Recent developments in international taxation

Chloe Burnett
Chair - Australia

Reuven Avi-Yonah
Panel member- USA

Shefali Goradia
Panel member - India

Adolfo Martín Jiménez
Panel member - Spain

Ana-Claudia Utumi
Panel member - Brazil

Scott Wilkie
Panel member - Canada

Peter Scott
Secretary - Australia

International Fiscal Association

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Recent Developments in International Taxation

25 November 2020

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Panel Members

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Agenda

- Transfer pricing:
  - What is the "transaction"? What role for private law?
  - Case law updates
- Coverage and influence of treaties: shrinking or growing? Case law updates
- Developing/middle income country interests – recent developments
- Exchange of information developments
- Dispute resolution developments
- Fiscal versus tax policy in the current economic "shock"

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Transfer pricing – What is the "transaction"? What role private law?

Transfer pricing – What is the "transaction"

- "Transfer pricing" … but conceivably more …?
- What is the first step in any tax analysis?
  - What is "the transaction" and who are the parties?
    - Is tax law "accessory" to general law that establishes legal personality, organizational form, and transaction "quality", or is it the other way around?
    - Whose law determines what? What about "conflicts" of view and perspective? Any normative standard, reference point?

Ages and stages of "(re)characterization" in OECD Transfer Pricing Guidance

- 1979, 1995, 2010 - 2017
  - Redetermine transactions that do not comport with evidence of dealings IF there is purposive tax avoidance
    - Recognize that in NAL setting, transactions of different legal kinds often are interchangeable and formulation doesn't matter much
  - Contracts and the private matter – mostly a lot

Ages and stages of "(re)characterization" in OECD Transfer Pricing Guidance

- 2017 +
  - First, decide what the transaction is using economics business judgment?
  - Second, having decided what it is, then go back and give it its "form", its terms and its consequential outcome under the tax law?
  - Contracts and private law matter … but how much?
  - What is the conditional role, if any, of purposive tax avoidance?

Transfer pricing

- Recent cases shine a bright light on these questions
  - *Coca-Cola* (US)
  - *Cameco Corporation* (Canada)
  - *Glencore* (Australia)
  - *Agracity* (Canada)
  - *Adecco* (Denmark)
- When should legally effective arrangements be displaced in favor of economically equivalent others with different tax outcomes?
- What makes a comparable transaction?

Transfer pricing

- Notions "in play", arising from BEPS's revision of transfer pricing guidance:
  - "Accurate delineation" of a transaction
  - "Commercial rationality" of a transaction
- Questions?
  - Normative standards?
  - Who decides in the event of a "conflict", and how? Article 9? Article 23?

Transfer pricing

- "Recharacterize" based on economically equivalent outcomes?
- What is the (continuing) role of "the law"?
- A convergence or conflation of income measurement and allocation of taxing rights, and anti-avoidance?
- What does Article 9 actually say? And what is the role of transfer pricing "guidance"?

Voting Question 1

In transfer pricing, should the hypothetical transaction be based more on legal form or on economic substance?

- Legal Form
- Economic Substance

How are differences of view and perception to be resolved, according to objective reference points and in a practical manner?

- MAP
- "Pre-MAP", i.e., Pillar 1? And then, maybe, MAP?
- APAs? Among whom?
- Increased "multilateralism"? But, in whose interests?
  - Is there the same enthusiasm to receive an allocation of "group losses", e.g., post COVID, as there would be profits? What does an allocation of losses mean?

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Coverage and influence of treaties: shrinking or growing?

Effects of OECD Secretariat Analysis of Tax Treaties and Covid-19 (3 April 2020)

- (Unstated) Policy Principle OECD's Note:
  - Disregard of (forced) physical presence due to Covid-19 lockdowns when applying tax treaties
- (Spanish) Ruling 17.06.2020 V1983/2020:
  - Lockdown period counts for the 183 days rule that triggers tax residence in Spain
  - Non treaty situation, but the ruling can have effects in tax treaty situations
- Policy principle of the OECD Note seems to get rid of the need for physical presence to 'participate in the economic life of a country', whereas the Ruling V1983/2020 goes in the opposite direction
  - Distortions in the application of tax treaties?
  - Value of OECD recommendations?

