Tax bodies publish final toolkit on taxing offshore indirect transfers of assets

July 8, 2020

In brief
The Platform for Collaboration on Tax has released the final version of a toolkit "to help developing countries tackle the complex issues around taxing offshore indirect transfers of assets." Of course, it is not just developing countries that will take notice of these recommendations. In this Alert, we focus briefly on:

• the Platform’s message that ‘location’ countries may be likely to adopt provisions taxing gains realised by offshore owner companies, given the revenue challenges posed by COVID-19
• the recommended scope, with a model definition of immovable property and additional rights or other assets that generate ‘location specific rents’
• the options to deem a disposal of the asset(s) or to charge the gains made on sales of interests in the ownership vehicle or chain
• enforcement and collection issues, and
• differences from the two earlier draft toolkits.

In detail
Background
The Platform for Collaboration on Tax—a body combining the OECD, IMF, United Nations and World Bank Group—has published a Toolkit on the Taxation of Offshore Indirect Transfers (OITs). The toolkit seeks to address a concern of mostly, but not exclusively, natural resource rich countries: that gains on assets located in those countries won’t be taxed there if the owner disposes of an ownership interest offshore. Taxation of these ‘offshore indirect transfers’ has been the subject of protracted public interest, and there were two earlier draft toolkits from the Platform on which we provided comments (the latest of which was September 24, 2018).
The toolkit states that location countries might not always tax OITs: they may have good reasons—depending, for example, on their capacity, revenue needs and desire to attract foreign investment—to choose not to, as some countries now do. However, the Platform’s press release of June 4 states that the topic is a concern that is magnified by the revenue challenges that governments around the world face as a consequence of the COVID-19 crisis (not a consequential impact but a relevant one if a country is seeking to raise funds). We have addressed the revenue pressures alongside other tax policy considerations in dealing with COVID-19 impacts in our Global Tax Policy Bulletin of May 29, 2020.

Recommended scope
The toolkit proposes that location countries may wish to tax offshore indirect transfers of at least those assets which are immovable “within the meaning of current UN and OECD model treaties.” Many existing treaties allow for those taxing rights, but the toolkit also suggests a model definition of immovable property for the purposes of domestic legislation on which treaties base their interpretation. Moreover, it recommends that those taxing rights also perhaps should include additional assets that generate ‘location specific rents.’

Model approaches
If location countries wish to extend taxing rights to such transfers the toolkit suggests two models for domestic legislation which such countries may adopt.

- The first model, Model 1, seeks to tax the resident asset owner under the deemed disposal model- treating it as having realized the gain on the assets in question immediately before the transfer and reacquired the asset immediately after the transfer.
- The second model, Model 2, seeks to tax instead the non-resident seller of the shares or other interest deriving value from the asset.

Enforcement and collection
The toolkit provides guidance to support enforcement and collection. Recommendations include one or more of the following:

- notification/reporting and information exchange mechanisms (e.g., domestic reporting requirements, supplemented, where appropriate, by international information exchange arrangements)
- withholding tax mechanisms (e.g., on payment of the purchase price)
- mechanisms imposing a tax payment obligation on a relevant local entity (e.g., as agent of the non-resident seller), and/or
- other legal protections, such as restricting the registration, renewal or validity of relevant underlying assets (e.g., extractive licenses), unless applicable notification requirements have been met and/or until it is demonstrated that: (i) no tax is payable; (ii) the relevant tax has been paid; or (iii) satisfactory arrangements have been made for the payment of that tax.

The toolkit also suggests that a General Anti-Avoidance Rule (GAAR) could be applied as a rule of last resort to tax a gain from an OIT in appropriate circumstances.

Amendments to the earlier draft toolkits
The final toolkit is substantially the same as the previous draft on which we commented. There are a few changes in wording that probably warrant further analysis in due course. Those changes include:

- amendments to examples of existing approaches applied by selected countries and clarification of particular taxpayer examples, together with caveats about accuracy and the intention to merely illustrate principles
- a statement that complex ownership structures, often designed for commercial purposes, involve interactions between laws and tax treaties which can lead to double taxation for which there may be no relief under current international norms, while others may lead to double non-taxation
• recognition that any policy decision to levy or not levy tax on a taxpayer in respect of the income derived from their activities of selling or actively exploiting the assets may also need to be carefully considered from the perspective of the principle of equality and ability to pay the tax (e.g., with instalment payment options, although it notes the offshore seller could provide funds to the local asset-owning entity via a loan or payment direction to the purchaser)

• valuation requirements, including for off balance sheet assets, insofar as a taxing right may arise when a threshold percentage (normally 50%) of the value of transferred shares, etc, derives from immovable property in the location country

• reference to the benefit of having definitions of what is meant by the terms ‘ownership’ or ‘change of ownership’ to ensure they are not interpreted too narrowly (i.e., strictly formalistically)

• recognition that it is now firmly established that countries are not restricted with respect to the taxation of their own tax residents under Model 1 in relation to offshore events (unless listed in the treaty)

• a comment that perceived economic double taxation under Model 1 in the country of the seller and the country of location of the asset(s) could be mitigated by affected countries engaging in bilateral negotiations in the context of the MAP procedure and over time by a step up in the values of the relevant assets.

In our prior comments, we called for detailed discussion of losses, reorganisations, minority shareholdings and valuations. The toolkit recognises that these are complex matters. It suggests that these issues are beyond its scope, suggesting only at this stage that further guidance might prove helpful based on the individual circumstances of the country concerned.

**The takeaway**

The decision on whether to tax OITs or what method to use in doing so is a policy choice for countries to make. Countries should consider the implications of disagreements between them in the allocation of taxing rights in this area alongside their specific preferences or revenue pressures, particularly following the COVID-19 pandemic. In particular, the international tax system and global growth would benefit from reducing as much as possible the potential for double or multiple taxation of the same gains.
Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

Global Tax Policy

Stef van Weeghel, Amsterdam
+31 (0) 88 7926 763
stef.van.weeghel@pwc.com

Edwin Visser, Amsterdam
+31 (0) 88 7923 611
edwin.visser@pwc.com

Will Morris, Washington
+1 (202) 213 2372
william.h.morris@pwc.com

Aamer Rafiq, London
+44 (0) 7771 527 309
aamer.rafiq@pwc.com

Pat Brown, Washington
+1 (203) 550 5783
pat.brown@pwc.com

Jeremiah Coder, Washington
+1 (202) 309 2853
jeremiah.coder@pwc.com

Phil Greenfield, London
+44 (0) 7973 414 521
philip.greenfield@pwc.com

Giorgia Maffini, London
+44 (0) 7483 378 124
giorgia.maffini@pwc.com

Sangeeta Mistry, London
+44 (0) 7725 633 364
sangeeta.mistry@pwc.com

Tom Corbett, Dublin
+353 (0) 87 257 1646
tom.corbett@pwc.com

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