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ITB International Tax Bytes by Steve Towers

"International tax news, explained"

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16 June 2023

HIGHLIGHTS

- **Recent international tax cases**
  - **Indian case on termination of PE**
  - **Spanish case on definition of "royalties" in Spain / US treaty**
- **Indirect share transfer dispute in Nepal concerning Ncell**
  - **Arbitration tribunal dismisses Axiata's claims**
- **Brazil's transfer pricing legislation signed into law**
- **Continuation of detailed review of Administrative Guidance on GloBE rules**
  - **Today: Deferred tax assets with respect to tax credits under transition rule in Art. 9.1.1**

HAPPY FRIDAY!

The **Fed** pauses; the **Nikkei** returns to 1990; and **Boris Johnson** is written off!

Meanwhile, in the tax world…

Achim Pross wants to declutter; **Australia** mixes capital with labour; **Nepal** indirectly wins; **Denmark** insists on culture; **Hertz** customises a loss; **Brazil** finally signs; and **SIS** is awarded a non-terminal PE!

But at the end of the week, the most important question is this: **"Should you declutter?"**

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: Transition (part 1)
4. Asia Pacific
   - Australia, Hong Kong, India, Nepal
5. Europe
   - Denmark, EU, Luxembourg, Spain
6. Americas
   - Argentina, Brazil, US
7. 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:**
  - **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: Transition (Part 1) (ITB, 16 June 2023)**
  - **Administrative Guidance on GloBE rules: Income & taxes (Parts 1 to 8) (ITB, 31 March; 14, 21 & 28 April; 5, 12 May; 2 & 9 June 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

Lucas de Lima Carvalho
" 'No More, No Less': The Misleading Fifth Peer Review Report on BEPS Action 6"
Tax Notes Today International, Tax Analysts, 25 May 2023 (subscription service).

Cihat Öner
"An Analysis of the 'Foreseeable Relevance' Standard and the International Exchange of Tax Information: Are the European Union and the OECD in Agreement?"
Bulletin for International Taxation, IBFD, 2023 (Vol. 77), No. 6 (subscription service).

Dhruv Janssen-Sanghavi
"That's Entertainment! The Taxability of Former President Obama's Speaking Tour"
Tax Notes Today International, Tax Analysts, 8 June 2023 (subscription service).

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company located in jurisdiction X, is a Constituent Entity in an MNE Group. The MNE Group will become subject to the GloBE rules, for the first time, for the fiscal year ending 31 December 2024. XCo's tax year for jurisdiction X purposes also ends on 31 December.

Jurisdiction X imposes a 20% corporate income tax, and applies a worldwide tax system. It provides non-transferable foreign tax credits (FTCs) to relieve double taxation. Excess FTCs can be carried forward for 5 years – at the end of 5 years, remaining FTCs lapse. The jurisdiction X tax law also provides non-transferable investment tax credits (ITCs) for qualifying expenditure. Excess ITCs can be carried forward for 6 years, for offset against the taxpayer's income tax liability. To the extent an ITC has not been offset after 6 years, it becomes refundable – i.e., the unutilised amount of the ITC is paid to the taxpayer as cash.

In the 2023 year, XCo receives a dividend from its 100% subsidiary, YCo, which is located in jurisdiction Y. The dividend brings with it an FTC of 35, which is a combination of jurisdiction Y dividend withholding tax and underlying corporate tax. XCo uses 20 of the FTC in 2023, and carries forward the balance of 15. XCo's 2023 financial statements do not recognise a deferred tax asset for the FTC, because the recognition criteria were not met.

Also in 2023, XCo qualifies for an ITC of 25. XCo does not have a sufficient tax liability in 2023 to use any of the ITC. The full amount of 25 is therefore carried forward. XCo's 2023 financial statements treat the 25 ITC as income.

In 2024:

- XCo's Adjusted Covered Taxes (before considering the FTC and ITC carried forward from 2023) is 200.
- XCo uses all of its carried forward FTC and ITC to offset its income tax liability.

