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Global Tax Insights

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EDITORIAL

Tax administrations across the world have effectively countered the menace of tax evasion through harmful tax practices by expanding cooperation among themselves to ensure a seamless exchange of information between jurisdictions.

On 6 September 2013, the G20 Leaders committed to automatic exchange of information as the new global standard and fully supported the Organisation for Economic Co-operation and Development (OECD) work, with G20 countries, aimed at presenting such a single standard in 2014. On 23 February 2014, the G20 Finance Ministers endorsed the Common Reporting Standard (CRS) for automatic exchange of tax information. On 6 May 2014, the OECD Declaration on Automatic Exchange of Information in Tax Matters was endorsed by all 34 member countries along with several non-member countries. More than 65 jurisdictions publicly committed to implementation, with more than 40 having committed to a specific and ambitious timetable leading to the first automatic information exchanges in 2017 (early adopters).

In August 2015, the first edition of the CRS Implementation Handbook has been published, providing practical guidance to assist government officials in the implementation of the Standard. It sets out the necessary steps to implement the Standard and helps to increase efficiency for financial institutions and governments implementing the Standard by promoting the consistent use of optional provisions, identifying areas for alignment with FATCA and addressing the operational and transitional challenges resulting from the staggered implementation of the Standard.

Not to be left behind in this crusade against tax evasion, India has inked reciprocal Model 1 inter-governmental agreement with the United States on 9 July 2015, which will enable the two-way automatic exchange of information between the two nations. The country update section from India contains a synopsis of this agreement.

This edition of the newsletter, besides the updates from various countries, incorporates one judgment from the Indian courts dealing with the concept of 'make available' as per the India–US Treaty. The section on international tax headlines that was introduced in the previous edition is being continued, and looks set to become a regular feature.

I express my gratitude to all the member firms that have contributed to this edition of the newsletter. I sincerely hope that the contents are useful to members and their clients. Feedback and suggestions on the contents are always welcome. You may email your suggestions to sachin@scvasudeva.com.

Happy reading!

Sachin Vasudeva
Senior Partner, S.C. Vasudeva, India

AUSTRALIA *Contributed by Michael Carruthers, Hayes Knight (NSW) Pty Ltd*

In May this year, the Federal Government announced plans to expand the scope of the Australian Goods and Services Tax (GST) system to capture items that do not currently give rise to a GST liability in Australia. The primary focus of the changes will be the supply of digital products to Australian consumers by foreign entities that do not have a significant physical presence in Australia. It is proposed that these changes will apply from 1 July 2017.

Dubbed the 'Netflix tax', the proposed measures are an attempt to ensure that there is consistency in the GST treatment when digital products and other services are provided to Australian consumers, regardless of whether they are supplied by a local supplier or a foreign supplier.

Under the current law, when things other than goods or real property are imported into Australia there is generally no GST liability unless the supplier has a physical presence in Australia. This means that when an Australian consumer downloads or streams music, movies, TV shows, apps, games or e-books from a foreign supplier there is often no GST liability. However, a GST liability would be triggered if the same product was purchased from an Australian supplier. A similar issue arises when an Australian consumer engages a foreign supplier to provide consultancy and professional services.

Under the proposed changes, these supplies will be subject to GST (the rate is currently 10%) when provided to an Australian consumer. Business-to-business transactions will not be captured by these rules. The GST liability would rest either with the supplier or with the operator of an electronic distribution service (e.g., where they have responsibility for billing, delivery and terms and conditions).

Special rules will be introduced to change the GST registration process for foreign entities that are affected by these provisions.

The challenge for the Australian Taxation Office will be trying to enforce these rules and collect the GST liability from the foreign suppliers, particularly as the proposed new rules are aimed specifically at businesses that do not have a physical presence in Australia.

Any foreign businesses that currently supply digital products or services to Australian consumers will need to start thinking about how they would manage their obligations under these proposed new rules. For example, foreign suppliers may be expected to collect more details from their Australian customers such as their residency status, GST registration status and whether the acquisitions by their customers could qualify for GST credits.

It is important to note that the legislation on these proposed changes is only in draft form and because the changes relate to GST there would need to be unanimous agreement between the Federal Government as well as the State and Territory Governments before the legislation can be passed.

