International Tax Bytes by Steve Towers

"International tax news, explained"

5 May 2023

HIGHLIGHTS

- **Latest developments on GloBE rules**
  - **National Foreign Trade Council proposes important changes to CFC ordering rules, treatment of tax credits, and QDMTT**
- **Recent international tax cases**
  - **Netherlands case on anti-hybrid rule**
  - **Spanish case on dividend withholding tax and free movement of capital**
  - **Advocate General Kokott issues opinion in Engie EU State aid case**
- **Detailed review of Administrative Guidance on GloBE rules**
  - **Today: Excess Negative Tax Carry-forward guidance**

HAPPY FRIDAY!

A **false flag drone** targets **Putin**; **DeSantis** is still fighting **Mickey Mouse**; and **Charles** is ready for the big day!

Meanwhile, in the tax world...

NFTC earns points for effort; **Australia** builds tax incentives; month-ends are important in **Cambodia**; **Engie** should manifestly win; the **UAE** allows folks to be sick, but not to work remotely; the **Netherlands** participates in a deductible dividend; and the **UK** defies a consultation!

But at the end of the week, the most important question is this: **"Where will Messi play next season?"**

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. Administrative Guidance on GloBE rules: Income & taxes (part 5)
3. Asia Pacific
   - Australia, Cambodia, Thailand
4. Europe
   - ECJ, Netherlands, Russia, Spain, UK
5. Middle East & Central Asia
   - Bahrain, UAE
6. Americas
   - US

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:**
  - **Tax certainty (ITB, 10 June 2022)**
  - **Regulated Financial Services exclusion from scope (ITB, 13 May 2022)**
  - **Extractives exclusion from scope (ITB, 22 April 2022)**
  - **Scope (ITB, 8 April 2022)**
  - **Tax base determinations (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)**

ITB series on Pillar Two

- **GloBE Implementation Framework:**
  - **Tax Certainty for the GloBE rules (ITB, 13 January 2023)**
  - **GloBE Information Return (ITB, 13 January 2023)**
  - **Guidance on Safe Harbours and Penalty Relief (ITB, 6 January 2023)**
- **GloBE model rules:**
  - **Administrative Guidance on GloBE rules: Income & taxes (Parts 1 to 5) (ITB, 31 March; 14, 21 & 28 April; 5 May 2023)**
  - **Administrative Guidance on GloBE rules: Scope (Parts 1 to 3) (ITB, 10, 17 & 24 March 2023)**
  - **Administrative Guidance on GloBE rules: Allocation of taxes arising under Blended CFC Tax Regimes (ITB, 3 March 2023)**
  - **Administrative Guidance on GloBE rules: QDMTTs (Parts 1 & 2) (ITB, 10 & 24 February 2023)**
  - **Art. 7.4 on ETR computation for Investment Entities (ITB, 2 December 2022)**
  - **Corporate Restructurings and Holding Structures (Parts 1 to 7) (ITB, 23 & 30 September; 7, 14 & 21 October; 11 & 18 November 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)**

WORTH READING

Michael C. Durst
"BEPS, Pillar 2, and the Replacement of Tax-Based Incentives With Nontax Incentives"
Tax Notes Today International, Tax Analysts, 3 May 2023 (subscription service).

Alexander Tale
"New Targeted Interest Deduction Limitation Rules Post *Lexel*"
Intertax, Kluwer, Vol. 51 (2023), Issue 4 (subscription service).

Ruth Mirembe
"A Not-So-Bright Line: Advertising, Marketing, and Promotion Expenditure in India"
Tax Notes Today International, Tax Analysts, 27 April 2023 (subscription service).

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

ACo is a Constituent Entity in a "within scope" MNE Group. It is the only Constituent Entity located in jurisdiction A. Jurisdiction A has a 15% corporate income tax rate.

