taxnotes® international

Volume 109, Number 2 ■ January 9, 2023

The UTPR, Treaties, and CFC Rules: A Reply to Avi-Yonah and Schler

by Jefferson VanderWolk

Reprinted from *Tax Notes International*, January 9, 2023, p. 187

© 2023 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®

© 2023 Tax Analysts. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

The UTPR, Treaties, and CFC Rules: A Reply to Avi-Yonah and Schler

To the Editor:

In his article on the UTPR (now known as the undertaxed profits rule) and tax treaties,[1] Reuven Avi-Yonah states:

> A tax treaty does not generally limit taxation by a country of its own residents, and that is true whether or not it has an explicit saving clause like the one found in all United States tax treaties (article 1(4): "this Convention shall not affect the taxation by a Contracting State of its residents").

I have trouble accepting this blanket statement, in light of the prohibition in most, if not all, tax treaties on taxing business profits of a resident of the other contracting state unless the nonresident carries on business in the country through a permanent establishment and the profits are attributable to that PE. It seems highly unlikely that treaty negotiators would accept the idea that a contracting state is free to tax business profits of a resident of the other contracting state who has no PE in the country by simply imposing the tax on a resident of the taxing country, as the UTPR would do.

In some circumstances, where it is clear that the taxpayer has received, or will receive, directly or indirectly, the economic benefit of the profits being taxed (as in the case of taxation under controlled foreign corporation rules), the treaty should not prevent taxation of a resident on profits attributable to its economic interest in a nonresident having no PE in the country. The UTPR, however, does not require any type of direct or indirect benefit to the resident taxpayer from the profits of the nonresident that are being taxed.

Michael Schler's letter on the UTPR and CFC rules[2] notes, correctly, that I neglected in my earlier comments on this topic[3] to address the fact that CFC rules may tax a shareholder on profits of the CFC even though the shareholder has less than a controlling interest. He recognizes, however, that the UTPR goes further than CFC rules in that it will apply regardless of whether the taxpayer has any interest in the entity whose profits are being taxed. Nevertheless, he concludes by saying that "a distinction between mere ownership 'up the chain' for CFC taxes and 'within the book group' for the UTPR seems like a rather subtle distinction to justify opposite outcomes for CFC taxes and the UTPR under international law and tax treaties."

I don't think that the distinction would be seen as overly subtle or insignificant by a minority investor in a group company that was being taxed under the UTPR on profits of other group companies from operations having no connection to the company being taxed. In such a case, the UTPR would be destroying part of the value of the investor's asset for no reason connected to the business in which the taxpayer invested or the country in which that business is located. How is that justifiable? ■

Yours sincerely,

Jefferson VanderWolk
Squire Patton Boggs
Jan. 5, 2023

---

[1] Avi-Yonah, "The UTPR and the Treaties," *Tax Notes Int'l*, Jan. 2, 2023, p. 45.

[2] Schler, "UTPR: The CFC Precedent," *Tax Notes Int'l*, Jan. 2, 2023, p. 27.

[3] Jefferson VanderWolk, "The UTPR: Taxing Rights Gone Wild," *Tax Notes Int'l*, Dec. 12, 2022, p. 1369.

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