Based on this information, what is the amount of XCo's Adjusted Covered Taxes in 2024?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

XCo 1 and XCo 2 are members of an "in scope" MNE Group. They are the only Constituent Entities located in jurisdiction X, which has a corporate income tax rate of 25%.

XCo 1 owns 100% of the shares in XCo 2.

Before considering the equity investments of the 2 companies, they have these respective GloBE numbers for a fiscal year:

- XCo 1:
  - GloBE Income: 1,600
  - Adjusted Covered Taxes: 300
- XCo 2:
  - GloBE Income: 800
  - Adjusted Covered Taxes: 200

At the start of the fiscal year, XCo 1 became a tax equity investor in a newly formed tax-transparent partnership in jurisdiction X, which will undertake an energy project. There is one other partner in the partnership: a jurisdiction X energy project developer, which is unrelated to XCo 1.

XCo 1 invested 1,000 in the partnership at the start of the fiscal year. At that time, XCo 1's expected return on its ownership interest was positive, but only because of the expected non-refundable tax credits (see below).

XCo 1 uses the equity method to account for its ownership interest.

For the fiscal year, the partnership allocates to XCo 1:

- A financial statement loss and a tax loss of 200
- A non-refundable, non-transferable tax credit of 180

These allocations are effective for jurisdiction X tax purposes.

During the fiscal year, XCo 2 sells all of its 20% shareholding in XCo 3, an unrelated company. XCo 2 derives a profit of 1,200 on the sale. Under the jurisdiction X tax law, 20% of the profit is taxable at the standard 25% tax rate (i.e., 80% is excluded). Prior to the sale, XCo 2 used the equity method to account for its ownership interest in XCo 3.

Based on this information, what is the jurisdiction X Top-up Tax for the fiscal year? Please ignore the Substance-based Income Exclusion.

LAST WEEK'S ANSWER

(1) If no Equity Investment Inclusion Election (EIIE) is made for jurisdiction X

XCo 1:

GloBE Income (GI): 1,600 (the loss of 200 is excluded by Art. 3.2.1(c)).
Adjusted Covered Taxes (ACT): 300 – (200 x 25%) – 180 = 70 (see AG, section 2.9.1).

XCo 2:

GI: 800 (the profit of 1,200 is excluded by Art. 3.2.1(c)).
ACT: 200 (the tax of 60, which is included in XCo 2's current tax expense, is excluded by Art. 4.1.3(a)).

Jurisdiction X ETR: (70 + 200) / (1,600 + 800) = 270 / 2,400 = 11.25%
Jurisdiction X Top-up Tax: 4.75% x 2,400 = 114

(2) If an EIIE is made for jurisdiction X

XCo 1's Ownership Interest in the partnership should be a "Qualified Ownership Interest" (New Comm, para. 57.8).

Both the tax loss and the non-refundable, non-transferrable tax credit should be "Qualified Flow-through Tax Benefits" (New Comm, para. 57.5).

Thus, the treatment described in the new Comm, paras. 57.5 to 57.7 should apply to XCo 1 (New Comm, para. 57.4).

XCo 1:

GI: 1,600 (the loss of 200 is excluded by Art. 3.2.1(c)).
ACT: 300 (New Comm, para. 57.5).

XCo 2:

The making of the EIIE will also impact XCo 2's computations:
GI: 800 + (1,200 x 20%) = 800 + 240 = 1,040 [See Note 1]
ACT: 200 + (240 x 25%) = 200 + 60 = 260 [See Note 2]

Note 1: See new Comm, para. 57.2(a)(iii): the taxable proportion of the profit (i.e., 1,200 x 20% = 240) is included in GloBE Income.
Note 2: See new Comm, para. 57.2(b): the current and deferred tax expense "associated with [this item]" is 240 x 25% = 60.

Jurisdiction X ETR: (300 + 260) / (1,600 + 1,040) = 560 / 2,640 = 21.2%
Jurisdiction X Top-up Tax: 0

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