Answer-to-Question-_2_

Introduction

To begin with,double taxation refers to imposition of tax on the same income, asset at two different point of time. We can have juridicial and economic double taxation but for the purposes of this question, the focus is juridiciail double taxation.

Juridicial double taxation can be defined as a narrower form of double taxation that arise due to jurisdictional conflict in the rules that are used to determine residence and/or source. In simpler terms, it means that the tax is payable in 2 states on the same income or capital.

Types of juridical double taxation

Residence - source conflict - this is farmost the most comomn conflict where the source state and the residence state claim that they have primary taxing rights. Each contracting state (CS) subject the same person on their worldwide income and there is a concureeent tax tax liability. For example, this can happen when a foregin entuty carry out business activity that meets the permanent establishtment treshold outline in article 5.

Residence - Residence conflict - This is for example when each CS clains that the entity/ indivisual is a Resident in their state and claim to have the primry taxing rights (dual residnt scenario)

Source - Souce conflict - this is where two States claim that source of income is arising in their state. For example, if an Irish company borrows money from a UK bank and use it to buy a property in France. France claims that the interest income is arising in their state (pay rule vs use rule).

Citizenship confict - the United states tax its resident on their

worldwide income irrespective of where the income is arising from.

Conflict of qualification - This is where two states intepret thet nature of income different arising from double taxation. For example, State A can classified this as business profit under Article 7 and the other State can classify as Dividend under Article 10 (refer to Anson vs HRMC case law).

Analysis

- The isuse of double taxation is on-going and there is always a debate on which county will have the primary taxing rights. To resove the issue, Double Tax Agreement is used to prevent double taxation and article 23 A and 23 B provides the mechamism of double taxation relief (credit and exemption method).

Before diving deeper into credit and exemption method, lets have a look at the relief methods available.

1. Credit method (to be explained below)
2. Exemption method (to be expliance below)
3. Participation exemption - provide relief to shateholders for disposoal of an interest in a subsidiary for example, depending on local rule with criteria
4. Deduction method

Credit method

- The residence state calculates its tax on the basis of its taxpayer's worldwide income.
- It allows deduction from its own state for the tax paid in the other state.
- The credit can be in 2 ways (i) full credit (ii) partial credit system. For **full credit system**, resident state may allow full credit for the whole amount of tax paid in the source country on its foreign earned income. **Partial credit** - only relevant when source state rate of tax is higher than residence rate of tax. The residence country will only provide the credit up to the level of tax that would be suffered in the residence state.

- Credit method is closely to be said consistent with **Capital Export Neutrality (CEN)**. CEN works in a way that its residents will face the same tax rate no matter where they operate around the world (taxation on worldwide income). However,in relaity, it is hard to achive a full credit system.

- Therefore, many countries operate partial credit system with onshore pooling of credit that can be carried forward and backwards. As an example, if the state of residnece operate at a CT rate of 12.5% with a foreign sub operates at a jurisidction where the CT rate is 5%, earning income of $1000. This means that after tax profit will be 950. A witholding tax of 5% will be imposed on the 950 which is equivalent to 47.5. This means that 902.5 will be paid back to the residence state as dividend. In this case, assuming the income to be earned at the residence state will be (1000*12.5% = 125) and yet 97.5 been incurred and hence a total of 27.5 is owed by the taxpayer to the state of residence. If there is excess credit arising from other transaction, no further tax is to be poid on this 27.5 and it can be used to offset other untitilsied credit.

- On the other hand, the exemption method can be related to Capital Import Neutrality (CIN)concept. CIN means that the same tax rate will be applied to all income or capital earned within a given country. This means that all tax system is based on source. It requires the seller/investor in the same location to face the same tax rate no matter where they are located.

- Having an overview of the CEN and CIN mechamisn, it is critical for MRA ro evaluate the pros and cons of the credit and exemption method:

Credit method/ CEN

- generally, tax authority will have more insights on the taxes paid by its resident entities of their overseas income

- The resident are treated equally from the perspective of domestic vs foreign tax burden

Credit method is neutral as to decision to invest locally or into another jurisdiction

- CEN would require full credit system to oprate, which is unlikely to happen
- Operating CEN will be burdensome for taxpayer and tax authority

Exemption method/CIN

- It is easy to adminester
- Encourage it residents to invest in country with lower tax
- Difficut to achieve as you need the pariticpating country to operate the same exemption system, which is beyond a tax authority's control
- Does not allow tax authority to have full overview on the tax paid overseas.

It encourage inbound investor

Conclusion

- Taxation can have an impact on the economy as companies may choose to invest in country based on after tax return and not from a pre tax perspective.

- Thus, MRA shall consider the pros and cons listed above for policy consideration
- If the country of MRA is of a low jurisdiction, then the suggestion is to go for CIN as it is easier to administer. There is no point of adopting the credit system of relief as it will always be the case to have unutilised credit which will never be utilsed.
- All double taxation relieft mechanism has their own practical issues in practice, hence MRA could consider the the combination of the 2 methods

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Answer-to-Question-_5_

Controlled foreign company (CFC) rule is a tax on a deemed on notional income. It is mainly a local antiavoidance rule to prevent / discourage the deferment of of taxes leaving certain passive income outside the state of residence.