BRAZIL

Contributed by Marcello Karkotli Bertoni (MHM Advogados) and Paulina Yeal Cho (Campos, Fialho, Canabrava, Borja, Andrade, Salles Advogados)

Provisional Measure No. 685 Introduces New Obligation to Report Tax Planning

Provisional Measure No. 685, issued on 22 July 2015, provides for an obligation to report to the Federal Tax Authorities on transactions regarded as tax planning.

According to the legal provisions, by 30 September of each year companies must submit to the Federal Revenue a return disclosing business performed in the previous calendar year involving acts and legal transactions that result in suppression, reduction or deferral of taxes, when

- the set of transactions do not present a relevant economic or business reason;
- the form adopted is not usual or uses an indirect legal transaction or contains a clause that jeopardises, even partially, the effects of a typical contract; or
- the acts or specific legal transactions are listed in a 'Tax Planning Blacklist' to be issued by the Tax Authorities.

Such measures were presented to the public as being part of an effort to align to OECD's Action Plan against Tax Base Erosion and Profit Shifting.

Further, if the Brazilian Internal Revenue Service does not recognise, for tax purposes, the legality of the operations disclosed, the taxpayer will be notified to pay the full amount of the taxes unpaid, reduced or deferred, plus accrued interest. On the other hand, non-compliance with the obligation of informing will be considered as wilful omission for the purpose of evasion or fraud and the due taxes will be charged with default interest and a fine of 150%, not to mention criminal prosecution on tax fraud.

This can also happen when

- the set of operations are submitted by a person who is not the taxpayer of the tax subjected to the tax planning;
- there is lack of information with the Tax Authorities for the full understanding of the operations;
- the statement contains a false declaration or misrepresentation; or
- the submitted return involves the fraudulent inclusion of individuals or legal entities.

It seems that the government's intention is to penalise cases of fraud, deceit or simulated business. Since the concept of 'business purpose' is not addressed in the tax legislation and still creates controversy in tax litigation, one may foresee more disputes arising in this regard.

Although this Provisional Measure is currently effective, it will automatically lose effectiveness if the Brazilian Congress does not approve and convert this bill into law within a period of 60 days, which may be extended for another 60-day term.

COLOMBIA *Contributed by Carolina Cañón Bohorquez, Cañón y Cañón*

Main Impacts of the latest Colombian Tax Reform to Foreign Investment

A new tax reform was made applicable in December 2014 by Law 1739 of 2014. The main changes introduced by this Law that affect foreign investors are explained below.

Wealth tax

This 'new' wealth tax has a general structure that does not significantly differ from its previous version. However, the latest reform added as new taxpayers (i) the non-resident physical persons and (ii) foreign entities and companies, even though they are not subject to income tax in Colombia.

The law would apply if they have a possession of wealth equal or over $1,000 million pesos (US$ 333.333)[1] on 1 January 2015, directly or through their permanent establishments in Colombia. Legal entities are subject to such tax for 2015–17, and physical persons even until 2018.

Therefore, these taxpayers must estimate their net worth in Colombia, which comprises the assets held in the country (e.g. shares in Colombian companies, receivable accounts, real estate, contribution to future capitalisation, etc.) minus the liabilities possessed in the country.

Surcharge to the equity tax (CREE)[2]

Foreign investors in Colombian companies or permanent establishments must consider that these vehicles will not only be charged with a rate of 25% for income tax and 9% for CREE, but also with a new surcharge to the CREE. This rate will be of 5% for 2015, 6% for 2016, 8% for 2017 and 9% for 2018, which will be charged to the CREE's taxable base equal or higher to $800 million Colombian pesos.

Likewise, this surcharge must be fully accrued in advance in the tax return of the previous year, and paid in two instalments annually.

Income tax for foreign investors

Foreign residents[3] who are liable to file an income tax return in Colombia will be taxed at the rate of 39% (2015), 40% (2016), 42% (2017) and 43% (2018).

However, the rates for withholding tax in respect of payments made abroad have not been modified.

For example, if a foreign company receives a royalty payment deemed as income sourced from Colombia, (i) its income tax will only be the levied withholding tax at the rate of 33% and (ii) it will not need to file the income tax return. In contrast, if the withholding tax is not levied, the foreign company will have to file the tax return and calculate the income tax with the new rates (e.g. 39% for 2015).

