ITB International Tax Bytes *by Steve Towers*

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21 May 2021

HIGHLIGHTS

- **2 developments in regard to digital taxation: the African Tax Administration Forum proposes Amount D for Pillar One, and the US indicates a floor of 15% for the minimum rate in Pillar Two**
- **European General Court decides 2 major EU State aid cases concerning tax rulings (Amazon and Engie)**
- **Continuation of in-depth analysis of Pillar One – today: Tax Certainty (Part 1)**

HAPPY FRIDAY!

The **European Commission** creates **DEBRA**, **BEFIT** and **CBAM**; but without **QMV**, what will actually happen? Meanwhile, elsewhere in the tax world…

The **US** draws the line at **15%** but **ATAF** wants its **vitamin D**; **Amazon** wins in **1995**, but it's **Engie's** transaction which is old-fashioned; **Australia** thinks **17%** is a low rate; **Russia** issues a warning; and the **UK** packages the future!

But at the end of the week, here is your "current affairs" question: **"Ceuta has been in the news recently: Is Ceuta: (1) a brand of tequila; (2) an electric sports car; or (3) a Spanish enclave in North Africa?"**

Have a great weekend!
Steve

THIS WEEK'S PODCAST

(For ITB video subscribers, please log in to access the video and documents/reports)

1. Digital taxation
2. EU State aid cases
3. Other global developments
4. Pillar One: Tax Certainty (Part 1)
5. Asia Pacific
   - Australia, India, New Zealand, Singapore
6. Europe
   - EU, Russia, UK
7. Treaties

ITB series on Pillar One

- **Scope (Part 1, 2 & 3) – ITB (22, 29 Jan & 5 Feb 2021)**
- **Nexus – ITB (19 Feb 2021)**
- **Revenue sourcing rules (Part 1 & 2) – ITB (26 Feb & 5 Mar 2021)**
- **Tax base determinations (Part 1 & 2) – ITB (12 & 19 Mar 2021)**
- **Profit allocation (Part 1 & 2) – ITB (26 Mar & 9 Apr 2021)**
- **Elimination of double taxation (Part 1 & 2) – ITB (16 & 23 Apr 2021)**
- **Amount B (Part 1 & 2) – ITB (30 Apr & 7 May 2021)**
- **Tax Certainty (Part 1) (ITB, 21 May 2021)**

ITB series on Pillar Two

1. **GloBE rules**
   - **Scope – ITB (9 Oct 2020)**
   - **Calculating the ETR (Part 1 & 2) – ITB (16 & 23 Oct 2020)**
   - **Carry-forwards – ITB (30 Oct 2020)**
   - **Carve-out, and computation of the ETR and top-up tax – ITB (6 Nov 2020)**
   - **Income Inclusion Rule – ITB (13 Nov 2020)**
   - **Switch-Over Rule, and Undertaxed Payments Rule (Part 1 & 2) – ITB (20 & 27 Nov 2020)**
   - **Associates, joint ventures and orphan entities; and Simplification options – ITB (4 Dec 2020)**
2. **Other topics**
   - **Subject to Tax Rule – ITB (2 Oct 2020)**
   - **Implementation and Rule Co-ordination – ITB (11 Dec 2020)**
   - **Unresolved issues, GILTI & hub jurisdictions – ITB (18 Dec 2020)**

WORTH READING

Ji-Hyun Yoon
"An Old Tale with Some New Perspectives: On Taxation of Royalty Income Relating to US-Registered Patents under the Korea-US Tax Treaty"
Asia-Pacific Tax Bulletin, IBFD, 2021 (Volume 27), No. 2 (subscription service)

Ryan Finley
"After Coca-Cola, Practitioners See DEMPE as Part of U.S. Law"
Tax Notes Today International, Tax Analysts, 21 May 2021 (subscription service)

INTERNATIONAL TAX QUIZ

THIS WEEK'S NEW QUIZ

XCo, a company resident in X, is the ultimate parent of an MNE group.

