Who Should Tax International Income?

February 1, 2019

International Tax Policy Forum

Georgetown Law's Institute of
International Economic Law

#InternationalTax

ITPF/GULC Conference 2019
Who should tax international income?

Recent Efforts to Assert Taxing Rights

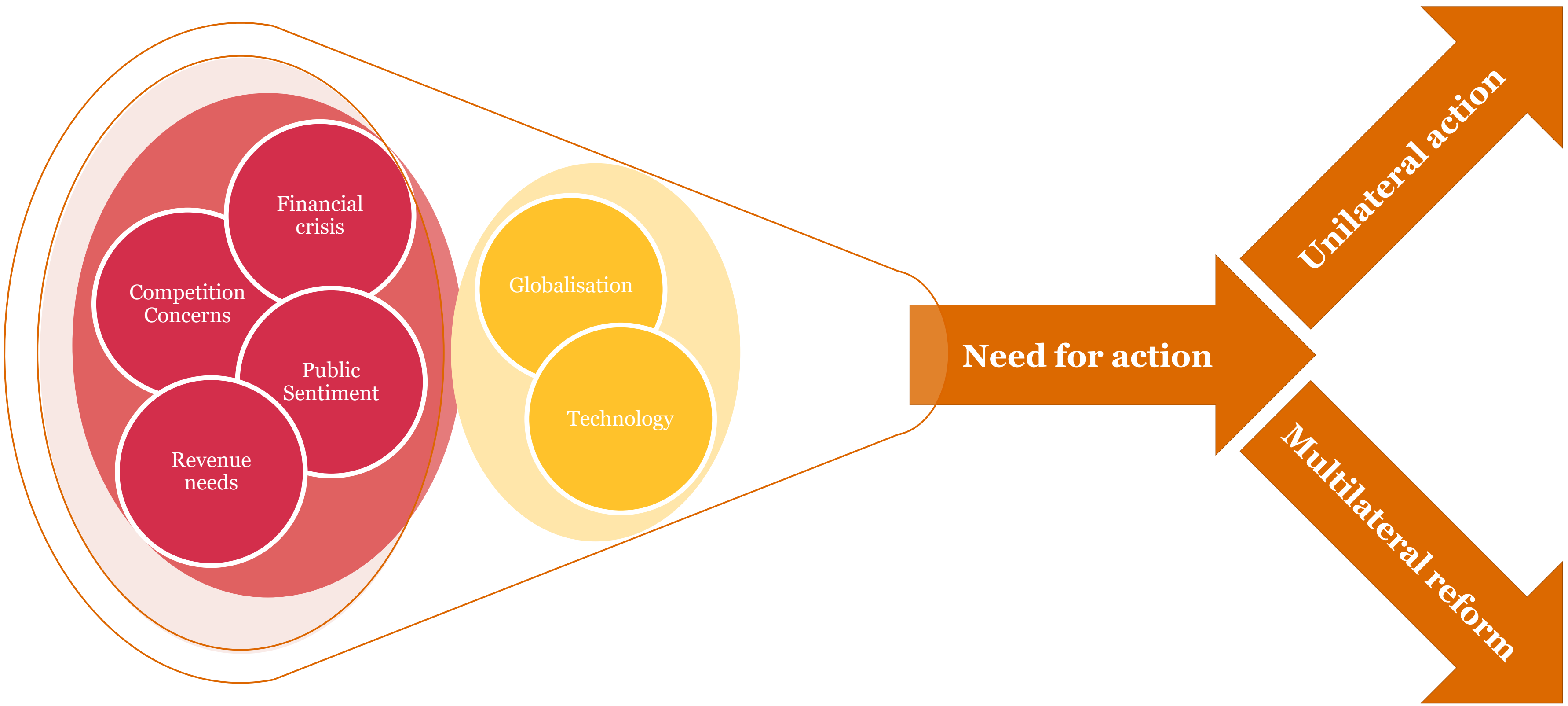
Will Morris,
Deputy Global Tax Policy Leader, PwC
February 1, 2019

pwc

Background

1

Recent efforts to claim taxing rights
Background – why now?



Recent efforts to claim taxing rights

Background – "recent" unilateral measures

Non-turnover based

Measure:	***DPT***	***Virtual PE***	***Novel new source / deeming provisions***	***Significant Economic Presence***
Rate:	*25% / 40%*	*28% / TBC*	*20% / CT rates*	*CT rates*
Effective from:	*2015, 2017*	*2019, TBC*	*2017 / 2018 / 2019*	*2019*
Countries:	*United Kingdom, Australia*	*Italy, Korea*	*United Kingdom, Hong Kong, Taiwan*	*India*

Turnover based

Measure:	***Equalisation Levy***	***VAT / Sales Tax***	***Digital Services Tax***	***Digital Advertising Tax***
Rate:	*6% / 5% / 10%*	*Various*	*3% / 3% / 2% / 3%*	*3%*
Effective from:	*2016, 2019, TBC*	*2016, 2017, 2018, 2019*	*2019, 2019, 2020, TBC*	*[2021]*
Countries:	*India, Pakistan, Chile*	*Russia, Israel, Saudi, Canada…*	*France, Austria, Italy United Kingdom, Spain*	*European Union*

Non-turnover based unilateral measures

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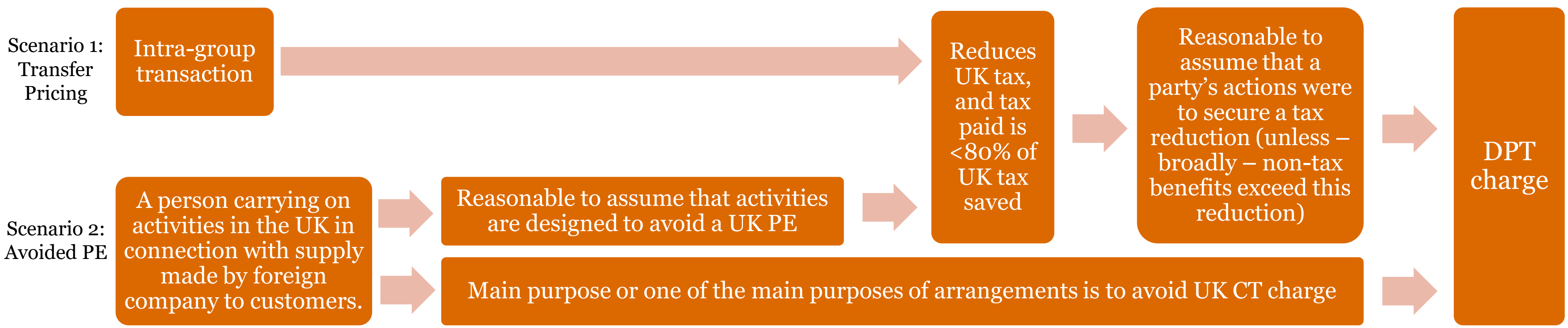
Non-turnover based unilateral measures

The UK's Diverted Profits Tax (DPT)

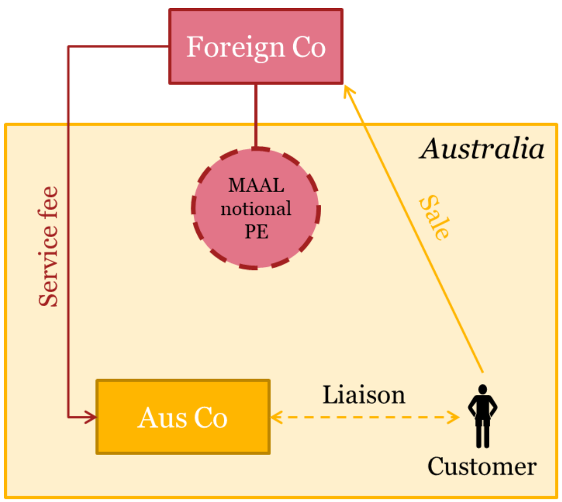
- Applies for profits arising from April 2015, regardless of when arrangements were entered into.