Finally, a Committee of Experts was appointed this year by the national government to propose a tax structural reform in Colombia in order to encourage foreign investment in the country.

References

1. The foreign exchange rate varies on a daily basis in accordance with the market supply and demand. For purposes of this document, we will use $3.000 COP to the US dollar as benchmark TRM.
2. The CREE tax is a national tax that levies the procurement of income susceptible to increase the equity of the contributor, and is not exempt by the law, after a filter established within the fiscal normativity.
3. Foreign residents are not subject to CREE and its surcharge.

GERMANY *Contributed by Lars Starke and Maja Güsmer, DIERKES PARTNER*

German Inheritance Tax Reform

The recent legislative proposal on German inheritance tax law

The German Federal Constitutional Court held in a judgment on 17 December 2014 (Case No. 1 BvL 21/12) that the German inheritance tax law is partially unconstitutional. Subject of the court's judgment were favoured tax treatments of business assets (Sections 13a and 13b of German inheritance tax law), as inheritance or gift tax exemptions apply for business assets to an extent that has become unconstitutional compared to other assets (e.g. real estate). The current version of the inheritance tax law, however, will be applicable until the German legislator enacts a new inheritance tax law, providing taxpayers with the possibility to actively check their opportunities in advance. The Federal Constitutional Court set a deadline of 30 June 2016 for the new law; but among those familiar with the legislation process, it is widely expected that it will be enacted much earlier. In line with this expectation, the Ministry of Finance released the draft legislation on this issue on 2 June 2015, and on 8 July 2015 the German cabinet released the government draft, which marks the starting-point to the legislative procedure.

As the regulations for transferring business property to the next generation were found to be unconstitutional, they are now being addressed by the German Ministry of Finance, which is making use of this opportunity to reinforce the regulations. Under the valid version of the inheritance tax law it is possible to transfer favoured business assets, agricultural and forest assets, as well as shares of corporations (if the testator/donor directly holds more than 25% of the share capital) free of inheritance or gift tax, provided certain strict conditions are fulfilled.

When transferring business assets to the next generation, a large proportion of the inheritance/gift tax burden originates from non-liquid assets. Although the beneficiary receives business assets of considerable value, in many instances insufficient available liquidity is transferred to pay the resulting taxes. It was therefore the legislator's intention to prevent companies from liquidity constraints originating from tax treatment by exempting business assets in order to preserve the existence of companies and protect the jobs involved. As a consequence, general conditions to be met in order to be eligible to claim for tax exemption are (i) continuing the company and (ii) keeping the company's payroll at the same level for a period of 5 (tax exemption of 85%) or 7 (100%) years.

New treatment of tax exemption for business property

According to the current legal framework, so-called administrative assets shall not be exempted from tax. However, if less than 50% of the company's business assets consist of administrative assets, 85% of the total taxable values are free of tax. Furthermore, if the proportion of administrative assets is 10% or less, a 100% tax exemption will apply. Thus, the current tax exemptions may include productive as well as administrative assets resulting in a total inheritance tax-free transfer opportunity in certain instances.

According to the draft legislation, the tax exemptions of 85% or 100% will remain, on condition that the company will be continued and jobs will be kept. Administrative assets, however, will no longer be included in the tax exemption. Instead, a new definition of productive business assets is planned. Those assets that are (directly) being used to carry out business activities ('productive assets') shall be favoured and therefore be free of tax, whereas 'non-productive' assets (formerly known as administrative assets) will be taxed in general. The value of the business's liabilities will be partially allocated to productive/non-productive assets, reducing their taxable value as a consequence. If non-favoured assets do not exceed 10% of the favoured assets value, they will also be treated as favoured assets.

All in all, it will be harder to generate total tax exemption for the transfer of business units in German inheritance tax planning compared to the current legislation. In addition, we expect this part of the draft to lead to excessive discussions with the tax office, as the new wording of the definition of 'favoured business assets' remains to be clarified.

Small and medium-sized entities

Following the guideline set by the Federal Constitutional Court (the current tax exemption

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for companies with no more than 20 employees is unconstitutional), small-sized entities with up to three employees shall not be taxed. In addition, entities with 4–10, as well as 10–15, employees shall be subject to inheritance tax, enjoying facilitated requirements for the tax exemptions of 85% or 100% when it comes to the regulation of total wages and salaries.

