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Global Tax Alert

OECD releases the Platform for Collaboration on Tax toolkit on taxation of offshore indirect transfers of assets

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Executive summary

The Platform for the Collaboration on Tax (PCT) is a joint initiative of the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), and World Bank Group (WBG). The PCT, at the request of the G20, has undertaken the development of a series of "Toolkits" to help guide developing countries in the implementation of policy options for issues in international taxation.

On 4 June 2020, the OECD released the final version of the PCT toolkit on the Taxation of Offshore Indirect Transfers (the toolkit). The toolkit provides guidance on the design and implementation issues when one country seeks to tax an entity that is a tax resident in another country on gains on its sale of interests in an entity that owns assets located in that country. The toolkit also includes two models for domestic legislation that countries could adopt to impose tax on such offshore indirect transfers. The toolkit represents the analysis and conclusions of the staffs of the four partner organizations and does not represent the official views of the organizations or their member countries.

According to the press release accompanied by the toolkit, the taxation of offshore indirect transfers is a concern of particular significance to developing countries, mostly but not exclusively countries that are rich in natural resources.

According to the press release, the relevance of the topic is also magnified by the revenue challenges that governments around the world currently face as a consequence of the COVID-19 crisis. The launch of this toolkit will be followed by a launch webinar in the coming weeks. French and Spanish versions of the toolkit will follow, as well as virtual learning opportunities based on the toolkit.

Detailed discussion

Background

The PCT has undertaken, at the request of the G20, the development of a series of "Toolkits" to help guide developing countries in the implementation of policy options for issues in international taxation of greatest relevance to these countries.

In 2015, the PCT released a toolkit on *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment* and in 2017 it released another toolkit on *Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses*.

Another issue of interest identified by developing countries is the taxation of offshore indirect transfers of assets because no unifying principle has been adopted by individual countries on how to treat these transactions. Even though this issue is addressed in both the OECD and the UN double taxation model treaties, countries currently follow different approaches in their domestic law and many treaties that are in effect do not include the relevant model treaty provisions.

In light of this, the PCT released in August 2017 a first draft of the toolkit on taxation of offshore indirect transfers and sought public feedback. That draft received detailed comments from various groups, including country authorities, non-governmental organizations, and the business community. On 16 July 2018, the PCT released a second draft of this toolkit with some new questions for consideration. Additional written comments from interested stakeholders were received and posted by the PCT online.

Taking into account the comments submitted during the two periods of public consultation in 2017 and 2018, the PCT released the final version of the toolkit on 4 June 2020.

Toolkit overview

The released toolkit addresses the capital gains tax treatment of offshore indirect transfers: when one country seeks to tax gains on the sale of interests in an entity owning assets located in that country by an entity which is a tax resident in another country. The toolkit is divided into six sections:

I. *Introduction*

II. *Analysing offshore indirect transfers*: This section provides background on offshore indirect transfers, sets out a simplified example to illustrate the issues that their tax treatment raises, and provides an analysis of the economic considerations.

III. *Three illustrative cases*: This section describes some recent cases that highlight the variety of current unilateral country rules.

IV. *Tax treaties and offshore indirect transfers*: This section focuses on the treatment of offshore indirect transfers as they are addressed in the OECD and UN model tax treaties and discusses the potential opportunities created by the OECD's Multilateral Instrument (MLI).

V. *Implementation challenges and options*: This section considers the implementation issues raised by two existing approaches to the taxation of indirect transfers.

VI. *Conclusions*

The toolkit also contains four appendices that provide information on the public consultations on this topic and further detail on the empirical analysis and on selected country experiences.

The toolkit reflects the view that it is appropriate for location countries to have the right to tax offshore indirect transfers, at least for assets that are likely to embody location-specific economic rents, including assets traditionally thought of as "immovable." This does not mean that location countries should always tax offshore indirect transfers as they may have good policy reasons to choose not to do so.

The provisions of both the OECD and the UN Model treaties suggest wide acceptance that capital gains taxation of offshore indirect transfers of "immovable" assets can be imposed by the location country. However, the relevant model Article 13(4) is found only in around 35% of existing bilateral double tax treaties and is less likely to be found when one party is a low-income, resource-rich country. The MLI has increased the number of tax treaties that include Article 13(4) and this impact is expected to further expand as new parties sign the MLI and amend their covered tax treaties to include the new language of Article 13(4).

At a domestic level, countries' policies have differed widely, in terms of both which assets are covered and the legal approach taken. To create a more uniform approach to the taxation of offshore indirect transfers and enhance coherence and tax certainty, the toolkit outlines two main approaches/models including sample legislation that countries could implement in their domestic law. The toolkit expresses no preference between the two models as the appropriate choice will depend on individual countries' circumstances and preferences. To help countries with their choices, the toolkit also includes a description of what is viewed as the key advantages and disadvantages of each model. Also, it is noted that the two models are not necessarily mutually exclusive. However, if both were to be adopted by a country, an ordering rule would need to be established.

- **Model 1**: This approach treats an offshore indirect transfer as a deemed disposal of the underlying asset. It takes into account the fact that a capital gain has been realized through the indirect transfer, triggered by a change of control. The relevant taxpayer under this model is not the seller entity, which effectively disposes of the shares, but rather the entity that actually owns the assets from which the relevant shares derive their value. Model 1 needs to be supported by a deemed disposal and reacquisition rule with respect to the assets from which the shares actually disposed of derive their value.
- **Model 2**: This approach treats the transfer as being made by the actual seller, offshore, but sources the gain on that transfer within the location country which enables that country to tax it. Model 2 must be supported by a source of income rule that provides that a gain is sourced in the location country when the value of the interest disposed of is derived, directly or indirectly, principally from immovable property located in that country. The source of income rule may be further supported by a taxable asset rule.

Implications

While the taxation of offshore indirect transfers has been a controversial topic, many countries have chosen to tax them and have taken different approaches to do so. The analysis provided in the toolkit may support a more coherent approach to the taxation of offshore indirect transfers by those governments that choose to tax such transfers. It should be highlighted that the purpose of the toolkit is merely to provide guidance/recommendations. It does not provide binding rules or authoritative provisions of any kind, nor does it aim to establish any international policy standard.

Businesses may want to review the toolkit and monitor the country developments related to the tax treatment of offshore indirect transfers.

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