Supreme Court of Spain 308/2020, 03.03.2020, *Stryker* : Facts, lower court decision

- Spanish Company applied exemption for profits (2005-2008) allocated to Swiss 'finance branch' (art. 23 Spain-CH tax treaty)
- Human and material resources of the branch were minimal, but was recognized as a PE by Swiss tax authorities
- Lower Court (09.02.2019): No PE (income allocated to Spain) because activity 'had an auxiliary character' as per the 2005-2010 Commentaries on article 5 OECD MC
- Problem?: Switzerland-Spain tax treaty followed 1963 Draft OECD MC: article 5.3.e) OECD MC (. . . Similar activities [to those mentioned in e)] which have a preparatory or auxiliary character *for the enterprise*')

Supreme Court of Spain 308/2020, *Stryker*: decision

- 'Auxiliary' in art. 5.3.e) was narrower in draft OECD MC (1963) and Swiss-Spain treaty than in the Model (2005-2010) and Comm. used by tax auditors / lower Court
- OECD MC or Commentaries are no legal basis on their own, "Creative dynamic interpretation" excluded, not dynamic interpretation!!!
- Strong defence of 'bilateral interpretation' (no unilateral modification) of tax treaties

Spanish Supreme Court 3062/2020, 23 September, *Colgate* : Facts

- In 2005 the Colgate Group restructured to operate with a principal / limited risk distributor model, Spanish subsidiary did not pay any more royalties to US Parent, it simply purchased goods from Swiss principal
- Restructuring was questioned in a previous judgement: principal only provides limited services to Spanish Subsidiary
- Decision referring to royalties paid to principal (AN 30.11.2018): Price of goods had a royalty element, Swiss principal was not the BO of the royalties but no proof royalties were repaid to US parent and US treaty was not applied
- Spain-Switzerland tax treaty (1966) does not include a reference to BO in article 12 (royalties)

Spanish Supreme Court 3062/2020, 23 September, *Colgate*: decision

- Dynamic interpretation cannot be an excuse to read BO into the Spain-Switzerland DTC
- For the SC it was 'arbitrary' that if Swiss principal was not the BO, the US parent were not regarded as such, but instead of disregarding the Swiss principal, the SC applied the Swiss-Spain tax treaty
- Wrong reasoning? SC confirmed BO = GAAR (not in line with its meaning in the 2014-2017 Commentaries to art. 10-12 OECD MC), but had no effect because treaty did not refer to it
- OECD Comm. 1977, 2003, 2014 did not help the SC: inconsistent interpretation of BO may be a limit to correct application of tax treaties

Coverage and influence of treaties: shrinking or growing?

- Influence of MLI beyond MLI parties
  - Even though Principal Purpose Test came as a tool to control treaty shopping, authorities of different countries may try to use this type of interpretation to disregard transactions that not necessarily involve treaties
- PPT raising uncertainty in all countries – reasonableness is a fluid standard
  - *MLI, Art. 7th "if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit"*
- How to assess when a certain transaction has as *one of the principal purposes* saving taxes?
  - If tax saving corresponds to 5% of a transaction, is this a PPT? What about 10%? And 15%? Or 20%? In which point a tax effect becomes **one of the principal purposes?**

The *Giesecke & Devrient* case – Treaty rate on dividends

- Indian Company pays a dividend distribution tax (DDT) @ 20.56 percent; dividends are exempt in hands of shareholders*
- The Taxpayer argued DDT should be restricted to 10 percent as per Article 10 of India Germany Tax Treaty
- The Tribunal held DDT is a tax on income and the incidence of DDT is on the payer company
  - Intention of DDT regime was administrative convenience rather than a legal necessity; DDT cannot exceed the rate specified in Article 10 of the Tax Treaty
- Whose tax is it? – Legal incidence v economic incidence
- Can the payer of dividend avail of the beneficial treaty rate?

* Effective 1 April 2020, DDT regime is abolished and shareholders are liable to tax on dividend income

Comments *Giesecke & Devrient* [concept of taxes covered by tax treaties (I)]

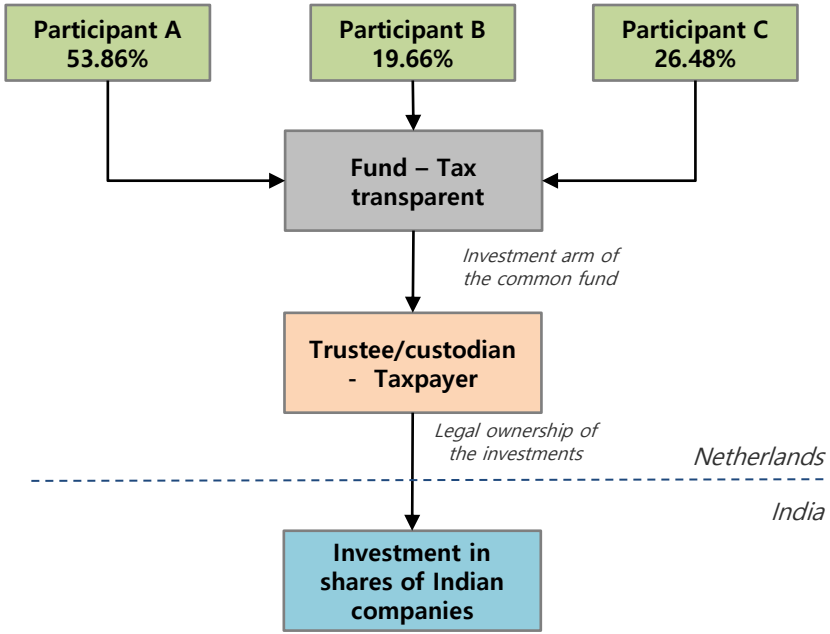
- The decision suggests an 'economic approach' to the concept of taxes covered by tax treaties or, rather, a more teleological interpretation that gives primacy to elimination of double taxation
  - Similar to CJEU *Athinaiki*, C-294/99 (2001) (abandoned later by CJEU)
- What if this interpretation is applied to the equalization levy or DST?
  - DST v. (Draft) Article 12 B UN
  - DST v. EU law:
    - Opinion AG Kokott 15 October 2020, Com. v. Poland, C-562/19 (Polish retail tax)
    - Possibilities of challenges under EU law diminish but open up under tax treaties?
  - OECD Interim Report Digitalized Economy 2018, para. 415 ff.
  - Effects of 'substantial interpretation' of tax treaties (i.e. *Stryker* Spain)