Transfer of large assets

Should the value of favoured assets exceed €26 million, it will no longer be possible to claim for the above-mentioned tax exemptions in future. If family-owned businesses that meet certain contractual provisions under company law are transferred, it is possible to claim for the exemptions unless the transfer exceeds €52 million.

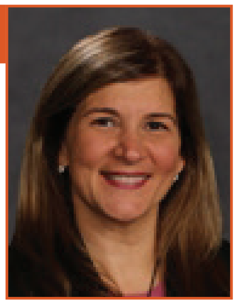
On application, the transferee will be provided with the opportunity to have a remission of their inheritance tax liability, if they can prove that they cannot bear the tax burden (economic needs test). To assess whether the remission shall be granted or not, half of the transferee's private wealth, half of the transferred private wealth and half of the transferred non-favoured business assets will be included. As a consequence, the economic needs test implies the necessity to disclose the transferee's whole wealth towards the tax office, which may not be desirable in every instance. In addition, the involvement of private wealth has already raised constitutional reservations, as it may lead to indirect taxation.

Another option for transferees of large assets shall be the newly implemented section 13c German inheritance tax law. On application of the transferee, this rule will provide an opportunity for using the tax exemptions of 85%/100% that are melting off on a pro-rata basis by 1% for every €1.5 million exceeding the amount of €26/52 million. Acquisitions of more than €116/142 million will be granted a flat exemption of 20%/35% if the requirements for the tax exemptions are fulfilled.

Conclusion

German inheritance and gift tax law will face some fundamental changes when it comes to the transfer of business property. Following the legislator's intention, the amount of tax-benefited assets will be limited, as so-called 'non-productive' assets will no longer benefit from tax exemption. Thus, opportunities for total tax exemptions will be limited. As the current law still applies until the new law is enacted, entrepreneurs with business assets located in Germany who have for some time been considering transferring the businesses to the next generation should check whether the current legislation is in their favour.

UNITED STATES *Contributed by Josefina V. Tranfa-Abboud, Marks Paneth LLP*



Transfer Pricing: A Primer for New International Entrants to the USA

Regardless of structure and revenue levels, the operations of corporations with related entities across international tax jurisdictions inevitably involve intercompany transactions.[1] International and local rules and guidelines require that the arm's length standard be met in the pricing of intercompany transactions, and require that sufficient transfer pricing contemporaneous documentation be maintained. International transfer pricing rules and guidelines are set forth by the OECD Guidelines.[2] In the case of the USA, transfer pricing rules and regulations are established by the US Department of the Treasury, Internal Revenue Service (IRS) and as set forth by Section 482 of the Internal Revenue Code (hereinafter IRC§482).[3]

As established by IRC§482 and by the OECD, sufficient documentation must be maintained to demonstrate that the pricing structure for intercompany transactions meets the arm's length standard. The type, content, and structure of contemporaneous documentation, however, may vary depending on the circumstances of each multinational enterprise (MNE).

Take, for example, the two following circumstances:

A. Corporation ABC is an established business outside of the USA and has been in operation for many years in the non-US market. Its related entity ABC-US has been in operation in the USA for 10–15 years and has generated revenues in excess of US$ 5 million per year for several years. ABC and ABC-US market and sell home décor that is manufactured outside the USA and placed in the US market through ABC-US. ABC sources the manufactured products and provides financing and management services, including the use of a proprietary software platform to maintain customer information, order tracking, and other key business operations data.

B. Corporation XYZ has a long-established presence outside the USA and entered the US market 2 years ago through its subsidiary, XYZ-US. XYZ-US has a sales team and a marketing department, with US revenues under US$ 2 million per year. XYZ sources retail products that are placed in the USA via the sales team at XYZ-US. All customer data, order tracking, planning, and bookkeeping is conducted by the management team outside the USA.

Both of the above corporations are faced with transfer pricing issues as they operate across international tax jurisdictions. However, they differ greatly in circumstances, type of intercompany transactions, revenues, and the characteristics of internal data and scope of operations.

To better understand the documentation requirements under specific sets of circumstances, the following key segments of IRC§482 must be considered:

1. 'A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realised if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). However, because identical transaction can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.'