- Tax due on the amount that would have been subject to corporate tax (CT) (or "alternative provision" absent CT considerations)
- Punitive 25% DPT rate (UK tax rate was 20%, but is reducing to 17% and withholding tax rate remains at 20% where applicable). Can be avoided by adjusting transfer pricing or declaring a permanent establishment (PE) and paying CT instead.
- Similar rules have subsequently been introduced in Australia
- Applies to more companies than was originally expected; compliance disclosure facility now being rolled out.

Non-turnover based unilateral measures
Australian Multinational Anti-Avoidance Law (MAAL)

- Applies from 2016, regardless of when arrangements were entered into
- Where gateway tests are passed (below), tax benefit calculated as difference between tax that would be paid on a hypothetical 'notional' MAAL PE (including withholding taxes) and what actually occurred. This amount must be paid as tax, plus penalties based upon it.
- Additional minimum 100% penalty (compared to 50% for transfer pricing, which can be reduced to 10% if position is 'reasonably arguable')



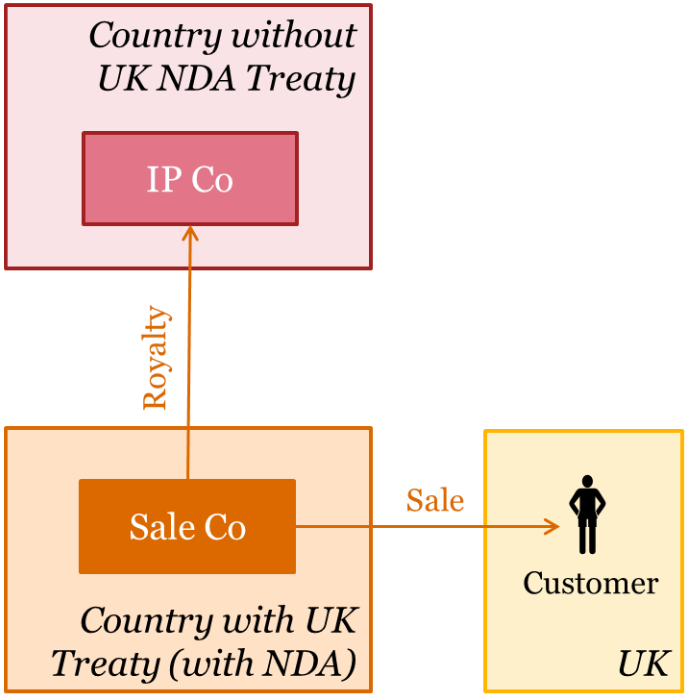
MAAL gateways for Significant Global entities (global group income > AUD 1bn)		
i.	A foreign entity makes a supply to an Australian customer	✓
ii.	Activities are undertaken in Australia 'directly in connection' with supply	✓
iii.	Australian taxable presence is "associate of or commercially dependent on the foreign entity"	✓
iv.	The foreign entity derives income from the supply	✓
v.	Some or all of that income is not attributable to an Australian PE of the foreign entity	✓

If gateways are met, requires a principal purpose to either:
- obtain an Australian tax benefit, or;
- to obtain an Australian tax benefit and to reduce liabilities to tax under a foreign tax law

Non-turnover based unilateral measures

UK tax on offshore receipts (in respect of intangible property)

- UK is currently in process of legislating to apply from 1 April 2019
- 20% tax will be charged on the gross income realised by a foreign resident entity in respect of intangible property (or rights) used to generate UK sales.
- Will apply to the proportion of the foreign entity's IP income derived from UK sales.
- Will not apply if the foreign entity is resident in a jurisdiction with which the UK has a full tax treaty
- The charge will also not apply where:
  - Related tax paid by the foreign entity is at least 50% of the (gross) charge
  - Total sales (of group) to UK do not exceed £10 million.
  - The IP in question has not been acquired from related parties, and the business undertakes all (or substantially all) of its trading activities in the low tax jurisdiction.



Non-turnover based unilateral measures
German royalty barrier

- German rules introduced following BEPS Action 5 recommendations, denying or partially denying some royalty deductions. Rules go beyond counteracting the “harmful tax practices” outlined in BEPS Action 5:

Royalty paid from Germany

Effective tax rate on receipt of <25%

Recipient benefits from regime not compliant with BEPS5 nexus approach

Recipient benefits from a regime only compliant with BEPS5 due to grandfathering

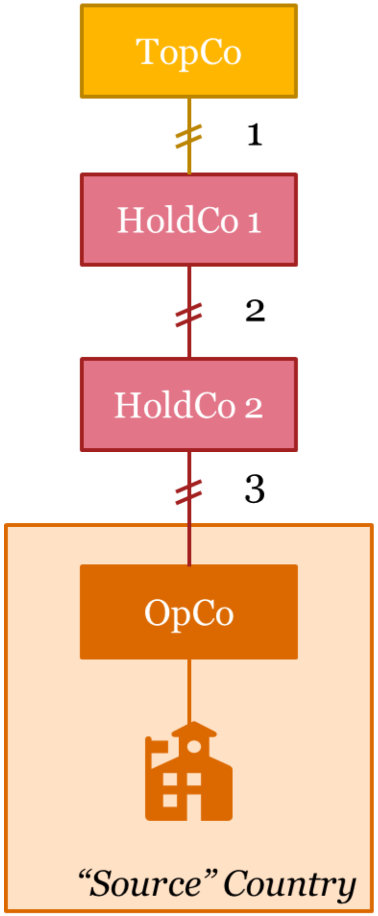
Deduction denied

- Deductions are not fully disallowed; a proportion of the royalty payment is allowable in proportion to the tax rate suffered against 25% (so if the tax rate suffered on the income is 10%, then 10%/25% = 40% of the payment is deductible, with 60% disallowed).
- The mechanics can result in a higher restriction of the deduction than the amount that is actually subject to lower rates of tax, because the gross deduction is limited even if only part of the payment is on-paid into a regime not compliant with post-BEPS5 nexus rules (or those compliant only due to grandfathering).
- If the recipient does not pay tax on the receipt because they are loss making or obligation is relieved by another company (e.g. under a fiscal unity), rules should not apply.

