ITB International Tax Bytes by Steve Towers

"International tax news, explained"

7 July 2023

HIGHLIGHTS

- **"Crunch time" for Pillar One**
  - **Will text of multilateral convention be finalised next week?**
  - **What will US do?**
- **International tax cases**
  - **GE Financial Investments case on residence definition in UK / US treaty**
  - **Cabot Plastics case on definition of "fixed establishment" for EU VAT purposes**
- **Tax authorities issue guidance on "place of effective management" and "central management and control"**

HAPPY FRIDAY!

Vietnam bans **Barbie**; **Meta** is a copycat; **Prigozhin** disappears; and **affirmative action** is not affirmed!

Meanwhile, in the tax world…

It's "crunch time" for **Pillar One**; **GE** has the right criterion; **Australia** is intangibly less aggressive; **Cabot** can't provide services to itself; **Turkey** turns up the heat; **South Africa** writes a POEM; **Pakistan** goes virtual; and the **US Supreme Court** will decide if **Moore** is less!

But at the end of the week, the most important question is this: **"Have you Threaded yet?"**

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. Other global developments
3. GE Financial Investments case
4. Asia Pacific
   - Australia, Fiji, India, Vietnam
5. Europe
   - ECJ, Netherlands, Turkey
6. Africa
   - South Africa
7. Middle East & Central Asia
   - Pakistan
8. Americas
   - Brazil, US
9. 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

Philip Baker
"The Need for Plan B"
Intertax, Kluwer, Vol. 51 (2023), Issue 8 & 9 (subscription service).

Jack Sheehan
"International Tax Planning for Structuring Investments in Vietnam"
Tax Notes Today International, Tax Analysts, 30 June 2023 (subscription service).

Gabriella Erdős and Gergely Czoboly
"Exiting from the Obligations of a Tax Treaty: An International Framework with Diverse Practices"
Bulletin for International Taxation, IBFD, 2023 (Vol. 77), No. 7 (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 which is "within scope" of the GloBE rules. The jurisdiction X corporate income tax rate is 20%. XCo is the only Constituent Entity located in jurisdiction X.

XCo owns 100% of the shares in YCo, a company located in jurisdiction Y. The jurisdiction Y corporate income tax rate is 10%. YCo is treated as a resident company for jurisdiction Y tax purposes; however, it is treated as tax transparent (a "disregarded entity") for jurisdiction X tax purposes. YCo is the only Constituent Entity located in jurisdiction Y.

Anti-hybrid mismatch rules are not included in the corporate income tax law of either jurisdiction X or Y. However, both jurisdictions have implemented the GloBE rules, including a QDMTT (in effectively the same form as the GloBE model rules).

For a fiscal year, YCo's GloBE Income is 100. Its taxable income (for jurisdiction Y corporate income tax purposes) is also 100. In computing the 100, these items are taken into account:

1. Interest expense of 30 (on a loan from XCo) is deducted.
2. Interest income of 10 (on a loan to a third party bank) is included.
3. Fee income of 15 (for provision of know-how to third parties) is included.

For jurisdiction X purposes, YCo's before-tax profit is included in XCo's taxable income. The amount of profit so included is 130, after "adding back" the disregarded interest expense of 30. XCo is entitled to a foreign tax credit for the jurisdiction Y corporate income tax paid by YCo on that profit.

Based on this information, what is YCo's Adjusted Covered Taxes for that fiscal year?

Answer in next ITB email alert!

LAST WEEK'S QUESTION

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 (located in jurisdiction U) 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 owned 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 owned 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 after tax) (in P&L): 40,000.
2. Equity method of accounting:
   a. Deducted in computing Profit: XCo 1's share of loss from YCo: (10,000).
   b. YCo is treated as tax transparent in jurisdiction X (but not jurisdiction Y) – 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 by jurisdiction X to the UPE when dividends are paid by XCo 1 to the UPE. The dividends will be tax-exempt to the UPE under jurisdiction X law.

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

LAST WEEK'S ANSWER

Computation of GloBE Income or Loss:

1. Profit: 40,000
2. YCo:
   a. YCo is a "Hybrid Entity" (defined in Art. 10.2.5). However, that status has an impact only on Art. 4.3.2(d), which is irrelevant to this question.
   b. If the MNE Group does not make an Equity Investment Inclusion Election (EIIE) (see AG, section 2.9.2), the 10,000 allocated loss would be added back as an "Excluded Equity Gain or Loss" (defined in Art. 10.1.1) under Art. 3.2.1(c). As the allocated loss is deductible for X tax purposes, this would cause a reduction in XCo 1's ETR.
   c. If the MNE Group makes an EIIE, the 10,000 would not be added back. I will assume that an EIIE is made – thus: no adjustment.
3. XCo 2:
   a. 3,000 dividend is an "Excluded Dividend" (defined in Art. 10.1.1), as the 8% shareholding is not a "Short-term Portfolio Shareholding". (I have assumed that XCo 2 is not an Investment Entity.) Deducted under Art. 3.2.1(b). Thus: (3,000) deducted.
   b. 5,000 gain is not an "Excluded Equity Gain or Loss" (defined Art. 10.1.1), as the 8% shareholding is a "Portfolio Shareholding". Not added back under Art. 3.2.1(c). Thus: no adjustment.
4. Change in accounting policy:
   a. This item qualifies as "Prior Period Errors and Changes in Accounting Principles" (defined in Art. 10.1.1). As it is an increase to opening equity, the adjustment is an add back under Art. 3.2.1(h).
   b. There are 2 issues with the amount of add back: (i) transition between pre- and post-GloBE fiscal years; and (ii) deduction of X corporate income tax of 2,000.
   c. First issue: Only the amounts relating to the 3 fiscal years after the introduction of GloBE rules, will be adjusted: Comm on Art. 3.2.1(h), para. 83.
   d. Second issue: Although not discussed in the Comm, it would make sense to add back the pre-tax amount. The relevant tax should qualify as Adjusted Covered Taxes under Art. 4.1.1(c). Therefore, if the pre-tax amount is not added back, the ETR could be materially increased.
   e. Thus: 12,000 x 3/5 = 7,200 added.
5. Income tax expense:
   a. Prima facie, 20,000 is added back.
   b. 12,000 is a "Disqualified Refundable Imputation Tax" (defined in Art. 10.1.1). It is not a "Qualified Imputation Tax" (defined in Art. 10.1.1), as the UPE is tax-exempt on the dividend in jurisdiction X. Thus, the 12,000 is included in "Net Taxes Expense" (defined in Art. 10.1.1).
   c. Thus, the whole 20,000 is added back under Art. 3.2.1(a). Thus: 20,000 added.

GloBE Income = 40,000 - 3,000 + 7,200 + 20,000 = 64,200.

Do you agree?

If you have a friend or colleague who you think might find this email alert interesting, please forward it to them.