2. The 'Standard of Comparability' establishes that a selected uncontrolled transaction does not have to be identical to the controlled transaction, but it must be sufficiently similar in order to provide a reliable measure of the arm's length result. The comparability between uncontrolled transactions and controlled transactions is determined via the functional analysis, which evaluates the functions performed and the resources employed '… by the taxpayers in each transaction.'

3. Under the 'Best Method Rule' of IRC§482, the 'arm's length of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result'. The methods set forth by IRC§482 are based on types of transaction. Depending on the circumstances, interrelated transactions may be analysed via joint method, or may have to be analysed separately.

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Accordingly, because the analysis of intercompany pricing requires the identification of comparable transactions, the initial step must be the determination of the economically significant intercompany transactions so that comparable, uncontrolled transactions may be identified. Comparable uncontrolled transactions may be existing transactions with third-party vendors or customers, or they may be identified via external databases that provide such information. The comparability of ABC/ABC-US to external data will likely differ greatly from the comparability of XYZ/XYZ-US to external data. While there is common ground relating to some of the documentation that must be maintained, what constitutes sufficient documentation for ABC/ABC-US is likely to differ from what constitutes sufficient documentation for XYZ/XYZ-US.

In order to adhere to the IRC§482 and OECD Guidelines requirements, generally speaking, transfer pricing documentation should include the following components:

Functional analysis: A description of the organisational structure, covering all entities, and a description of the business activities, markets, and geographic locations, as well as sufficient details regarding each type of economically significant intercompany transaction. Organisational charts, the history and evolution of the corporation, and information on structural changes should be considered as part of the functional analysis. The functional analysis should also include a discussion of the economic circumstances affecting each of the related entities. IRC§482 states that the determination of the degree of comparability between controlled and uncontrolled transactions requires a comparison of all functions performed by the taxpayers and the identification of the resources utilised by the taxpayers in performing such functions. The objective is to identify 'economically significant activities undertaken, or to be undertaken, by the taxpayers in both controlled and uncontrolled transactions'. The functional analysis should provide information on all resources utilised or to be utilised, and give consideration to all tangible and intangible assets used. Information regarding any transaction with third-party vendors or customers that may be comparable to the intercompany transactions should also be discussed. The functional analysis, however, does not provide a method and does not establish whether the arm's length standard is met.

Economic analysis or benchmarking: This segment of the transfer pricing documentation focuses on the identification of the appropriate methodology for the analysis of each set of intercompany transactions. While the OECD Guidelines are to be considered in the economic analysis, in the case of the USA, the specific rules and the specific methods set forth in IRC§482 are to be applied. The 'Standard of Comparability' as well as the 'Best Method Rule' need to be considered and discussed as part of the economic analysis. The economic analysis segment of the contemporaneous documentation must also include the identification and analysis of comparable, uncontrolled transactions. Comparable, uncontrolled transactions establish the market price range for intercompany transactions.

Financial analysis: This segment of the analysis requires the evaluation of the historical financial data for the tested party. Generally speaking, the price charged for intercompany transactions is expected to fall within percentiles 25 and 75 (the inner quartile) of the price range identified through the applicable comparables search.

The first step for, and the first challenge that arises in, maintaining transfer pricing documentation is the complete identification of all economically significant intercompany transactions, which precedes the identification of comparable, uncontrolled transactions either via existing third-party relationships or via external databases, and which, in turn, precedes the application of the best method to the analysis of financial data. Intercompany transactions that are not documented may present reporting issues and, if economically significant, will impede the proper identification of comparable uncontrolled transactions and hinder both the economic and financial analyses. Therefore, the identification of the applicable documentation must commence with complete identification of all economically significant intercompany transactions.

IRC§482 defines intercompany (controlled) transaction as any transaction occurring between two or more related entities, and it specifically defines intercompany (controlled) transactions as 'any sale, assignment, lease, license, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, however such transaction is effected, and whether or not the terms of such transaction are

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formally documented. A transaction also includes the performance of any services for the benefit of, or on behalf of, another taxpayer'.