Non-turnover based unilateral measures
Offshore Indirect Transfers (OITs)

> *The country in which the underlying asset is located may wish to tax gains realized on such transfers—as is currently the case for direct transfers of immovable assets. Such treatment might reasonably be applied to a wider class of assets, to include more those generating location specific rents—returns that exceed the minimum required by investors and which are not available in other jurisdictions. This might include, for instance, telecom licenses and other rights issued by government.*
>
> Platform for Collaboration on Tax

- A small number of such regimes exist, but they differ considerably in scope and application
- Examples:
    - **Peru** taxes all OITs, not just those whose value arises from immovable property located in Peru. The sale of an interest of any non-resident company whose value results at least 50 percent from shares of companies residing in Peru would be taxed in Peru (retail exemptions apply).
    - **China** would seek to tax the value of OpCo's immovable Chinese property by taxing HoldCo 2 (right) at the domestic rate of 25% for a sale at #3. China would not seek to tax HoldCo 1 for a sale of HoldCo 2 (at #2) unless HoldCo 2 were located in a low taxed country (<12.5%).



Non-turnover based unilateral measures

Virtual/Digital PEs and Significant Economic Presence

European Union

- Directive on Significant Digital Presence (i.e. digital PE)
- Threshold:
  - *3000 contracts; or*
  - *100,000 users; or*
  - *€7m revenues in a Member State*
- Scope:
  - *Broad – almost all digitally supplied services, except specific exemptions*
- Basis:
  - *Income allocated by profit split on destination favourable factors*
- Application:
  - *From January 1, 2020*
- **Status: under negotiation (although not currently being focused on)**

India

- New threshold introduced under Finance Act 2018
- Threshold:
  - *Revenues from physical goods / services (TBC)*
  - *Revenues from digital goods / services (TBC)*
  - *Number of users (TBC)*
- Scope and Basis:
  - *Broad – income from India (from services above) deemed to arise in India*
- Application:
  - *From April 1, 2019*
- **Status: comes into force on April 1, 2019; guidance expected on detail imminently (following consultation in 2018)**

Italy

- New threshold introduced under Finance Act 2018
- Threshold and scope:
  - *"A significant and continuous economic presence in the territory of the State set up in a way that it does not result in a substantial physical presence in the same territory"*
- Basis:
  - *No change from previous application; OECD TPG*
- Application:
  - *From January 1, 208*
- **Status: in force**

- Only applicable where no relevant bilateral tax treaty

Non-turnover based unilateral measures
United States

Global Intangible Low-Taxed Income (GILTI)

- The tax on GILTI is designed to **ensure that foreign operations of US corporations are subject to a minimum level of taxation**. Despite its name, GILTI is not limited to intangible or low-taxed income
- This rule generally subjects a US shareholder to tax on the combined net income of its controlled foreign corporations (CFCs) that (1) is not otherwise taxed in the U.S. on a current basis (e.g., effectively connected income (ECI) and, subpart F income) nor specifically excluded (e.g., related dividends), and (2) exceeds a 10% return on the CFC's tangible depreciable assets. GILTI is included in gross income of a US shareholder in a manner similar to subpart F income
- Corporate US shareholders receive a 50% deduction (subject to a taxable income limitation) on the amount of their GILTI inclusion, which reduces the tax on GILTI from 21% to 10.5% (the 50% deduction is reduced to 37.5% after 2025). Note that 80% of foreign taxes related to the GILTI inclusion can be claimed as a foreign tax credit to reduce the US tax on GILTI

Base Erosion and Anti-Abuse Tax (BEAT)

- The base erosion and anti-abuse tax (BEAT) is a tax imposed on 'applicable taxpayers', which are generally US C-corporations that (1) make a certain percentage of their deductible payments to foreign related parties and (2) have average annual gross receipts of at least $500 million for a 3 taxable year period ending with the preceding tax year
- Taxpayers subject to BEAT will generally incur tax of 10% of modified taxable income to the extent it exceeds regular tax liability (taxpayers retain the benefit of certain credits, such as for R&D, but not foreign tax credits). Modified taxable income is essentially regular taxable income without the benefit of deductible payments to foreign related parties

Turnover based unilateral measures

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Turnover based unilateral measures

Equalisation Levies and Digital Service Taxes (DSTs) and

India

- Indian Finance Act 2016
- Threshold:
  - *Online advertising supplied to Indian residents by non-Indian residents*
- Scope:
  - *Online advertising services*
- Basis:
  - *Gross revenues, tax to be withheld and remitted by the payer*
- Rate:
  - *6%*
- Application:
  - *From June 1, 2016*
- **Status: In force**

European Union

- Directive for a common Digital Services Tax (DST)
- Threshold:
  - *€750m global turnover, with >€50m from EU*
- Scope:
  - *Advertising*
  - ~~*Intermediation platforms*~~
  - ~~*Transmission of user data*~~
- Basis:
  - *Where user (rather than payer or payee) is located*
- Rate:
  - *3%*
- Application:
  - ~~*From January 1, 2020*~~
  - *From January 1, 2021*
  - *Sunset clause – 2025, or OECD or EU agreement*
- **Status: Negotiations ongoing; agreement could be reached by March 2019**

Turnover based unilateral measures

Digital Service Taxes and Equalisation Levies

France, Italy, Austria	United Kingdom

• Local law intended to introduce European Commission's original proposals (following no agreement at EU level).
• Threshold:
  • *€750m global turnover*
    • *>€3m from Austria*
    • *>€25m from France*
• Scope:
  • *Advertising (Austria, France, Italy)*
  • *Intermediation platforms (France, Italy)*
  • *Transmission of user data (France, Italy)*
• Basis:
  • *Where user (rather than payer or payee) is located*
• Rate:
  • *3%*
• Application:
  • *From 1 January 2019 (France), mid-2019 (Italy), TBC (Austria)*
• **Status: Enacting legislation / detail not yet available in any country; above based on original EC proposal**
	• Local law announced in advance of EU negotiations reaching initial conclusions. Tax based on user participation.
	• Threshold:
	  • *£500m global turnover, with >£25m from in scope, UK activities*
	• Scope:
	  • *Search engines*
	  • *Social media*
	  • *Online marketplaces*
	• Basis:
	  • *Direct or indirect revenues from activities in scope relating to UK users*
	• Rate:
	  • *2%*
	  • *Safe harbour for low margin businesses (unclear how this margin / profitability will be calculated)*
	• Application:
	  • *From 1 April 2020*
	• **Status: Domestic consultation running to February 19, 2019**

