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Global Tax Insights

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EDITORIAL

The year 2013 will go down in the history of tax legislation as a year when countries around the globe intensified their efforts to check tax evasion and curtail avenues for tax planning. At the request of G20 Finance Ministers, in July 2013 the OECD launched an Action Plan on Base Erosion and Profit Shifting (BEPS), and for the first time non-OECD countries and the G20 nations are involved on an equal footing on this project. Besides the intense work being done by the OECD, many countries have signed the Exchange of Information Agreements to check tax evasion.

While BEPS will be the buzzword in international taxation in 2014, it would not be surprising to see tax authorities across jurisdictions taking a more aggressive stand during transfer pricing audits in the year 2014 to ensure that they get a fair share of the total pie. The OECD has also updated the Commentary on Article 26 of the OECD Model Tax Convention on Exchange of Information between the competent authorities of the Contracting States. The OECD section in the newsletter carries a summary of the changes made to Article 26 of the Model Commentary.

The European Court of Justice delivered its first Court Judgement on VAT deduction and adjustment in case of acquisition of land and buildings constructed on that land, with a view to demolishing the buildings and carrying out a construction project on the land. The case law section contains a summary of the landmark case law. The other case covered in the newsletter deals with the interpretation of Article 13 of the India–UK treaty. In addition to the above, the newsletter contains the regular updates from various countries.

As this is the last issue of 2013, I express my gratitude to all member firms that have contributed to the newsletter throughout the year. I hope this support continues in 2014, and encourage other member firms to contribute. I sincerely hope that the contents of this newsletter are useful to members and their clients. Feedback and suggestions on the contents are always welcome; please email your suggestions to me at sachin@scvasudeva.com.

Finally, I take this opportunity to convey my best wishes for the festive season and wish everyone a merry Christmas and a very happy and peaceful 2014!

Happy reading!

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

AUSTRALIA *Contributed by Michael Carruthers, Hayes Knight*

Tax Office wins another case dealing with contractors

In recent years, the Australian Taxation Office (ATO) has been actively targeting contractor arrangements, seeking to argue that the workers should really be treated as employees for certain purposes. This is an important issue for businesses that engage contractors in Australia, because the obligations of a business are significantly higher when a worker is treated as an employee rather than an independent contractor.

For example, if a worker is treated as an employee, then the business that engages them would be exposed to the following obligations:

- They would need to withhold tax from payments made to the worker and remit the tax to the ATO under the Pay As You Go (PAYG) system. They would also need to provide annual reports to the worker and the ATO
- Non-cash benefits could trigger a fringe benefits tax liability in the hands of the business
- Compulsory contributions would need to be made to a superannuation fund on behalf of the worker (currently 9.25% of ordinary earnings)
- The payments may be subject to payroll tax
- The payments may also be taken into account in determining the worker's compensation insurance premiums that are payable by the business.

One of the biggest problems in practice is the fact that there are no time limits on unpaid superannuation contributions. If a business has a relatively high level of contract labour, then the quantum of unpaid superannuation liabilities (plus penalties and interest) can accumulate very quickly if the classification of the workers is successfully challenged by the ATO. If a company is unable to pay these liabilities, the directors can be personally liable for the unpaid amounts.

The ATO is currently enjoying a very high success rate when it comes to challenging the classification of contractors through the courts. The most recent decision is from the Administrative Appeals Tribunal in Floorplay Pty Ltd v. Commissioner of Taxation [2013] AATA 637.

In this case, the Tribunal affirmed the Commissioner's decision that contractors under a 'share fishing' contract were not independent contractors of a company for the purpose of the superannuation guarantee rules, even though the relevant contracts referred to the workers as independent contractors.

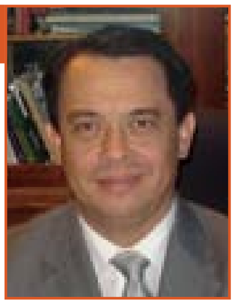
The company engaged individuals to crew four commercial fishing vessels. The arrangement between the company and the crew members was that the company would pay 33% of the net sale proceeds of each catch to the crew members.

The Tribunal focused on whether the crew members were carrying on a business in their own right rather than serving an employer in the employer's business. After working through a number of key factors, the Tribunal concluded that the crew members were not carrying on their own businesses. Some of the key factors that led the Tribunal to this conclusion were:

- The crew members were not free to deal with the catch as they chose: the catch had to be processed and sold through an entity related to the company
- The parties agreed that the company would deduct PAYG withholding tax from the amounts payable to the crew members. This is not consistent with an independent contractor arrangement
- The company had the capacity to control the duration and destination of voyages.

The end result was that the crew members were treated as employees and the company was liable to make superannuation contributions on behalf of the workers. This is yet another case where the ATO and courts have applied a 'substance over form' approach to determine whether a business has superannuation obligations for workers.

COSTA RICA *Contributed by Carlos Camacho, Grupo Camacho S.A.*



Transfer pricing regulations

On 13 September 2013, the Costa Rican government published Decree No. 37898-H. This regulates transactions between related parties, and is applicable from the date of its publication. In summary, the decree enforces the arm's-length principle in transactions with related parties. This principle dictates that these transactions, for purposes of income tax, should be agreed in a manner as agreed with independent entities.