While the transfer of tangible goods and the licensing of intellectual property, for example, may be obvious types of intercompany transactions, other transactions may not be as easily identifiable, particularly in the case of entities that are start-ups in a new market, such as the USA. Such is the case for a corporation as delineated through the XYZ/XYZ-US example above. Transactions such as services provided by management and the administration team, access to centralised databases, and the use of proprietary data and systems platforms or other intellectual property, sales and marketing, and financing, to name a few, may be involved in the cross-border operations to varying degrees.

All the necessary identification of economically significant intercompany transactions may be more readily available and more clearly defined for larger corporations and for those with a longer-standing history of operations, or for segments of a corporation with a longer-standing history of operations. For newer entrants, or for newer segments or markets for an established corporation, identifying intercompany transactions may pose a significant challenge as there may be significant overlap in duties of management and operations personnel across the related entities. In addition, the resources and costs associated with intercompany transactions may not be sufficiently recorded. Moreover, structural changes are typically more frequent for newer corporations or those corporations with a limited number of years in operation and more limited revenue streams.

While transfer pricing considerations are relevant for all MNEs, transfer pricing offers significant planning opportunities surrounding the preparation of contemporaneous documentation for US subsidiaries of foreign entities at their early stages (US MNE start-ups),[4] and careful evaluation of the circumstances should be geared towards defining sufficient documentation fitting the realities of the specific US MNE start-up. As a place to start, US MNE start-ups should prepare, update, and maintain documentation to be used for the preparation of the functional analysis. In order to do so, the following information should be maintained and updated as necessary:

1. Documentation on the organisational structure, structure of operations, functional responsibilities and assets/resources utilised or to be utilised, as well as documentation on any structural or market changes affecting the roles and responsibilities of the related entities.
2. Documentation identifying all economically significant intercompany transactions, and updates to such documentation as roles and the use/provision of resources change as the corporation evolves.
3. Documentation detailing the resources provided by each entity for each aspect of the operations of the corporation and for each of the identified economically significant intercompany transactions. This includes the identification of the individual(s) at the management and operations levels who may dedicate time for the benefit of a related entity, and clear and sufficient records of the time dedicated for the benefit of each related entity, as well as records of all associated direct and allocated costs.
4. Documentation on any third-party transactions similar in nature to the intercompany transactions as well as descriptive information on third-party transactions not comparable to the intercompany transactions.
5. Documentation on any intellectual property that may be utilised across the related entities, such as methods and know-how, as well as systems/software/platforms or any other intangibles.

As stated earlier, what constitutes sufficient transfer pricing documentation may differ depending on the circumstances of each MNE, and it will be contingent on the availability of the required information. The functional analysis requires that all economically significant intercompany transactions, functions, responsibilities and assets used be properly identified. The economic analysis (benchmarking) requires that comparable transactions under comparable circumstances can be identified. And the financial analysis requires the availability of sufficient and reliable financial data for all entities analysed, as well as for the comparables. Reliable and sufficient documentation can only be established when sufficient data is available and maintained for each of the three above components of documentation.

When structural changes are more frequent, as is the case for more recent MNEs (i.e., those organisations that can be considered US MNE start-ups, or for MNEs

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entering new markets), meeting the requirement of maintaining sufficient transfer pricing documentation will probably result in more frequent updates to the functional analysis. For these entities, the financial data, as well as data on comparable, uncontrolled transactions, may not be sufficient for or conducive to a full and complete financial analysis. However, sufficient documentation must still be available to satisfy the requirements under the rules. In contrast, for more established MNEs with more stable markets of operation, more established intercompany interactions, and fewer structural changes, the functional analysis and the identification of comparable transactions may be relatively more stable as well. In such a case, the preparation of transfer pricing documentation may focus more on the financial analysis, accompanied by relatively brief updates to the functional analysis and corresponding updates on the identification of comparable, uncontrolled transactions.

References

1. While transactions across local tax jurisdictions may also be subject to transfer pricing considerations, this article focuses on international intercompany transactions.
2. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010.
3. Section 482 of the Internal Revenue Code of 1986, as amended.
4. For purposes of this discussion, we define US MNE start-ups as US subsidiaries of foreign entities with only a few years of operations and with revenues under US$ 2 million. This, however, is solely a practical definition by the author, and not a formal definition.