XCo owns 100% of the shares in YCo, a company resident in Y. YCo is a holding company with very little substance.

YCo owns 100% of the shares in ZCo, a company resident in Z. Under Z domestic law, a withholding tax of 20% applies to outbound dividends.

ZCo is a major operating company which generates significant profits. To achieve 2 tax objectives (i.e., (1) to extract dividends from ZCo with zero Z withholding tax, and (2) to avoid X tax on dividends paid directly to XCo), YCo was interposed in the shareholding structure many years ago. Since then, ZCo has paid significant dividends to YCo. YCo has invested the cash elsewhere in the group in the form of intragroup loans (with arm's length interest).

The Y/Z treaty is identical to the 2008 OECD model treaty, but with zero source country tax on dividends on substantial shareholdings.

The Y domestic law provides an exemption for foreign sourced dividends, and it does not impose tax on outbound dividends.

There have been 3 recent developments: (1) The MLI has commenced operation in regard to the Y/Z treaty (the "PPT only" option has been adopted by both Y and Z); (2) X and Z have entered into their first double tax treaty, which is identical to the 2017 OECD model treaty, but with zero source country tax on dividends on substantial shareholdings (the treaty has become effective); and (3) X has changed its law to introduce an exemption for foreign sourced dividends.

XCo now wants to implement this plan: ZCo would pay a large dividend to YCo, and YCo would immediately use the cash to pay the same amount of dividend to XCo.

Will Z withholding tax apply?

Answer in next week's ITB email alert!

LAST WEEK'S QUESTION

ACo, a company resident in A, owns 3 assets in B: (i) a block of land; (ii) shares in BCo 1 (a company resident in B); and (iii) shares in BCo 2 (a company also resident in B). BCo 1 and BCo 2 are not land-rich. ACo holds all 3 assets as long-term investments: it does not carry on a business of trading in land or shares.

During a particular year, ACo sells all 3 assets. It derives a gain of 500 on the land, and a gain of 300 on the BCo 1 shares; however, it incurs a loss of 200 on the BCo 2 shares.

All 3 assets fall within the B capital gains tax rules. Accordingly, under B domestic law, ACo's loss on the sale of the BCo 2 shares (200) can be offset against its gains (500 + 300 = 800) on the sale of the land and the BCo 1 shares – giving a net capital gain of 600, which is subject to B tax.

The A/B treaty is identical to the 2017 OECD model treaty.

After applying the treaty, what is the net capital gain which is subject to B tax?

LAST WEEK'S ANSWER

Preliminary comments:

The 500 gain on the land is taxable in B: Art. 13(1); but the 300 gain on the BCo 1 shares is exempt in B: Art. 13(5).

But what about the 200 loss on the BCo 2 shares? Art. 13 refers only to "gains" – there are no references to "losses". Also, there is no discussion of losses in the OECD Comm. on Art. 13. Should Art. 3(2) apply to supply the B domestic law meaning of "gains"? – and would that domestic law meaning include losses?

Under B domestic law, ACo is entitled to deduct the 200 loss. Should the treaty be interpreted so as to deny ACo that domestic law benefit?

Let me change the numbers slightly: the 500 gain on the land and the 300 gain on the BCo 1 shares remain the same, but ACo incurs a loss of 400 on the BCo 2 shares. This would mean that, under B domestic law, ACo's net capital gain would be 400 (500 + 300 – 400). If the treaty were interpreted to deny ACo the benefit of deducting the 400 loss, ACo's net capital gain (after applying the treaty) would be 500: the treaty has increased ACo's B tax liability!

2 issues:

(1) Should "gains" also include "losses"? In the absence of any treaty or Commentary support, it is difficult to conclude that "gains" includes "losses".

(2) Can ACo take inconsistent positions? That is, rely upon the treaty to exempt the gain on the BCo 1 shares, but claim the benefit of domestic law for the loss on the BCo 2 shares? Some countries (e.g., Canada and the US) require taxpayers to rely upon the treaty only, or the domestic law only, in regard to all items of the same category of income.

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