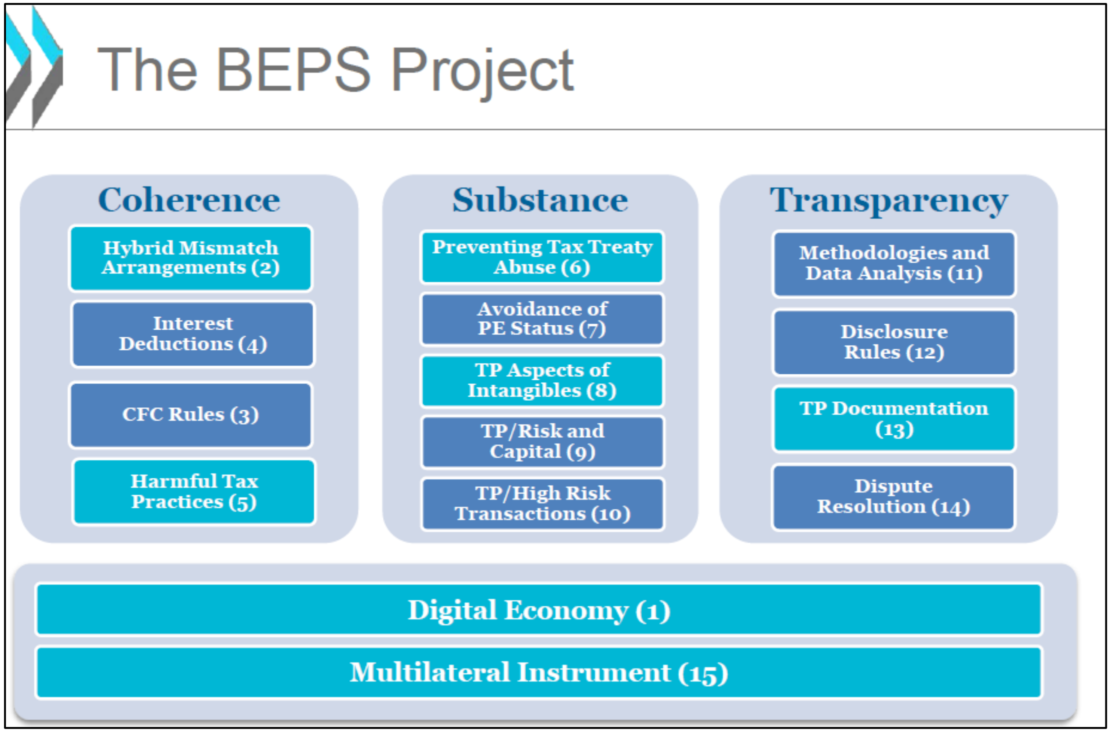
Multilateral measures

4

Digital Tax Landscape

OECD Base Erosion and Profit Shifting Project

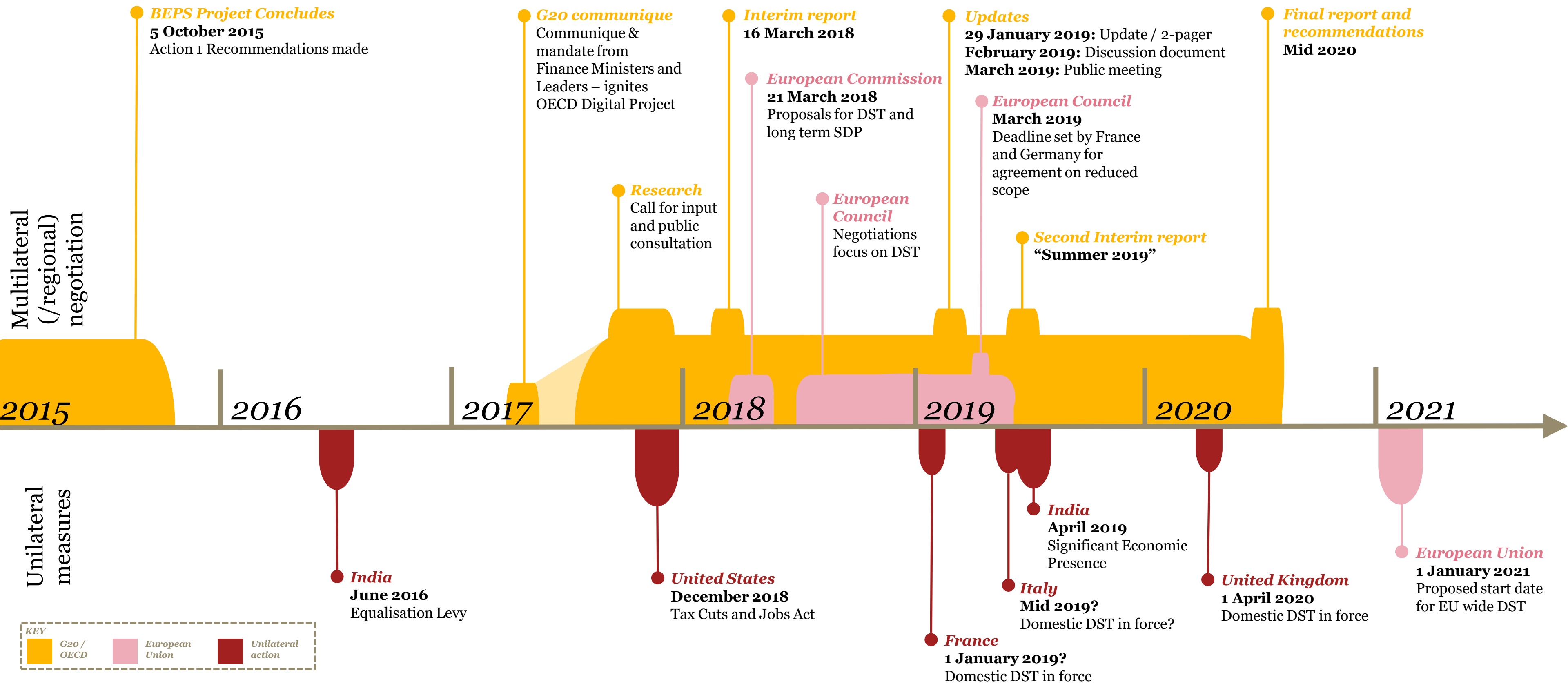
- Minimum Standards affecting primary taxing rights:
  - Action 5: Harmful Tax Practices
  - Action 6: Treaty Abuse
- Changes to international guidelines and model treaties affecting primary taxing rights:
  - Action 7: Lowering PE threshold
  - Actions 8-10: Transfer Pricing – less reliance on contractual arrangements
- Other recommendations / best practices for domestic rules affecting primary taxing rights:
  - Action 2: Anti-hybrid rules
  - Action 3: CFC rules
  - Action 4: Interest deductibility restrictions



Source: OECD

Global timeline

Multilateral and unilateral measures relating to taxation of the digitalizing economy



OECD Project on Taxation of the Digitalizing Economy

Two … and Four Pillars (with late breaking SEP inclusion)

MinTax

- Minimum taxation
  - Potentially similar to GILTI?
  - Potentially similar to German Royalty deductibility rules?
  - Combination of the two?
- Either poses significant compliance burden
- Not believed by many countries to solve perceived problems… but as more of an "anti-avoidance" measure it may also not garner as much *opposition* ("BEPS 2.0")

+

Market Based

- Increase allocation of residual profits to "marketing intangibles"
- Distinction between "production" and "marketing intangibles" would need to be drawn
- Unclear how much could be allocated, or how to distinguish between the two or relative values.
- Not believed by many countries to solve perceived problems… but it may be more attractive to exporting countries

User Contribution

- Digital PE thresholds and attribution rules
- Threshold remains unclear; number of users, revenues, or contracts remain leading ideas
- Attribution divides opinion further – profit splits vs arbitrary amounts
- Unlikely to be agreed by US as proposals stand

Significant Economic Presence

- Presumably based on new Indian law, but likely would want to make applicable also in Treaty context – so new Treaty provisions?