TAX HEADLINES *Contributed by Saurabh Jain, S.C. Vasudeva & Co.*

US Signs Tax Information Agreement with India for FATCA

On 9 July 2015, US Ambassador to India, Richard Verma, and Indian Revenue Secretary, Shaktikanta Das, signed an agreement to implement the Foreign Account Tax Compliance Act (FATCA). The agreement is designed to increase transparency between the two nations on tax matters. The agreement takes effect from 30 September 2015 and underscores growing international cooperation to end tax evasion.

Hong Kong is becoming more investment-friendly by granting a profits tax exemption to offshore private equity funds

On 17 July 2015, the Hong Kong Government through a legislative amendment has extended the profits tax exemption that was hitherto available for offshore funds to private equity funds by expanding the definition of 'specified transactions' to include transactions in securities of private companies that meet the definition of an 'excepted private company'. To qualify as an excepted private company, the private company must be (a) incorporated outside of Hong Kong and (b) for 3 years prior to the relevant disposal of its securities it must not have (i) carried on any business through a permanent establishment (i.e., a fixed place of business) in Hong Kong; (ii) held shares in another private company which carries on business through a permanent establishment in Hong Kong if the total value of these shares exceeds 10% of the private company's assets; and (iii) neither held immovable property in Hong Kong, nor held shares in another private company with holding of immovable property in Hong Kong, if the total value of these immovable properties and shares exceeds 10% of the private company's assets.

Introduction of value added tax and corporate tax in UAE

On 18 August 2015, the UAE's Ministry of Finance (MoF) released an official statement addressing the progress it has made in respect of the Gulf Cooperation Council (GCC) value added tax (VAT) proposal and the potential UAE corporate tax (CT) introduction. It has been confirmed that UAE MoF has been conducting studies in relation to the implementation of VAT in the GCC along with its fellow GCC member states (Bahrain, Kuwait, Oman, Qatar and Saudi Arabia), and also confirms that the UAE has made an agreement to implement VAT simultaneously along with the other GCC member states. The announcement also provides a brief update on the UAE's progress in respect of CT confirming that a draft UAE CT law is being studied in relation to the eventual CT regime to be implemented.

Key taxation measures by UK Conservative government's Summer Budget

The Summer Budget, presented on 8 July 2015, highlighted the following key measures in relation to international taxation:

- The main UK corporation tax rate will be reduced from the current rate of 20% to 19% with effect from 1 April 2017, and to 18% with effect from 1 April 2020
- For profits arising on or after 8 July 2015, companies may no longer offset UK losses and expenses against profits taxable under the controlled foreign companies (CFC) rules
- For acquisitions arising on or after 8 July 2015, no corporation tax relief will be available for the amortisation of purchased goodwill and certain customer-related intangibles
- Several changes will be made to the taxation of corporate debt and derivative contract rules for companies, most of which will take effect for periods beginning on or after 1 January 2016
- The link company requirements for consortium relief claims will be simplified with retrospective effect from 10 December 2014.

Australian Taxation Office updated Tax Risk Management and Governance Review Guide

The Australian Taxation Office (ATO) has recently updated the *Tax Risk Management and Governance*

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Review Guide (the Guide). As a result, Australian subsidiaries of foreign multinational enterprises (MNEs) may have to adopt better tax corporate governance practices to identify and manage their tax risks where current policies and activities do not align with the Guide. In the event of non-conformity with the Guide, ATO may view the company's tax risks as not being well managed and tax positions being less certain, which may increase compliance costs associated with ATO audits.

ABB Inc. v. Deputy Director of Income-tax-International Taxation [2015] 59 taxmann.com 159 Bangalore

Contributed by Parul Jolly, S.C. Vasudeva & Co.

The Bangalore Bench of the Income-tax Appellate Tribunal has held that business development, market services and other support services do not make available technical knowledge, skills, etc. Therefore, payment for these services is not taxable as Fees for Included Service under Article 12(4)(b) of the India–USA tax treaty. Another issue that the Tribunal adjudicated upon was whether the associated enterprise constituted a Dependent Agency Permanent Establishment.

Facts of the case

The taxpayer was an American company engaged, *inter alia*, in providing business development, market services and other support services to its associated enterprises in India. During the relevant previous year, the taxpayer earned certain fees for providing these support services.

It claimed that the said services did not make available any technical knowledge, experience, skill, etc. to associated enterprises of the taxpayer and, hence, it was not liable to tax in India under the head 'fees for included services' as per the India–USA Tax Treaty (DTAA).