The *Flipkart* case

- Three Mauritius companies sold shares of a Singapore Co to a Luxembourg Co in 2018; Singapore Co derived value substantially from Indian assets (shares of Indian companies)
- Applications of the Mauritius companies were rejected noting that the transaction was designed *prima facie* for tax avoidance*
  - Control and management did not lie in Mauritius; based on the overall holding structure
  - Mr C (founding partner of the applicant group based in the US) had the authority to operate bank account of the Applicants for transactions beyond USD 250,000
  - The Authority was of the view that the Mauritius treaty (original as well as amended) never intended to exempt indirect transfers
- Authority is empowered to give a ruling on GAAR issues; it could have pronounced its decision rather than reject the application

* Under Indian law, an Advance Ruling application can be rejected if the Authority is of *prima facie* view that it involves tax avoidance

The *ING Bewaar Maatschappij I BV* case



- The Fund was formed as a *Fonds voor Gemene Rekening* under the Dutch law; it is not a legal entity but a contractual relationship between the investors, fund manager and the custodian
- Income of the Fund accrued to the investors and was taxable in their hands, who also were Dutch tax residents
- Transfer of Indian investments held through trustee-custodian; a taxable entity in Netherlands resulted in capital gains; claimed to be not taxable in India under India Netherlands Tax Treaty

The *ING Bewaar Maatschappij I BV* case

- The tax officer denied treaty relief since the Fund was not a taxable entity in the Netherlands
- The Court observed that it is important that the income is taxable in the treaty partner jurisdiction, rather than the manner in which the income is taxed*
- The beneficiaries were taxable in the Netherlands; the trustee-custodian, in a representative capacity, was eligible for treaty relief
- What is important - Person '**liable to tax**' or Income '**subject to tax**'?

* Reference was made to an earlier decision in case of Linklaters LLP

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Developing/middle income country interests – recent developments

Taxation and developing/middle income country interests

- Developing countries and use of withholding taxes to assure minimum taxation
  - Countries implementing WHT and/or DSTs to assure tax revenues from digital economy
  - UN Model Treaty with source taxation on royalties/intangibles

Taxation and developing/middle income country interests

- Countries that did not sign the MLI
  - How to prevent treaty shopping if the relevant treaty is silent or insufficient to tackle it? Or if there is no match on MLI options?
  - Necessity of renegotiating each treaty to avoid treaty override due to application of unilateral measures that can cause double taxation?

UN Model Draft Article 12B

- Provides a taxing right to the source country for 'income from automated digital services'
- At the option of the taxpayer, the income to be taxed by the source country
  - On **gross** basis (proposed rate under consideration at 3% or 4%)
  - On **net** basis (deems 30% as qualified profits, based on segmented / overall profitability ratio of the beneficial owner / MNE Group)
- Next step:
  - The Committee will work to improve the Article and the Commentary
  - Which will be finalised at the 22nd Session in April 2021

UN Model Draft Article 12B

- No taxing right for CFB under Article 12B
  - Is it possible to ring-fence digital economy? Interplay with Pillar One?
- Nexus: Need for minimum threshold for global or market revenues
- Net basis taxation: Concerns on determination of beneficial ownership
- Includes payment by individuals (unlike Article 12A) – practical challenges for WHT
- FTS and royalties are excluded – Article 12B last in the pecking order

UN Model Article 12 – Proposed Inclusion of Software Payments

- Needs a clear articulation of policy principle for proposed inclusion of software payments
- Factors provided - increasing level of engagement in the economic life of a state, reliance on telecom network, IP laws, etc. Sufficient for allocation of a taxing right?
- Should there be an option for net basis of taxation?
- Overlap with taxation of digital services (in Article 12B)

ATAF – Suggested Approach to DST

- Proposes structure and legislation – for consistency throughout Africa
- Minimum thresholds and a low percentage as DST is applied on gross revenue and is payable even where losses are made
- Allows group reporting by one representative entity to ease the administrative burden
- Recommends that member countries repeal DST when a consensus based international solution is achieved

Voting Question 2

Will unilateral DSTs become the norm, with the role of international organizations limited to suggesting best practice DST design?