OECD Project on Taxation of the Digitalising Economy

“Two pillars” – Some Further Thoughts

Pillar 1 Broader challenges of the digitalized economy			**Pillar 2 Remaining BEPS issues**
Active user participation	Broader market added value	Significant Economic Presence	Minimum tax
• Favored by UK • Limited to “highly digitalized businesses” who generate value through “active user participation” • Significant treaty changes required (OECD Model Articles 5 (PEs), 7 (PE attribution), and 9 (Business Profits)) • Outlined in two detailed discussion documents from UK Treasury in November 2017 and March 2018?	• Favored by US • Not limited to “highly digitalized businesses” • Treaty changes would be required to the extent that nexus and attribution of taxes could not be addressed through adjustments to the OECD Transfer Pricing Guidelines alone. • Further treaty changes on dispute resolution may also be required.	• Supported by India, Colombia, and others? • Not limited to “highly digitalized businesses” • Treaty changes may be required, although said to be easier to administer	• Favored by Germany (and publicly supported by France) • Not limited to “highly digitalized businesses” • No treaty changes required (anti-avoidance rules could be “best practices”)

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Expanding Source, Destination, and User Taxation

Michael Devereux

Oxford University Centre for Business Taxation

Key proposition

Eventually, the taxation of profit must move towards the location of consumer (or possibly, shareholder)

- Individuals are (so far, much) less mobile than the activities of multinational businesses

- So it is possible to tax profit in that location, without the tax base relocating

But we have path-dependence …

… in institutions, language, beliefs and attitudes

- There are moves in the direction of destination taxation, but they are dressed up – and justified - as being forms of source taxation

- We may therefore end up with a patchwork of largely inconsistent taxes which combine to increase complexity and possibly inefficiencies

Two examples

- UK proposal to tax digital companies in the place of users, on the grounds that their users create value

- US proposal to identify the returns from marketing intangibles held in the market country

  - Separating the contributions of manufacturing intangibles and marketing intangibles is “particularly difficult”

Study of Intercompany Pricing Under Section 482 of the Code, US Treasury and IRS, 1988

Moving towards a destination base …

- … is inevitable and reflects underlying powerful economic forces

- What we may be offered is piecemeal, inconsistent, and based on pretense

Alternatives to Residence Taxation: Destination, Source, Users, and More

Lilian V. Faulhaber
Professor of Law

GEORGETOWN LAW

Alternatives or Additions?

- OECD Policy Note (Jan. 23, 2019):
  - Pillar 1: allocation of taxing rights
    - User contribution,
    - Marketing jurisdiction, *or*
    - Significant digital/economic presence
  - Pillar 2: anti-BEPS rules
    - Income inclusion *and*
    - Tax on base-eroding payments

Alternatives or Additions?

- OECD Policy Note (Jan. 23, 2019):
  - Pillar 1: allocation of taxing rights
    - User contribution ← *user*
    - Marketing jurisdiction ← *destination*
    - Significant digital/economic presence ← *user or destination*
  - Pillar 2: anti-BEPS rules
    - Income inclusion ← *residence*
    - Tax on base-eroding payments ← *source*

Unilateral and multilateral proposals and legislation

– Diverted profits taxes

– Equalization levies, turnover taxes, and digital services taxes

– Significant economic presence tests

– Anti-base erosion taxes

Source or something else?

- Assets
- Consumers
- Users
- Advertising

Political and legal constraints

- Political:
  - Who benefits from unilateral proposals?
  - Unilateral proposals as means to get to multilateral agreement
- Legal:
  - Treaty amendments
  - Domestic law limitations
  - EU law limitations
  - Other international law limitations

Who should tax international income?

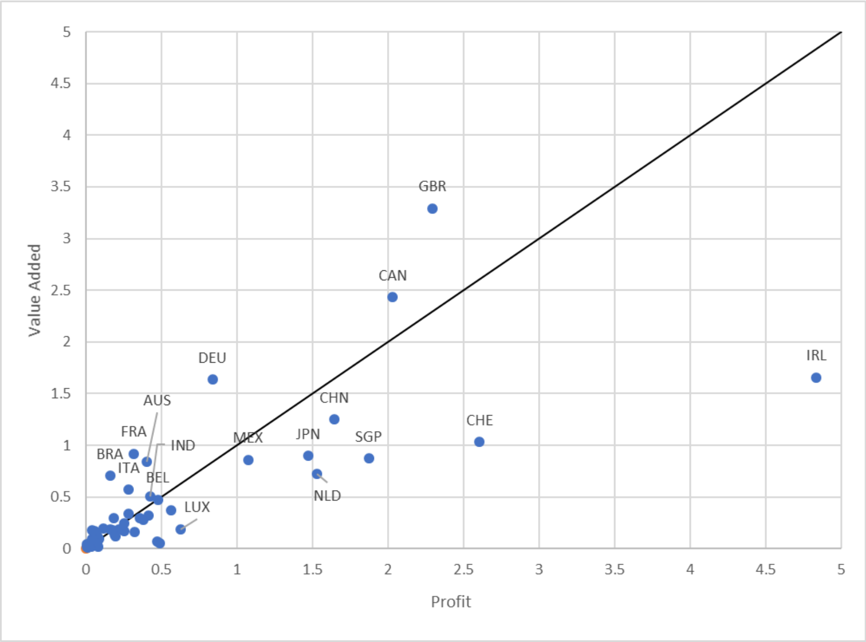
Expanding Source, Destination and User Taxation