A double tax agreement provides relief from double taxation when a payment is made by a subsidiary to a parent company. However, there is actually no actual payment that is made by the subsidiary to the parent under CFC rule as it is only notional income that was paid hence it is not covered by the treaty. This means also means that taxpayer will not have acccess under MAP Article 25 as this relates to double taxation (if arise) that falls outside the treaty.

In terms of consideration for CFC rule for a particular country, reference should be made to Action 3 of BEPS Project. In designing CFC rules, consideration shall be made to the following:

Definition of CFC - As CFC rule are generally applied to foreign companies that are controlled by shareholder in the parent jurisdiction, an important consideration is to evaluate how much influence a shareholder has over its foreign subsidiaries. It usually requires a miminum level of shareholding/ voting rights/ rights to income of a parent company on the subsidiary for this rule to be applicable. There is no point of subjecting this rule to a parent company which owns 10% ownership of another subsidiary.

Exemption and treshold requirement - Relating back to the purpose of CFC rule, Action 3 suggest that this CFC rules will only be

applicable to controlled foreign companies which are subject to a significantly lower effective tax rate in the other state. This is again consistent to align with the objective of preventing controlled companies in deffering the income back to the parent company. It should not be targeted on foreign subsidiary that operates genuine business activity. **This can be reference to the Cadbury Schewepeper case law where it is found that the controlled foreign company is operating genuiine activity and not supposed to be subject to CFC rule.**

Definition of income - It is important to classify which type of income would ne covered under CFC legistlation as tax authority would not want to ended up in a situation that they tax each and every single income of the foregin sub, which will lead to inconsistency in CFC rule objective which is to target offending income. The income that shoud be covered under CFC rules are passive income such as management fee, royalty, dividend etc.

Computation of income - Action 3 recommends that CFC rules use the rules of the parent jurisdiction to calculate the CFC income that to be allocated to shareholder. One important element is also that CFC losses can be offet against the profit of the same CFC ir other CFC in the same jurisdiction.

Attribution of income - Action 3 recommends that the attribution of profits should be tied to a control treshold and the amount of income attributed should be with reference to the propotionate ownership/ influence. This means that if a parent company only owns 60% of the foreign entity, the income attributed should be proportiated to 60% for instance.

Prevention and elimination of double taxation - When designing CFC rule, Action 3 recommends that the implementation of such rules do not cause double taxation. Credit shoud be allowed for foreign taxes that is actually paid. It also recommend tax authority to provide relift on dividend/ gain of disposals, where

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the income has been taxed under CFC rules. For example, if theforeign subsidiary is sold and the parent company is subject to cpaital gain tax, credit should be provided in this case.

Areas of CFC rule which are compatible with OECD Model Tax Convention

- There is no clash between CFC rules and OECD Model DTA and this is supported by Commentary of Article 1 (para 81 and 84).

- This also can be evident that from commentary from Article 7 (paragrapgh 14) and Article 10 (paragrapgh 37-39) that supports the argument that there is no clash between the two.

- In the US context, this can be supported by ss747-756 and Schedules 24-26 Income and Corporation Tax

Reference can me made to the Bricom Holdings case law where it is held that the character of the income subject to tax in the UK under CFC rules was altereed byt he operations of the rules, as it was only taxed as "notional income", with tax charge being based on provision which "deemed" the income to be subject to UK tax in the hands of the UK company. Such charge and income was not within the terms of the treaty and hence double taxation relift is not provided under the DTA.

Conclusion

Answer-to-Question-__3_

To: MR XYZ
From: Mr ABC
Subject: Understanding of pillar 1 (Amount A)and argument for and agianst the exclusion of regulated financial servicer undr Amount A
Date: 06-12-2022

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3 (1) - Amount A under pillar 1

- Pillar 1 (Amount A), is designed to allocate taxing rights to market jurisdiction in a formulaic manner in which they would have allocated under the arm's length standard.

- It is proposed to be implemmented in a way that it allocate taxing rights over a portion of group's residual profit, calculated using a formula between countries, using a revenue based allocation key.

- The treshold for group to be subject to Pillar will be EUR20 billion and profit margin over 10%

- The design of pillar 1 is primarily to tackle the challenges faced in the digital economy as outlined in Action 1 - data, nexus, characterisation. Specifically, this is designed to provide a solution for what we call "digital permanent establisment" as it is noted that MNE today can generate profit in another jurisdiction without any phycical presence in another country, without being taxed (i.e. nexus, data characterisation issues).

- There is no taxing rights in the said country if there is no phycical presence in the said juridisction to create a PE and subject the taxpater under Article 5. It is also argued that the MNE rely on user participattion (which claim to be where in the intangible are created) to generate profit in s said country but again not being taxed.