- Yes
- No

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Exchange of Information developments

- **International standards v. taxpayers' (or holders of information) rights**
- CJEU (Grand Chamber) 6.10.2020, E. Luxembourgeois, C-245/19 and C-246/19 (audit to a well-known Colombian singer being audited as a tax resident of Spain): clash of international tax standards and taxpayers' rights
- EOIR was built around the right of the requesting State to have access to taxpayers' information with minimum recognition of the role of the taxpayer, the person holding the information or requested State (with relevant impact on how countries such as Luxembourg reformed their domestic legislation)
- National Court decisions and case law of the CJEU have an important impact on the peer review process GF and eventually the standards
- *Berlioz*, C-682/15, 2017, challenged the reform of Luxembourg of its legislation on EOIR and:
  - Recognized the right of appeal of the requested person against sanctions for not providing the requested information (art. 47 EU CR: judicial review) (but did not refer to appeals of the information order)
  - The 'foreseeable relevance' of the information can be (materially and not only formally) controlled in the requested State in terms of proportionality (subject to several doubts as to the scope of that control: meaning of 'devoid of any foreseeable relevance')

- **E. Luxembourgeois, C-245/19 and C-246/19: decision, effect for third countries**
- Addressee of an information order has the right to judicial review ('direct appeal' ex art. 47 EU CR) without waiting for a penalty to be notified or imposed
  - Same right not recognized to taxpayer (S, cf. Sabou, C-276/12: only against tax assessment in the requesting State) or third parties (C vis-a-vis Bank)
  - But recognizes that EOI can affect the 'right of private life' and 'protection of personal data' (art. 7, 8 EU CR) (new addition)
- Clarifies *Berlioz*: a request that refers to 'any relevant relevant contract' (without being more specific) in relation to the taxpayer in the relevant period, in the context of a request that explains the specific procedure taxpayer, person having the information and years under audit is not 'devoid of foreseable relevance' (contrary to national Lux courts which concluded otherwise)
- Relevant for non EU Countries? Are taxpayers' rights relevant in other situations of definition of international tax standards or interpretation or application of tax treaties? Time to take rights seriously?

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Dispute resolution developments

Treaty dispute resolution and countries that do not accept arbitration

- While more countries have been adopting arbitration to solve disputes on tax treaties via MLI or bilaterally
- There are countries that do not accept arbitration in tax matters
  - So, international tax disputes have been decided by local courts
  - Oftentimes local courts adopt interpretations that are not in line with Model Treaties or international interpretations, nor take into account the opinion of the other country
  - Local court decisions on tax treaties may result in double taxation? If so, can this be considered a treaty override?

Dispute resolution – *Vodafone* arbitration and Indian BITs

- Who are the parties concerned?
- What is the transaction?
- Arbitration Court held India's action to be in breach of 'fair and equitable treatment' provided in the India-Netherlands BIT
- India is not a member of ICSID Convention and hence, enforcement of the arbitral award - a challenge

United Nations arbitration update – June/July 2020

- Article 25 – and supplementary / alternative means including mediation
- Revisit commercial treaties
- Is another layer of arbitration or the like for the transfer pricing aspect of digital intangibles (Pillar 1) even conceivable?
  - What that would mean for resolving disputes?

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Fiscal versus tax policy in Covid-19 times

- Using the tax system as a benefit delivery systems (e.g., US NOL rules)
- Stresses on tax administration and implications for international accommodations among tax authorities, countries' experiences and implications for business organization and tax accountability
- Illumination of typical perceptions of markers of tax jurisdiction: Countries' accommodations of itinerant presence (individuals and corporations), PEs, "carry on business IN" a place

- Illumination of fiscal unity of multinationals where adopted legal constructions matter even less fiscally because "everything happens from home" – the fiscal significance of private law formalities and the "formulation" of income allocation, tax reporting
- Many countries will want to tax the multinationals that are doing well but give tax relief to smaller/local companies to survive Covid-19 – how can they discriminate? A super-profits tax for companies?
- No bail-outs for companies using tax havens - punishment for past tax sins

Voting Question 3

Are States more likely to fund their Covid-19 economic recovery through:

- Lower taxes to stimulate growth
- Higher taxes on multinationals
- Higher taxes on wealthy individuals