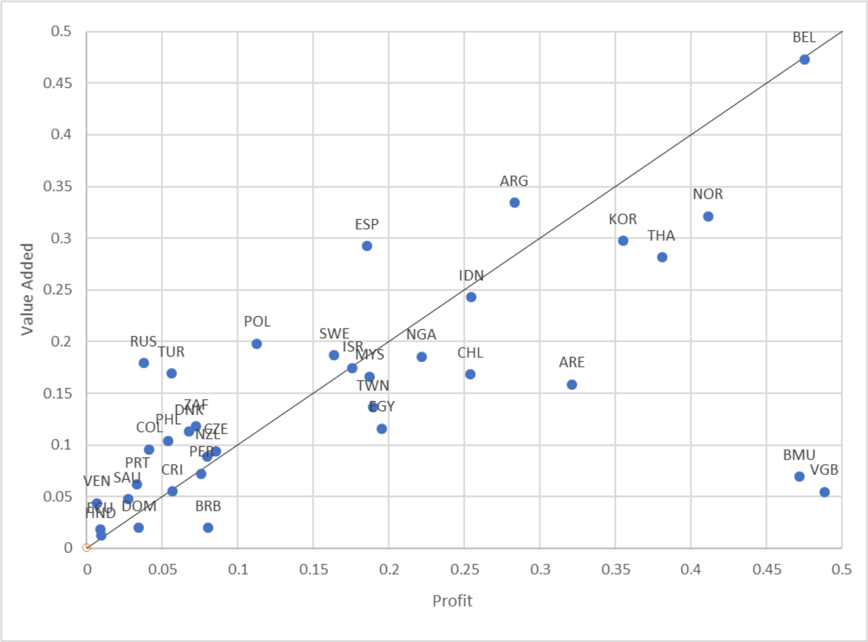
Ruud de Mooij
Fiscal Affairs Department

ITPF/Georgetown Conference

February 1, 2019

Misalignment of taxable profit and value creation



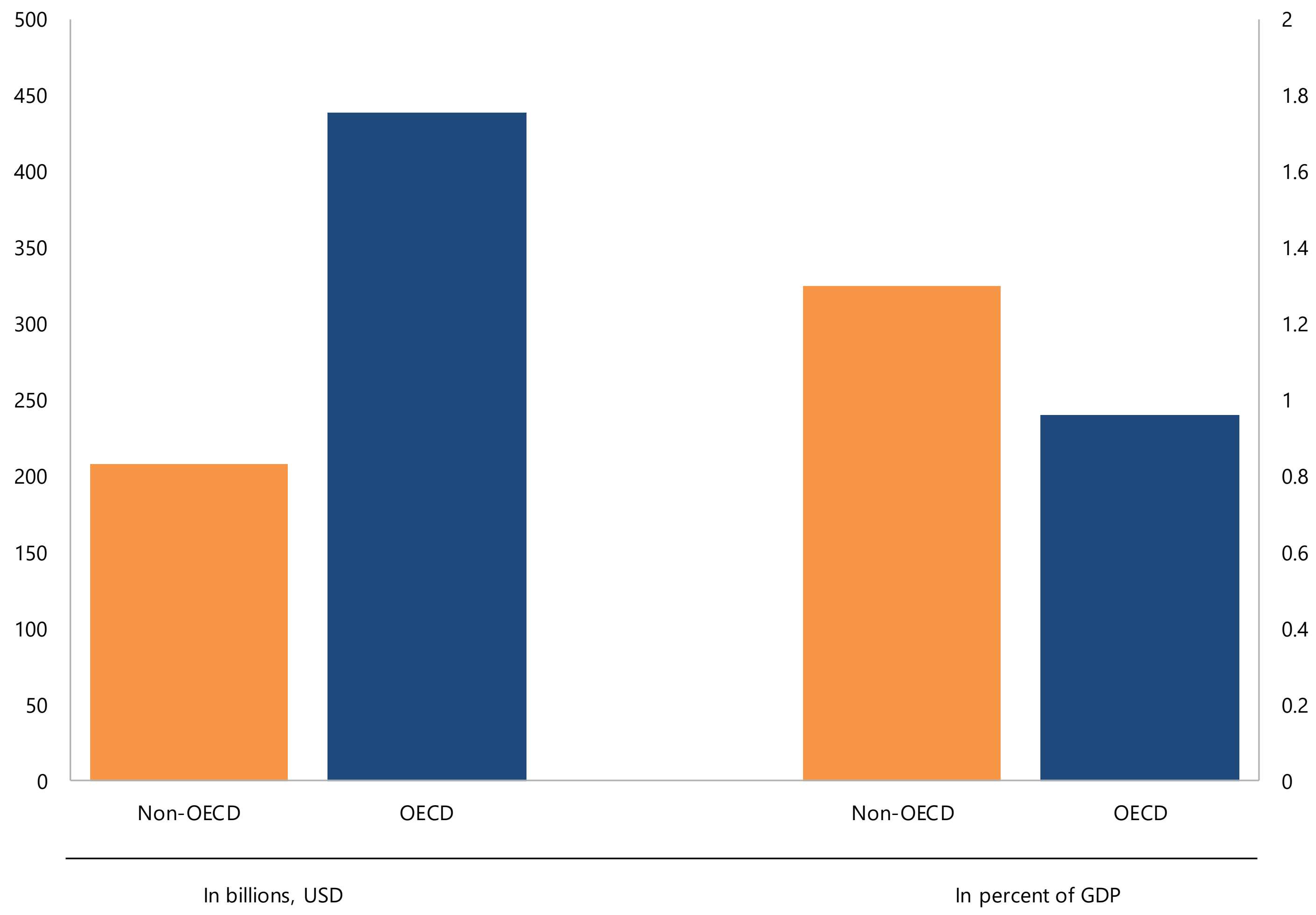


Source: IMF staff calculations using BEA data on US MNCs

The current debate for LICs

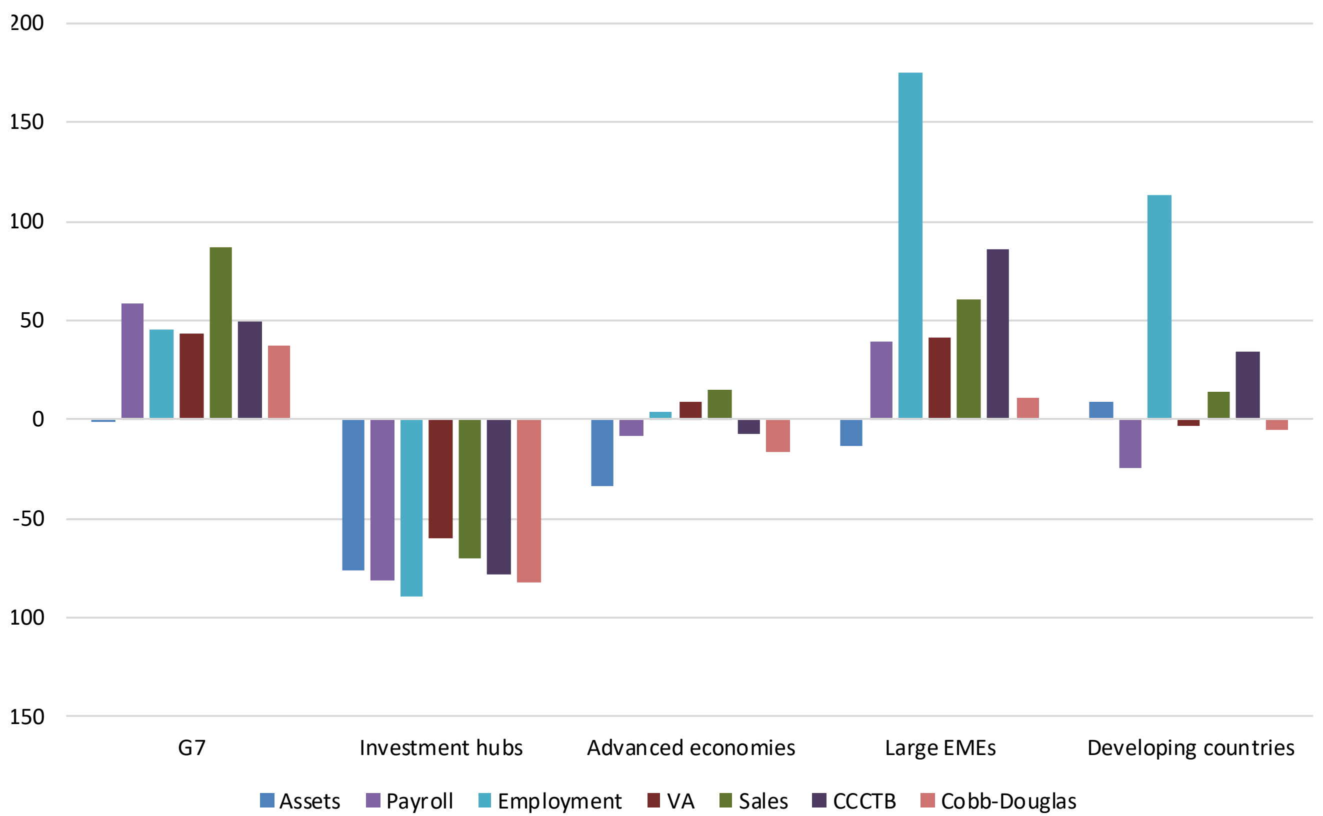
	G20/OECD	LICs
Century-old system …	Long seems to have performed well	DTAs restricted 'source'
… gradually got 'broken'	- Spillovers BEPS & tax competition - Complexity - Fairness concerns (digital)	- Spillovers are larger for them (Fig) - Complexity an even bigger concern
BEPS addressed some …	- … forms of avoidance - Yet, complexity grew - Did not address 'allocation' - Did not address tax competition	- Distinct BEPS concerns (OIT, DTA) - Distinct remedies (simplified) - Distinct interest on taxing rights - Different form of tax competition
Current debate goes beyond	- Source (BEAT-like minimum) - Residence (GILTI-like minimum) - Destination (DST, RPA)	- Simplified source measures alike - Formulary apportionment? (Fig)
Multilateralism	Avoiding double taxation / mitigating distortions	

BEPS in LICs



Source: Crivelli, de Mooij, and Keen (2016).

