taxnotes® international

Volume 108, Number 11 ■ December 12, 2022

The UTPR: Taxing Rights Gone Wild

by Jefferson VanderWolk

Reprinted from *Tax Notes International*, December 12, 2022, p. 1369

© 2022 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® International* content, please visit www.taxnotes.com.

tax notes international®

© 2022 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

The UTPR: Taxing Rights Gone Wild

To the Editor:

In response to professor Tarcísio Diniz Magalhães's recent article challenging me and others who have pointed out the UTPR's nexus problem to defend our position,[1] I will walk through the argument in favor of our stance as clearly and concisely as I can. I will not address the straw man put forth by Magalhães, which misrepresents the argument,[2] other than to say that those who think that there is no nexus requirement for jurisdiction to tax the income of nonresidents should read the excellent discussion of the subject by Philip Baker KC, which concludes: "There needs to be recognition of the obvious: that an adequate nexus is required for tax jurisdiction."[3]

The issue is whether the UTPR (now known as the undertaxed profits rule) violates accepted principles of international taxation by enabling UTPR jurisdictions to assess tax on a resident entity regarding low-taxed profits earned by a nonresident affiliate that is not owned by the resident entity and has never had any dealings with the resident entity or any other resident of the UTPR jurisdiction. In other words, the nonresident affiliate whose profits are being taxed through a resident affiliate has no nexus with the taxing jurisdiction, and the profits being taxed are not owned by the resident taxpayer, either directly or indirectly, and are not linked to any economic factors in the taxing jurisdiction. Affiliation — that is, common ownership — with an entity resident in the taxing jurisdiction is the only connection between the owner of the income being taxed and the jurisdiction imposing the tax.

For example, assume that Country P does not have a qualifying income inclusion rule, and Parent Company, a resident of Country P, wholly owns Subco, an entity operating solely in Country X and dealing only with unrelated parties in Country X. If Subco's profits are taxed in Country X at an effective rate below 15 percent, then under the global anti-base-erosion (GLOBE) rules the amount of top-up tax needed to bring the effective rate on Subco's profits up to 15 percent will be allocated among all the countries worldwide that have enacted the GLOBE rules (including the UTPR) in proportion to the Parent Company group's employees and tangible assets located in those countries (without regard to employees and tangible assets in countries that have not enacted the GLOBE rules). So if Parent Company has a wholly owned subsidiary in Country Y, and Country Y has enacted the GLOBE rules, then the Country Y tax authorities can collect top-up tax from the Country Y subsidiary on Subco's profits, even though the profits have absolutely no connection to anyone or anything in Country Y.

I maintain that this goes beyond accepted notions of jurisdiction to tax the income of a nonresident. There appear to be only two types of rules imposing tax on a resident on profits of a nonresident lacking nexus to the taxing jurisdiction: (1) controlled foreign corporation rules; and (2) rules relating to offshore indirect transfers of property located in the taxing jurisdiction. In the case of CFC rules, it seems reasonable to tax the parent company on a subsidiary's profits that the parent company has the power to obtain, even though it has chosen not to obtain them yet. In the case of offshore indirect transfers, the taxing jurisdiction is taxing gain

[1] Tarcísio Diniz Magalhães, "Give Us the Law: Responses and Challenges to UTPR Resisters," *Tax Notes Int'l*, Dec. 5, 2022, p. 1257.

[2] Magalhães claims incorrectly that, because I and others who are uncomfortable with the UTPR have noted that controlled foreign corporation rules are an understandable exercise of tax jurisdiction resulting from the parent company's control over its subsidiaries, we are therefore somehow arguing that, under international law, there is a control requirement that must be satisfied for tax jurisdiction. We are simply arguing that there is a requirement for some kind of nexus between the taxed income and the taxing jurisdiction, and that mere common ownership of the resident entity being taxed under the UTPR and the nonresident entity whose income is being taxed is not an adequate nexus.

[3] Philip Baker KC, "Chapter 11: Some Thoughts on Jurisdiction and Nexus" in *Current Tax Treaty Issues: 50th Anniversary of the International Tax Group* 441-465 (2019).

For more *Tax Notes® International* content, please visit www.taxnotes.com.

from the sale of an asset located in the jurisdiction. The UTPR, in contrast, allows a UTPR jurisdiction to tax profits that the taxpayer has no power to obtain and that were not derived from any property or activity in the taxing jurisdiction or from any property or activity of the taxpayer.

Magalhães and others have argued that the GLOBE rules apply to multinational enterprise groups rather than separate entities, and therefore any profits earned by a group member can be viewed as fair game for taxation anywhere that the group has a presence. However, the GLOBE rules use separate-entity income and taxes to determine the top-up tax amount for each jurisdiction in which the group does business. There is nothing in the GLOBE rules or their commentary to support the idea that the countries of the inclusive framework on base erosion and profit shifting intended to disregard separate entities and instead treat MNE groups as taxpayers.

Magalhães and others have also suggested that the UTPR should be viewed as an acceptable new development in international taxation because a large number of countries signed the October 2021 statement on the two-pillar solution and subsequently agreed to the issuance of the GLOBE rules. Again, however, the record shows no evidence of a conscious decision by those countries to depart from existing principles of international taxation such as the nexus requirement, except with regard to the pillar 1, amount A rules.

Furthermore, neither the high-level political agreement of October 2021 nor the issuance of the GLOBE rules constitutes an agreement among sovereign states of the type recognized as having international law consequences, such as a treaty ratified by its signatories. Some countries, such as the United States, were represented by officials having no authority to bind their government. Others, such as Hungary, have since shown that they are not willing to live with the GLOBE rules. Still others, such as New Zealand, have indicated in the course of public consultation that they do not consider themselves bound to enact either of the two pillars.

The fact is that the UTPR departs from one of the fundamental elements of tax jurisdiction — the nexus requirement — in an unprecedented way, and there is precious little evidence that the departure occurred as the result of a process of careful and conscious deliberation. If the countries of the world really want to adopt a radical break from existing notions of tax jurisdiction, they should do it in a way that shows that they know what they are doing. ■

Yours sincerely,
Jefferson VanderWolk
Squire Patton Boggs
Dec. 5, 2022

© 2022 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes® International* content, please visit www.taxnotes.com.