ITB International Tax Bytes by Steve Towers

"International tax news, explained"

23 June 2023

HIGHLIGHTS

- **Latest on Pillar Two**
  - **Switzerland's public referendum approves introduction of GloBE rules**
  - **UK releases detailed guidance**
  - **US Joint Committee on Taxation estimates significant US tax revenue losses if rest of world implements GloBE rules and US does not**
- **2 major tax announcements by European Commission**
  - **Proposed FASTER Directive on withholding tax procedures**
  - **"Temporary statistical based own resource on company profits"**
- **Continuation of detailed review of Administrative Guidance on GloBE rules**
  - **Today: Applicability of Article 9.1.3 to transactions similar to asset transfers**

HAPPY FRIDAY!

Blinken takes one step forward, but **Biden** dictates one step back; **Ghosn** sues; and **Modi** is the world's most popular leader!

Meanwhile, in the tax world....

Switzerland says yes, and the **US** counts its cost if it continues to say no; **China** incentivises new energy; the **EU** wants its own resources to be faster; **Germany** agrees with the **OECD** in 800 pages; the **UK** wants to outsource legislative drafting; and **Australia** and **Egypt** tighten thin cap rules!

But my thought for the week is this ... **The EU's proposed contribution of 0.5% on company profits will be levied on Member States, not companies - but I wonder where the Member States will get the money from?**

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 2)
4. Asia Pacific
   - Australia, China
5. Europe
   - EU, Germany, Ireland, Italy, UK
6. Africa
   - Mauritius, Rwanda, Tanzania, Egypt
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 (Parts 1 & 2) (ITB, 16 & 23 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

Peter A. Barnes
"The Unhelpful Myth of Tax Certainty"
Talking Points, IBFD, 2023, No. 29 (subscription service).

Reuven Avi-Yonah
"Do Intangibles Fit BEFIT?"
Intertax, Kluwer, 2023 (Vol. 51), Issue 8 & 9 (subscription service).

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo 1, a company located in jurisdiction X, is a Constituent Entity in an MNE Group which is "within scope" of the GloBE rules.

The UPE owns 100% of the shares in XCo 1.

XCo 1 owns (1) 8% of the shares in XCo 2, which is another company located in jurisdiction X (the other shares in XCo 2 are held by unrelated parties); and (2) 30% of the shares in YCo, which is a company located in jurisdiction Y (the other shares in YCo are held by unrelated parties).

XCo 1 has the following financial income for the fiscal year (determined in accordance with the Acceptable Accounting Standard used by the UPE in preparing its Consolidated Financial Statements):

1. Profit (i.e., net income) (in P&L): 40,000
2. Equity method of accounting:
   a. Deducted in computing Profit: XCo 1's share of loss from YCo
   b. YCo is treated as tax transparent in jurisdiction X - thus, for X corporate income tax purposes, the share of YCo's loss is deductible for XCo 1
   c. No dividend or other distribution was paid by YCo
3. 8% shareholding in XCo 2 (all of XCo 1's shares were held for 14 months):
   a. Included in Profit: dividend from XCo 2: 3,000 (tax exempt for X corporate income tax purposes)
   b. Included in Profit: gain on sale of all of XCo 1's shares in XCo 2: 5,000 (tax exempt for X corporate income tax purposes)
4. Change in accounting policy, causing an adjustment to the opening equity in XCo 1's balance sheet for the fiscal year:
   a. Adjustment is an increase of 10,000 to opening equity
   b. The change in accounting policy relates equally to the 5 preceding fiscal years (i.e., an adjustment of 2,000 relates to each of the 5 preceding fiscal years) - 2 of these fiscal years were prior to, and the other 3 fiscal years were after, the application of the GloBE rules to XCo 1
   c. In computing the adjustment of 10,000, X corporate income tax of 2,000 has been deducted
5. Income tax expense (deducted in computing Profit):
   a. 20,000
   b. Included in the 20,000 is 12,000, which is refundable to the UPE when dividends are paid by XCo 1 to the UPE (i.e., the 12,000 is an imputation tax credit).

Based on this information, what is XCo 1's GloBE Income or Loss for the fiscal year?

Answer in next ITB email alert on 7 July 2023!

LAST WEEK'S QUESTION

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 remaining amount of 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 are 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?

LAST WEEK'S ANSWER

2024 is the "Transition Year" for the MNE Group (definition in Art. 10.1.1).

This question requires the application of Art. 9.1.1.

1. FTC (15)

The fact that no deferred tax asset (DTA) is recognised in XCo's 2023 financial statements for the FTC because the accounting recognition criteria are not met, will not prevent such a DTA being recognised, for GloBE purposes: AG, section 4.1.3 (new Comm, para. 6.3); also, text of Art. 9.1.1.

By virtue of AG, section 4.1.3 (new Comm, para. 6.1), Art. 4.4.1(e) does not apply to DTAs arising prior to the Transition Year.

The dividend from YCo is an "Excluded Dividend" (definition in Art. 10.1.1). Prima facie, Art. 4.4.1(a) would probably prevent the recognition, for GloBE purposes, of a DTA with respect to the FTC. However, the restriction in Art. 4.4.1(a) does not apply to attributes imported into the GloBE rules by Art. 9.1.1, unless Art. 9.1.2 applies: see AG, section 4.1.3 (new Comm, para. 6.3). Art. 9.1.2 will exclude the DTA if it is "generated in a transaction that takes place after 30 November 2021". Is the declaration and payment of the dividend by YCo, in 2023, such a "transaction"? The Comm to Art. 9.1.2 suggests that the provision is targeted at transfers of assets involving the Constituent Entity, not a dividend received by the Constituent Entity - although this is not totally clear. Nevertheless, my preferred view is that Art. 9.1.2 should not apply to the dividend from YCo.

As jurisdiction X's corporate income tax rate is 20%, the amount of the DTA will be reduced, in accordance with the formula in AG, section 4.1.3 (new Comm, para. 6.1): 15 / 20% x 15% = 11.25.

Thus, for GloBE purposes, a DTA of 11.25 will be recognised at the beginning of the Transition Year.

2. ITC (25)

The threshold issue is whether the ITC is a "Non-Qualified Refundable Tax Credit" (NQRTC) (defined in Art. 10.1.1). [It is clearly not a "Qualified Refundable Tax Credit" (QRTC), due to the breach of the 4-year condition.] The definition of NQRTC refers to "refundable in whole or in part". The ITC is refundable, but only after 6 years - does this qualify as "refundable in whole or in part"? Based on the Comm to the Art. 10.1.1 definition of QRTC, it seems that the ITC would be "refundable".

XCo treats the ITC as income in its 2023 financial statements. Therefore, those financial statements do not reflect any DTA for the ITC.

According to AG, section 4.1.3 (new Comm, para. 6.2): "[The] settlement of refundable tax credits that accrued prior to the beginning of the Transition Year, whether or not the amount satisfies an income tax liability, generally should not be treated as a reduction to Adjusted Covered Taxes."

3. Adjusted Covered Taxes (ACT) computation

XCo's ACT (before considering the FTC and ITC carried froward from 2023): 200

Impact of offsetting FTC:

a. Current tax expense: (15)
b. DTA reversal: 11.25

Impact of offsetting ITC:

a. Current tax expense: Nil (see above).

Thus, XCo's ACT: 200 + (15) + 11.25 = 196.25

Do you agree?