Redistribution under FA



Source: IMF staff calculations, based on BEA data for US MNCs

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BEPS, ATAP and the New Tax Dialogue: A Transatlantic Competition?

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Introduction

- General view: following the conclusion of the BEPS negotiations and the change of Administration, the United States is stepping back from the BEPS process.
- Indicia:
  - did not join the CRS to further automatic exchange of information;
  - decided not to sign the MLI.
- This view is partially wrong.

Introduction

- Tax Cuts and Jobs Act (TCJA) signed into law by President Trump on 22 December 2017 contains multiple provisions that incorporate the principles of the OECD/G20 BEPS into domestic US tax law.
- On 17 February 2016 Treasury announced release of 2016 US Model Income Tax Treaty.
- United States is following the European Union in implementing BEPS and its underlying principle, the *single tax principle*.
- TCJA should not be considered as a 'tax war': it is a long-overdue response to the BEPS by US and a correct application of the *single tax principle* to prevent double non-taxation.

Newly revised US Model Income Tax Convention

- Several measures consistent with the single tax principle:
  - Art. 1(8) revised version of the so-called '*triangular permanent establishment*' rule that has been included in some of the US income treaties since the 1990s
  - New language added to Artt. 10(5); 11(2)(d); 12(2)(b) and 21(2)(b): dividends, interest, royalties and other income paid by an 'expatriated entity' can be subject to 30% WHT for a period of 10 years after the inversion that created it
  - Newly defined term '*special tax regime*' used in Artt. 11(2)(c); 12(2)(a) and 21(2)(a) that would prevent reduction of withholding taxes for deductible related-party payments when the beneficial owner of the payment pays little or no tax on the related income
  - Significant revisions to Art. 22 in order to make treaty access more difficult.

Rev. Proc. 2015-40

- Procedures for Requesting Competent Authority Assistance under Tax Treaties.
- The U.S. competent authority typically will not exercise its discretion to grant benefits where:
  (i) the applicant or any of its affiliates is subject to a *special tax regime* in its country of residence with respect to the class of income for which benefits are sought. An example of such a regime for interest income is one that allows a notional interest deduction with respect to equity in the residence country;
  (ii) no or minimal tax would be imposed on the item of income in both the country of residence of the applicant and the country of source, taking into account both domestic law and the treaty provision ('*double non-taxation*'). For example, double non-taxation would occur if a payment under a *hybrid instrument* was exempt from withholding and generated a deduction in the country of source, while being treated as income exempt from tax in the country of residence of the applicant.

Three BEPS provisions included in TCJA

- § 965: one-time ‘transition tax’ on untaxed accumulated earnings and profits of certain non-US corporations.
- § 951A: foreign minimum tax on 10% US shareholders of controlled foreign corporations to the extent the CFCs are treated as having ‘global intangible low-taxed income’.
- § 59A: base erosion and anti-abuse tax (BEAT) that will be imposed in relation to deductible payments made by certain corporations to their non-US affiliates.

Past accumulations

- These earnings currently exceed $2.6 trillion, are located in just 7 low-tax jurisdictions and are highly concentrated: Apple, Microsoft, Pfizer and GE hold approximately 24% of the offshore profits.
- One-time deemed repatriation on previously untaxed accumulated foreign earnings: 15.5% (cash amounts) and 8% (illiquid assets).
- Taxpayer may elect to pay this tax over an eight-year period.
- If a US shareholder becomes an expatriated entity at any point within the ten-year period following enactment of TCJA, the benefits of the reduced rates would be recaptured.

Future Accumulations – the stick

- § 951(A) a US shareholder of any CFC must include in gross income for a taxable year its GILTI in a manner generally similar to inclusions of Subpart F income.
- GILTI means the excess (if any) of the shareholder’s net CFC tested income over the shareholder’s net deemed tangible income return.
  - GILTI = Net CFC Tested Income – [(10% x QBAI) - Interest Expense)]
- Tax rate of future GILTI 10.5% (21% corporate tax rate and allowing a deduction of 50%).
- Creates incentive to move jobs (not just profits) offshore.

Future Accumulations – the carrot

- § 250(a)(1)(A) provides a 37.5% foreign-derived intangible income deduction (FDII).
- Result: portion of a US corporation's intangible income derived from serving foreign markets is effectively taxed at 13.125%.
- Intent: encourage US multinationals to remain in the country and keep their assets, earnings, jobs and functions there.
- Issues:
  1) Roundtripping transactions / level of further processing required to qualify as foreign use.
  2) Modified nexus approach adopted by the OECD: provision does not require that anything be manufactured in the U.S. Formula is based only on profits from exports. Taxpayers can get the lower rate by importing goods and immediately exporting them.
  3) WTO: FDII regime is a subsidy contingent upon export performance, explicitly prohibited by Art. 3.1(a) of SCM.

Base Erosion

- § 59A(a) an 'applicable taxpayer' is required to pay a tax equal to the 'base erosion minimum tax amount' for the taxable year.
- Generally applies to corporations that over a three-year period have average annual gross receipts of at least $500 million and a 'base erosion percentage' for the taxable year of at least 3%.
- Issues:
  1) Ambiguous and confounding purpose behind BEAT: protection of the US tax base or lack of confidence in policing transfer pricing?
  2) Tax planning opportunities
  3) Can the BEAT be seen as violating non-discrimination provision of Art. 24?

Key BEPS Actions that generated the most controversy in the United States

- Action 1: The Digital Economy
- Disagreement btw US and EU where value is created
- US view: profits originate and taxes are due where R&D is conducted
- Some EU MS: profits should be taxed where the sale of final products is made
- US view is inconsistent with the TP dispute involving *Glaxo* (settled on 11 September 2006) – value of marketing efforts prevails over the value of patents and technical know-how

Digital Taxation in the United States

- Different context, same question: U.S. Supreme Court agreed to hear South Dakota's contention that *Quill Corp v. North Dakota* is obsolete in the e-commerce era and should be overturned.
- *Quill Corp. v. North Dakota* 504 U.S. 98 (1992): an out-of-state business with no physical presence ('*nexus*') in a state could not be required to collect and remit use tax on goods purchased by resident of that state. Requiring collection would violate the Commerce Clause of the U.S. Constitution.
- GAO estimated that state and local governments could gain from about $8 billion to about $13 billion in 2017 if states were given authority to require sales tax collection from all remote sellers.
- Case will also affect Amazon. When selling its own inventory, Amazon collects sales taxes in all states that impose one, but it does not require third-party sellers on its Marketplace platform to collect state sales taxes. For those sales that make up to about half of the company's volume, Amazon says the third-party vendors bears the collecting responsibility.
- However, Amazon collects and remit sales tax on third-party sales into Washington state since November '17 and into Pennsylvania since April '18.