- There are some concern for Pillar 1 , if implemented
:

a) It requires multilevel convention for implementation , which will formalize a country commitment to withdarw any unilateral digital services taxes. FOr example, EU proposed rule of Digital Tax Package that includes significant digital precense, i.e digital service income of more than 7 million euro, 100,00 plus usrs or 3000 business contrats)/ WHT of 3% on digital taxes in EU.
b) Pillar 1 could create an ueven playing field between developed and developing countries.
c) There will be always a question which entity within the MNE is going to allocate the residual profits within the group and at the same time ensuring no double taxatio will arise
d) Issue with elimination of double taxation when profits are potentially going to be taxed twice.
e) Concern that this will overides the amr's length principle - but this would not because the case as introduction of pillar 1 is just an an overlay (i.e. another layer) of taxation after arm's length principle is applied to determine the profits.

3 (2) -

Answer-to-Question-_6__

To: MR XYZ
From: Mr ABC
Subject: Residence status overview
Date: 06-12-2022
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Introduction

The evaluation of the residency status of Algero will be referenced to Article 4, speficially Article 4 (3) of the OECD Model DTA as it ivolves the detemermination of a company residence.

Algero is a resident in Country A based on reasons outlined in the question and resident in Country B as well because of its incorporation.

Observations

1. Country B's position to deemed Algero as a resident in based on incorporation could be challenged. This is because mere incorporation itslef is not a sufficient nexus for a country to be a Resident (except countries like the US/ Sweden). The argument for this is simply because a MNE can go an incorporate a company in a no tax jurisdiction (UAE for now)to enjoy the tax free benefits.

2. Company residence is typically determined by domestic legistlation - either my "central of management control" is located (i.e where the board of directors/ most powerful executives exercise its decision rights or "company seat

approach" (i.e testing where the decision is taken). Common law country usually follows central manangement approach and civil law country tend to follow legal seat appraoch. This might be the procedure followed by Country A to determine Algero as resident of the state.

3. It is imperative to note that most countries will adopt the incorporation test together with "esentially managed" test (i.e. central of management & control test)

Analysis

1. The OECD Model 2017 changed the corporate residence tie breaker test from the Place of effective management (POEM) to a test where it requires both Country A and B being required to "endaveor to determine by Mutual Agreement Procedure" as per article 25, having regards to its place of effective management, where it is incorporated etc, based on a case to case basis. Hence ocuntry A and B will need to resolve this via MAP as per article 25.

2. However, it can be noted also if Country A or Country B is located is a US MNE. No double taxatoion relief will be provided as it is dual resident as per US model DTA.

3. When resolving the case via MAP, relevants factors to be considered are such as where the meeting of the board of Directors are held, , where the executive level employees carry on their activity, where the headquarters is locatd etc.

4. In this case of Country A and B (with reference to the factors on point 3 above),we need to critically evaluate the role of the two Directors from Country and B to understand in more detail on their role in signing off the decision agreed by the management team located in country A. Assuming boththe Directors have the right to reject the decison of the management team, we need to go to he next steps to see either is the Director from Country A or

Country B that has the final decision say. This scenario can b related to the Laerstate vs UKFTT case law which will be explianed in the next point.

5. Laesstar case law - This is acase revolving a potential capital gain tax charge on the sale of a Dutch Co by the UL. The Dutch Co has 2 Directors and one of them (the UK Director) resigned right before the sale of the Ducth Co. HMRC argued that the Ductch Co is a residence of the UK eventhough all the board meeting are held outside the UK. HMRC's decision was made because even after the UK Director resigned, it is found that the UK Director is stil making the decisions (i.e excercising its relatictic positive management" and the other Director is just signing off the documents. Hence, this can be related to the case of Algero to see where the "decison making rights" is made -- is it with the management team or with either of the Directors from Country A and B.

6. This can be constrated with the De Beers case law where it is a case on central management of control. It was stated that in this case even though it is a company estabalised in South Africa and its main business activity is carried out there, the Board of Directorss excercised its powers in the UK and therefore it is deemed to be a UK resident instead of South Africa. Relating to the scenario of Algero, it is again important for us to know the role of the Directors from both Country A and Country B vis-a-vis the management team of country A having said to have make the decision.

Conclusion

1. It is based on the MAP outcome between Country A and B to determine the residence of Algero, based on the aforementioned factors.

2. Assuming of the Director from Country A have the right to reject the decison made by the management team in Country A, it

is reasonable to conclude that Algero is a resident in State A as it is where the key decisons are made (both the management team and the Director) and Country B is just merely place of incorporatetion and there is no clear exercise of executive rights over there.

Answer to Question 6(2)

-If Country A or B implement the exemption method/ Capital Import Neutrality, it would not have much an impact for either country because applying exemption method is said to focus on source taxation rather than based on residence.

- Operating Capital Import Neutrality will encourgae inbond investment and hence the rules which will be dsigned needs to consider the factors revoving Place of effecive management

- Both the country will tax its resident and exempt the foreign income earned outside of Country A and B.