
o Germany: government releases draft legislation for public comment
• Recent international tax cases
o French case on unusual foreign tax credit provision in France / UAE treaty
o Netherlands case on interest deductions
• Detailed review of Administrative Guidance on GloBE rules
o Today: (1) clarifying definition of "Excluded Entity", and (2) meaning of "ancillary" for Non-profit Organisations

HAPPY FRIDAY!

"Dear friends" meet in Moscow; another Coppola makes movies; and Australia has way too many dead fish!

Meanwhile, in the tax world...

Transferable is not refundable; Chile clarifies time; the UN receives predictable responses; Bulgaria really likes excess profits taxes; France gives credit; Uruguay provides substance; and the US proposes to put its CHIPS down!

But at the end of the week, the most important question is this: "Will Macron survive?"

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. Other global developments
3. Administrative Guidance on GloBE rules: Scope (part 3)
4. Asia Pacific
o Australia, New Zealand
5. Europe
o Bulgaria, France, Italy, Netherlands
6. Africa
o Egypt
7. Americas
o Chile, Uruguay, US
8. Treaty news

ITB series on Pillar One

- Draft MLC provisions for commitments on DSTs and other relevant similar measures (ITB, 6 January 2023)
• Consultation document on Amount B in Pillar One (ITB, 16 December 2022)
• Progress Report on Amount A in Pillar One (ITB, 22 July 2022)
• Draft model rules for Amount A in Pillar One:
o Tax certainty (ITB, 10 June 2022)
o Regulated Financial Services exclusion from scope (ITB, 13 May 2022)
o Extractives exclusion from scope (ITB, 22 April 2022)
o Scope (ITB, 8 April 2022)
o Tax base determinations (ITB, 25 February 2022)
o Nexus and revenue sourcing (ITB, 11 February 2022)
• Inclusive Framework's final agreement on Pillars One & Two (ITB, 15 October 2021)

ITB series on Pillar Two

- GloBE Implementation Framework:
o Tax Certainty for the GloBE rules (ITB, 13 January 2023)
o GloBE Information Return (ITB, 13 January 2023)
o Guidance on Safe Harbours and Penalty Relief (ITB, 6 January 2023)
• GloBE model rules:
o Administrative Guidance on GloBE rules: Scope (Parts 1 to 3) (ITB, 10, 17 & 24 March 2023)
o Administrative Guidance on GloBE rules: Allocation of taxes arising under Blended CPC Tax Regimes (ITB, 3 March 2023)
o Administrative Guidance on GloBE rules: QDMTTs (Parts 1 & 2) (ITB, 10 & 24 February 2023)
o Art. 7.4 on ETR computation for Investment Entities (ITB, 2 December 2022)
o Corporate Restructurings and Holding Structures (Parts 1 to 7) (ITB, 23 & 30 September; 7, 14 & 21 October; 11 & 18 November 2022)
o Scope (Parts 1 & 2) (ITB, 24 June; 1 July 2022)
o Charging Provisions (Parts 1 to 5) (ITB, 6, 13 & 20 May; 10 & 17 June 2022)
o Computation of Effective Tax Rate and Top-up Tax (Parts 1 to 4) (ITB, 18 & 25 March; 1, 8, 22 & 29 April 2022)
o Flow-through Entities and Hybrid Entities (ITB, 4 March 2022)
o Computation of Adjusted Covered Taxes (Parts 1 to 9) (ITB, 11, 18 & 25 February; 29 July; 5,12,19 & 26 August; 16 September 2022)
o Computation of GloBE Income or Loss (Parts 1 to 4) (ITB, 7, 14, 21 & 28 January 2022)

WORTH READING

Peter R. Merrill, Karl Russo, Aaron Junge, Damien Boudreau, and Florian Hoffe "Where Credit is Due: Treatment of Tax Credits Under Pillar 2"

Tax Notes International, Tax Analysts, 20 March 2023 (subscription service).

Aitor Navarro

"An Introduction to Research in Transfer Pricing"

Max Planck Institute for Tax Law and Public Practice, March 2023 (freely available on www.ssm.com; and posted on LinkedIn by the author).

Mindy Herzfeld

"Parcal to Maral: What to Expect From Leadership Changes at the OECD"

Tax Notes Today International, Tax Analysts, 20 March 2023 (subscription service).

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo is a company located in jurisdiction A. ACo runs the public hospital system in jurisdiction A. It is incorporated as a company by Act of parliament, it is required to provide comprehensive hospital services and not pursue profits, and it is exempt from jurisdiction A corporate income tax.