In Years 1, 2, and 3, ACo has these financial numbers:

1. Year 1:

- GloBE Income: 300
- Substance-based Income Exclusion (SBIE): 100
- Tax loss (jurisdiction A corporate income tax): 100 (can be carried forward indefinitely)

2. Year 2:

- GloBE Income: 200
- SBIE: 100
- Taxable income (before deduction of carry-forward tax loss): 60
- Taxable income (after deduction of carry-forward tax loss): 0

3. Year 3:

- GloBE Income: 250
- SBIE: 120
- Taxable income (before deduction of carry-forward tax loss): 40
- Taxable income (after deduction of carry-forward tax loss): 0

Based on this limited information, what is the Top-up Tax for jurisdiction A in each of Years 1, 2, and 3?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

An MNE Group which is "within scope" of the GloBE rules, has this simplified structure:

- UPE (located in jurisdiction U) owns 100% of the shares in ACo (located in jurisdiction A)
- ACo owns 100% of the shares in each of 2 sister subsidiaries: BCo (located in jurisdiction B) and CCo (located in jurisdiction C)

CCo is the only Constituent Entity located in jurisdiction C.

BCo manufactures goods and sells them to CCo, which distributes the goods to third party customers in jurisdiction C.

In Year 1, CCo has these (prima facie) financial numbers (before considering any TP adjustments - see below):

- FANIL: 1,000
- Purchases from BCo: 400
- Adjusted Covered Taxes: 120

In Year 2, the jurisdiction C tax authorities claim that the purchases from BCo exceed the arm's length price. They therefore make a primary transfer pricing adjustment for Year 1: CCo's deductions for purchases from BCo are reduced by 100. The jurisdiction C corporate income tax rate is 15%.

The jurisdiction C tax authorities also make a secondary transfer pricing adjustment for Year 1: the "extra" cash of 100 which has been paid by CCo to BCo is deemed to be a dividend paid by CCo to ACo, followed by a deemed capital contribution by ACo to BCo. Dividend withholding tax of 20% is imposed on the deemed dividend. The withholding tax is imposed on ACo, but CCo has a collection obligation - therefore, the jurisdiction C tax authorities collect the withholding tax from CCo.

CCo accepts that both of these adjustments are appropriate.

In Year 2, CCo has these (prima facie) financial numbers (before considering any TP adjustments):

- FANIL: 1,200
- Purchases from BCo: 450
- Adjusted Covered Taxes: 200

CCo expects that there will be no transfer pricing adjustment in Year 2 in regard to its purchases from BCo, because the intercompany price was changed in Year 2 in accordance with the Year 1 adjustment.

Based on this limited information, what will be the amount of Jurisdictional Top-up Tax (if any) for jurisdiction C in each of Year 1 and Year 2?

Please assume that (1) there are no adjustments in computing CCo's GloBE Income, except those which follow from the facts stated above; and (2) CCo has no Substance-based Income Exclusion in either Year 1 or Year 2.

LAST WEEK'S ANSWER

Year 1

The primary TP adjustment will be reflected in CCo's GloBE Income in Year 2, not in Year 1: see para. 99 of Comm on Art. 3.2.3, and also see Art. 4.6.1. The additional jurisdiction C income tax (i.e., 100 x 15% = 15) will be reflected in CCo's Adjusted Covered Taxes in Year 2, not Year 1: Art. 4.6.1.

GloBE Income: 1,000 + 120 (assuming Adjusted Covered Taxes = Net Taxes Expense) = 1,120

Adjusted Covered Taxes: 120

ETR: 120 / 1,120 = 10.7143%

Top-up Tax Percentage: 4.2857%

Top-up Tax: 4.2857% x 1,120 = 47.9998

Year 2

GloBE Income: 1,200 + 200 (assuming prima facie Adjusted Covered Taxes = Net Taxes Expense) + 100 (Art. 3.2.3 adjustment, caused by primary TP adjustment for Year 1) = 1,500

Adjusted Covered Taxes: 200 + 15 (jurisdiction C tax increase, caused by primary TP adjustment for Year 1) + 20 (Art. 4.3.2(e): see below) = 235

ETR: 235 / 1,500 = 15.6667%

Top-up Tax: nil

The jurisdiction C dividend withholding tax of 20, caused by the secondary TP adjustment, probably qualifies as a Covered Tax on a deemed distribution: see AG, section 2.6. If so, and assuming the tax is reflected in ACo's financial accounts, Art. 4.3.2(e) will allocate the Covered Tax to CCo. The question arises as to whether this tax should be added to CCo's Adjusted Covered Taxes in Year 1 or Year 2. As it is an increase in Covered Taxes, I think that Art. 4.6.1 probably requires it to be added to CCo's Adjusted Covered Taxes in Year 2.

Do you agree?