Digital Taxation in the United States

- What can the United States and the European Union learn from each other?
- What happens for direct taxes if the *Quill* physical presence standard is gutted in favor of an economic presence standard?
- Meanwhile, States have enacted three basic approaches:
  - *Click through nexus* (New York State, 2008): if a seller enters into a commission agreement with a NYS resident for referring customers to the remote seller via link on the resident's website, the seller has created a taxable presence in NY and is required to collect and remit sales taxes.
  - *Affiliate nexus* (Louisiana, 2016): dealer includes any person who sells similar products as a Louisiana retailer under a similar name and similar intellectual property, solicits business through an agent with a Louisiana nexus, holds a substantial ownership (over 5 percent) in a Louisiana retailer, or is more than 5 percent owned by a Louisiana retailer.
  - *Economic nexus*: (South Dakota, 2016): an online retailer with a sales threshold of more than $100,000 per year or over 200 transactions essentially created an economic nexus even if there is no physical presence.

Action 2 – Neutralising the Effects of Hybrid Mismatch Arrangements

- § 245A(e) disallows the participation exemption for hybrid dividends that are treated as deductible payments at source.
- § 267A limits the deductibility of payments on hybrid instruments or to hybrid entities.
- The United States will tax at residence if there is no tax at source and will tax at source if there is no tax at residence.
- Is all of this consistent with the spirit of BEPS?
- What about the case where both source and residence are foreign?
- TCJA does not have any material impact on foreign-to-foreign hybrid planning.
- Neither § 245A(e) nor § 267A(a) will significantly impact foreign reverse hybrid entities, i.e. entities that are treated as opaque by its foreign investor and transparent under the jurisdiction where they are established, such as CV-BV and SCS-Sarl.
- Obama Administration's proposal: §§ 954(c)(3) and 954(c)(6) would not have been applied to payments made to a foreign reverse hybrid held by one or more US persons when such amounts were treated as deductible payments received from foreign related persons.

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

- The United States did not join the MLI primarily due to the inclusion of a general anti-abuse rule based on the principal purposes of transactions.
- In 1999, the US Senate refused to approve the ratification of negotiated treaties with Italy and Slovenia that originally contained a main purpose clause.
- Italian negotiators wanted to include a very broad anti-abuse provision, similar to Art. 30 of the '95 treaty with Israel:
  - 'The competent authorities of the Contracting States, upon their mutual agreement may deny the benefits of this Convention to any person, or with respect to any transaction, if in their opinion the receipt of those benefits, under the circumstances, would constitute an abuse of the Convention according to its purposes.'
- West declared that this broad, subjective anti-abuse rule was rejected for several reasons:
  - Provided less certain standard against which a taxpayer could meaningfully evaluate its transaction;
  - Main purpose test appears in a significant number of treaties around the world and it is more consistent with international norms and will likely be the subject of more interpretive law than the other standards.

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

- They gravitated toward the main purpose standard because it corresponds to the U.S. a principal purpose standard which is applied in almost 30 provisions of the IRC, e.g., § 269A; § 877 etc.
- The main purpose test was apparently modelled on similar provisions found in many modern treaties of the United Kingdom.
- Lindy Paull (JCT): '… the main purpose tests … inject considerable uncertainty into the treaty provisions because such tests are subjective and vague.'
- US Senate Committee: '… the inclusion of such tests represents a fundamental shift in US treaty policy, which is based on clear, bright-line objective tests.'
- Should the term 'a principal purpose' be interpreted according to *Santa Fe* or according to settled case law involving IRC provisions, such as §§ 367 and 877, e.g. *Furstenberg*, *Dittler Brothers*, etc.?

Panel on Strengthening Residence-Basis Taxation

ITPF/IIEL 2019 Conference

Itai Grinberg

February 1, 2019

Coordinated Minimum Effective Taxation

- Proposed at the OECD as a backstop for the traditional residence-based system
  - Addresses profit shifting to low rate jurisdictions without, as a standalone matter, reallocating taxing rights
- Unilateral minimum tax regimes and multilateral min tax regimes in which defection is easy raise redomiciliation and cross-border M&A incentive issues

  → need for a defensive measure
- Defensive measure should only apply to MNCs parented in jurisdictions that fail to adopt a qualifying outbound minimum tax.
- If agreed multilaterally, how would this system be enforced?

Shareholder Residence:
The Other Residence Tax Base

Alan D. Viard
American Enterprise Institute
February 1, 2019

“Worldwide”-territorial debate

- Debate often misleading – “keeping jobs in United States” versus “competiveness,” “bring home profits trapped abroad”
- Jobs are not the right metric – no country can have competitive advantage in all sectors – repatriation penalty can be avoided under either system

“Worldwide” misnomer

- Truly worldwide system would be great for United States – tax everyone everywhere
- Impossible because U.S. can’t tax foreign parents’ overseas income
- “Worldwide” system combines territorial system (all firms taxed on U.S. income) and charter-based system (U.S.-chartered parents also taxed on overseas income)

Pure territorial system

- Regardless of charter, all corporations taxed only on U.S. income
- No penalty on investing through U.S.-chartered corporations
- But, high penalty on investing (and booking profits) in Unites States for all corporations

Pure “worldwide” system

- *For U.S.-chartered parents*, no penalty on investing (and booking profits) in United States
- But, penalty still fully applicable for foreign-chartered parents
- And, high penalty on investing through U.S.-chartered parents

Shareholder taxation

- Tax capital gains and dividends of American shareholders, regardless of where corporation is chartered and invests (or books profits)
- Eliminates penalties on investing through U.S.-chartered parents *and* on investing (and booking profits) in United States
- But, doesn’t tax economic rents foreigners earn from U.S. operations

Toder-Viard 2016 plan (1)

- Reduce corporate tax rate from 35 to 15 percent
- Tax dividends and capital gains as ordinary income, with imputation credit
- Mark-to-market taxation of capital gains and losses (with smoothing provision) to negate lock-in effect

Toder-Viard 2016 plan (2)

- Lowers, but does not eliminate, penalty on investing (and booking profits) in United States
- Lowers, but does not eliminate, penalty on investing through U.S.-chartered parents
- Still taxes foreigners’ economic rents, but not to the same extent

Toder-Viard 2016 plan (3)

- Revenue neutral in long run, with revenue gain during transition
- Slight increase in progressivity

Update (1)

- May still be beneficial to lower corporate rate to 15 percent – raising capital gain and dividend taxes could still offset revenue and distributional effects
- Smaller capital gain tax increase needed for revenue neutrality – could probably maintain realization basis, but maybe tax gains at death

Update (2)

- If policymakers desire to raise more revenue from taxation of corporate income, tax increases should be focused at shareholder level

Who Should Tax International Income?

February 1, 2019

International Tax Policy Forum

Georgetown Law's Institute of International Economic Law

#InternationalTax