ACo has several subsidiaries (with ACo's shareholding percentage indicated):

1. Sub Co 1 (100%), which is located in jurisdiction B, but with a PE in jurisdiction F. Sub Co 1 carries out administrative activities which are ancillary to ACo's hospital activities in jurisdiction A. Sub Co 1 also invests funds for the benefit of ACo. Both of these activities are performed in the Main Entity and the PE.
2. Sub Co 2 (97%), which is located in jurisdiction C. The other 3% shareholding is owned by senior management in Sub Co 2. Sub Co 2 has been funded by equity from ACo and has borrowed from third parties. It has used the funding to acquire a broad range of debt and equity investments.
3. Sub Co 3 (100%), which is located in jurisdiction D. Sub Co 3 has also been funded by equity from ACo and has borrowed from third parties. It has used the funding to acquire shares, from which Sub Co 3 derives only Excluded Dividends and Excluded Equity Gains or Losses.
4. Sub Co 4 (100%), which is located in jurisdiction E. Sub Co 4 operates several private hospitals in jurisdiction E, using IP and services provided by ACo.

ACo prepares consolidated financial statements in accordance with the applicable financial accounting standard in jurisdiction A, and as required by jurisdiction A law. For the latest fiscal year, those consolidated financial statements report revenue of EUR 3 billion.

Also for that latest fiscal year, the "separate entity" revenue for the 5 companies in the group is:

- ACo: EUR 2.5b
• Sub Co 1: EUR 250m (comprising: (i) Main Entity: EUR 180m; and (ii) PE: EUR 70m)
• Sub Co 2: EUR 150m
• Sub Co 3: EUR 100m
• Sub Co 4: EUR 200m

All of the 6 jurisdictions (A to F) have implemented the GloBE rules (IR and UTPR) and a QDMTT.

Based on this information, ACo's tax director has told you that it is not possible for any of those 5 companies to have an IIR, UTPR or QDMTT tax liability for that fiscal year. Do you agree?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

SCo, a company located in jurisdiction S, is a sovereign wealth fund which is 100% owned by the government of jurisdiction S. SCo's principal purpose is to invest the government's funds through the making and holding of investments.

The applicable financial accounting standard which applies in jurisdiction S does not provide an exclusion, from consolidation, for "investment entities". However, jurisdiction S law exempts SCo from the requirement to prepare consolidated financial statements - and thus, SCo does not do so.

Jurisdiction S has implemented the GloBE rules. Jurisdiction S does not have a CPC regime. SCo is a taxpayer under the jurisdiction S corporate income tax law.

One of SCo's many investments is a 60% direct shareholding in XCo, a company located in jurisdiction X. The other 40% of the shares are owned by unrelated investors who are located in jurisdiction Y. XCo carries on an R&D business in jurisdiction X, which enables it to qualify for an exemption from the 25% jurisdiction X corporate income tax. However, jurisdiction X has implemented the GloBE rules and a QDMTT (which is effectively identical to the GloBE rules). XCo has no subsidiaries.

For the purposes of the GloBE rules and the QDMTT, XCo has: (1) GloBE Income of 100; (2) Adjusted Covered Taxes of nil; and (3) a Substance-based Income Exclusion of 40.

Based on this information, what tax liability will arise, in respect of XCo, under the GloBE rules (in jurisdiction S or X) or QDMTT (in jurisdiction X)?

In answering this question, please assume that the revenue threshold in Art. 1.1.1 is satisfied.

LAST WEEK'S ANSWER

SCo meets the definition of "Governmental Entity" in Art. 10.1.1.

SCo is therefore an "Excluded Entity" (Art. 1.5.1(a)). Thus, SCo is excluded from being a "Constituent Entity" (Art. 1.3.3). Accordingly, SCo will not be liable for IIR tax in jurisdiction S (Art. 2.1.1), even if there were a Top-up Tax for jurisdiction X (which is there is not - see below).

The applicable financial accounting standard in jurisdiction S does not provide SCo with an exclusion from consolidation. However, the jurisdiction S law exempts SCo from the requirement to prepare consolidated financial statements. Therefore, prima facie, SCo would have a "Controlling Interest" in its subsidiaries, under para. (b) of the definition in Art. 10.1.1.

However, that conclusion is reversed by the Administrative Guidance (para. 36.4 in new Commentary on the definition of "Ultimate Parent Entity" in Art. 1.4.1): a sovereign wealth fund that meets the definition of a Governmental Entity (1) will not be considered to be a UPE, and (2) will not be considered to be part of an MNE Group.

I would also note that the government in jurisdiction S is not an "Entity" (para. 17.1 in new Commentary on definition of "Entity" in Art. 10.1.1), and therefore the GloBE rules do not apply to it.

As SCo is not the UPE of an MNE Group, XCo is not included in a Group (Art. 1.2.2). Therefore, XCo is not a "Constituent Entity" (Art. 1.3.1).

Accordingly, for jurisdiction X, there is (1) no ETR (Art. 5.1.1); (2) no Net GloBE Income (Art. 5.1.2); (3) no Additional Current Top-up Tax (Arts. 4.5.1 & 5.4.1); and (4) therefore, no Jurisdictional Top-up Tax (Art. 5.2).

Therefore, XCo will not be liable for UTPR tax in jurisdiction X (see also Art. 2.4.1), and XCo will also not be liable for QDMTT in jurisdiction X.

Do you agree?



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