Issues involved

- Whether business development, market services and other support services provided are taxable as Fees for included services (FIS) under the India–USA tax treaty?
- Whether taxpayer's associated enterprises which carried out some trading transactions on behalf of taxpayer would be considered a Dependent Agency Permanent Establishment (DAPE) in respect of all activities including such trading transactions?

Assessing Officer's contention

The Assessing Officer rejected the taxpayer's plea by observing that 'a person, without the technical knowledge, cannot provide these services' and, hence, the taxpayer was providing technical services to its associated enterprises and also made available technical knowledge to the service recipients.

Order of Dispute Resolution Panel (DRP)

The DRP confirmed the stand of the Assessing Officer.

The DRP also held that, without prejudice to taxability of fees for technical services, the taxpayer had a DAPE in India, as the Indian associated enterprises of the taxpayer acted as agent of the taxpayer in purchasing the products from entities of the taxpayer and distributed the same to various companies.

Therefore, so much of the profit that was attributable to the operations in India was to be brought to tax by the Assessing Officer, in accordance with Article 7 of the DTAA.

Decision of the Tribunal

Issue 1

The law is settled, as far as the connotations of the 'make available' clause in the definition of 'fees for technical services' in the contemporary DTAA are concerned. It is held to be a condition precedent for invoking this clause that the services should enable the person acquiring the services to apply technology contained therein.

The Tribunal held that unless there is a transfer of technology involved in technical services extended by the US-based company, the 'make available' clause is not satisfied and, accordingly, the consideration for such services cannot be taxed under Article 12(4)(b) of the India–USA Tax Treaty.

The lower authorities have been swayed by normal connotations of the expression 'make available'; however, this expression has specific legal connotations, as held by the Hon'ble Karnataka High Court in the case of *CIT v. De Beers India Minerals (P.) Ltd* [2012] 346 ITR 467 (Kar). In the light of the law so laid down, the consideration for these services cannot be brought to tax under Article 12(4)(b) as these services

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do not involve enabling the recipient of the services to utilise the knowledge or know-how independently in future, without the aid of the service provider.

Issue 2

The DAPE has been justified by the DRP on the ground that Indian affiliates, to which the services were rendered, were involved in purchase and sale of products of the taxpayer but the taxability is held to be in respect of the fees for technical services rendered to these very entities.

Even if a permanent establishment (PE) exists and the taxpayer carries on business through the PE, under Article 7(1) of the DTAA the profits of the taxpayer may be taxed in the source jurisdiction, but only so much of them that are attributable to (i) that PE; (ii) sales in the other state of goods or merchandise of the same or similar kind as those sold through that PE; (iii) other business activities carried on in the other state of the same or similar kind as those effected through that PE.

In the instant case, the PE was in respect of the trading transactions only, and hence no part of the earning from rendering of services to the associated enterprises can be related to the nature of the PE activities. Therefore, consideration for these services cannot be brought to tax in India.

Relying on the decision of *SET Satellite (Singapore) Pte Ltd. v. DDIT* [2009] 307 ITR 205 (Bom), even if there is a DAPE in India, it will have no taxable profits to be taxed in the hands of the taxpayer in the absence of the finding that the DAPE has been paid less than arm's length remuneration. Accordingly, there was no need to examine the aspect regarding the existence of the DAPE. Therefore, additions made with respect to income under Article 12(4)(a) as Fee for Included Services and with respect to business income under Article 7(1) of the DTAA were deleted.

EDITORIAL COMMENT

The meaning of the term 'make available' in the India-US DTAA has been subject matter of many disputes between the tax payer and the tax authorities. Inspite of the clear guidance given in the Protocol to the DTAA, the tax authorities do not provide relief and the tax payer has to seek the desired relief from the appellate authorities like in the present case. The Tribunal has correctly interpreted the meaning of the term 'make available'. The Tribunal was also correct in holding that once the PE is remunerated on an arm's length then there is no further attribution that can be done to the PE in India based on the provisions of the DTAA.

Morison International

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Contact Morison International to discuss your needs

www.morisoninternational.com

Morison International
193 Praed Street
Paddington
London, W2 1RH
United Kingdom

T: +44(0)20 7638 4005
E: info@morisoninternational.com

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