

The UTPR Is Flawed: A Response to Prof. Picciotto

by Jefferson VanderWolk

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To the Editor:

Sol Picciotto's letter on tax treaties and the UTPR (now known as the undertaxed profits rule)¹ suggests that article 9 of tax treaties somehow supports the idea that a contracting state has an unrestricted right to tax a resident company under the UTPR, in respect of profits earned by an affiliated company resident in the other contracting state from business having no connection to the first contracting state or its resident taxpayer. Article 9, however, relates only to situations in which affiliates resident in the two contracting states have had dealings with each other. It would have no relevance to a case where the UTPR was being applied to a local resident to collect top-up tax allocated to the UTPR jurisdiction and the top-up tax was attributable to income of an affiliated nonresident that never had any dealings with the taxpayer, and such income arose from business having no connection to the UTPR jurisdiction or the local taxpayer.

Another treaty article — article 7 — would be highly relevant if the affiliated nonresident was a resident of a country having a tax treaty with the UTPR jurisdiction. Article 7 prevents the contracting states from taxing business profits of a resident of the other contracting state unless the profits are attributable to a permanent establishment in the taxing jurisdiction. True, this has not prevented taxation of nonresident affiliates' profits under controlled foreign

corporation rules, but this is understandable, given that a controlling shareholder has power over its subsidiaries. Obviously, this is not the case with affiliates that are commonly controlled but have no control over each other and have no other connections.

As for whether there is a principle of general international law limiting, in professor Picciotto's words, "a state's sovereign right to tax as it thinks fit either persons or activities within its jurisdiction," I expect that the principle of comity extends to income taxation, such that a sovereign state may tax a resident on all of its income from any and all sources but may not properly tax that resident on the basis of income arising elsewhere that does not belong to the taxpayer in either form or substance, but rather belongs to a resident of another country. I doubt that the professor, assuming he is a U.K. tax resident, would argue that Parliament could properly tax him on income of a sibling or cousin living in a low-tax jurisdiction simply because there is a familial relationship.

Contrary to the professor's view, commentators such as myself who have noted this problem with the UTPR's design are not "casting around for legal arguments" to "put a spanner in the works of international tax reforms." We are simply calling attention to issues that seem to have been overlooked. If a proposed reform of international tax laws appears to have a flaw, surely there is nothing wrong with pointing it out. n

Sincerely,
Jefferson VanderWolk
Squire Patton Boggs
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¹Sol Picciotto, "UTPR Critics Miss the Point of Tax Treaty Principles," *Tax Notes Int'l*, Oct. 10, 2022, p. 153.