Relevant aspects:

- All taxpayers carrying out transactions with related parties abroad or within Costa Rican territory must perform a transfer pricing analysis, along with supplying adequate supporting documentation to demonstrate that transactions with related parties are carried out according to the arm's-length principle
- There is a new obligation of filing an information return for large taxpayers, large local corporations and corporations within free zone regimes
- The arm's-length principle in transactions with related parties must be reflected on tax income returns as from the 2013 tax year, so all related parties/entities must analyse all transactions subject to the new rule in this period.

Other aspects:

- Both local and foreign entities are considered to be related parties
- Those companies with which the taxpayer carries out transactions, that are located in jurisdictions where it is not possible for the tax administration to get information, are also considered related parties
- Obligation to file an annual return.

MALTA *Contributed by Justin Spiteri, Mahoney & Co.*

Qualifying Employment in Innovation and Creativity (Personal Tax) Rules

Introduction

Following the successful introduction of the Highly Qualified Persons Rules, applicable to individuals engaged in the financial services and i-gaming sectors, a new scheme has now been launched that widens the scope of eligible activities to include the digital gaming sector.

Qualifying contract of employment

The emoluments derived from a qualifying contract of employment shall be taxed in Malta at a flat rate of 15%. The beneficiary may qualify under the Rules if they occupy an eligible office and are in receipt of a minimum of €45,000 in annual emoluments, excluding the value of any fringe benefits attributable to the employment package. Moreover, if the income derived from the qualifying contract of employment exceeds €5 million, no further tax shall be charged on the excess. Nonetheless, the minimum emoluments shall be adjusted annually in line with the Retail Price Index as published by the National Statistics Office.

Furthermore, the emoluments shall not qualify as income from a qualifying contract of employment if the said emoluments are paid by an employer who is either related to the beneficiary or has benefited or is benefiting from other business incentives arrangements available through various incentive laws in Malta.

The tax charge of 15% shall apply without the possibility for the beneficiary to apply and opt for any deductions, reductions, reliefs and credits of any kind as available under the Income Tax Act except for those specifically stipulated.

Eligible office

A person is said to occupy an eligible office when employed in a role that is directly involved in the development of innovative and creative digital products. The roles that qualify under these rules are the following:

Chief Executive Officer	Director of Online Community
Chief Technical Officer	Head of Art Design and Visualisation
Chief Creative Officer	Art Director
Head of Writing	Digital Artist
Lead In-World Writer	Commercial Director (Digital Licensing)
Lead Game Programmer	Head of Game Design
Software Engineering Director	Game Director
Game Developer	Game Designer
Audio Director	Video Director
Producer	Head of Marketing

The applicant must prove to the satisfaction of the Malta Enterprise Corporation that they occupy an eligible office.

The beneficiary

In order to benefit from the said Rules, the beneficiary must demonstrate to the satisfaction of the Malta Enterprise Corporation that s/he:

- Is engaged in an employment relationship and derives emoluments related to a qualifying contract of employment and in respect of duties and assignments carried out in Malta, or in respect of any period spent outside Malta in connection with such duties or assignments
- Is protected as an employee as stipulated under Maltese law, irrespective of the specific legal relationship between the employer and the beneficiary
- Has the relevant qualifications and/or professional experience
- Can perform activities of an eligible office
- Receives stable and regular resources that are deemed to be sufficient to maintain themselves and their dependants
- Resides in an accommodation regarded as normal for a comparable family in Malta

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- Holds a valid travel document
- Holds valid and adequate health insurance that covers the beneficiary and their dependants for all risks normally covered for Maltese nationals
- Is not domiciled in Malta.

All emoluments are to be fully declared for income tax purposes. Besides, the beneficiary shall disclose all income derived from a person related to his employer paying out income from a qualifying contract as subject to tax under the Malta Income Tax Act.

Applicability

EEA and Swiss nationals may avail themselves of the scheme for a consecutive period of not more than 3 years, commencing from the year preceding the first year of assessment in which the beneficiary is first due to be taxed under the reduced flat rate of 15%. Besides, if the first year of assessment has occurred prior to 2013, then the option is still available, but only for year of assessment 2013 (i.e., basis year 2012) or thereafter, so long as this falls within the 4-year period from the first year of assessment.

With respect to third-country nationals, the scheme shall apply for a consecutive period lasting not more than 3 years commencing from the year preceding the first year of assessment in which the beneficiary is first due to be taxed on their emoluments at the rate of 15%. Meanwhile, if the first year of assessment happened to fall prior to 2013, then the scheme is still available for a 3-year period commencing either from 2012 or from the first year of assessment.

General conditions

The special tax status shall be immediately withdrawn, with retrospective effect, if the beneficiary's stay in Malta is deemed not to be in the public interest.

Besides, the rights granted under this scheme shall be withdrawn with retrospective effect if the beneficiary is a third-country national and either:

- Physically stays in Malta for >1,460 days; or
- Directly or indirectly acquires or holds beneficial interest over real rights over any immovable property situated in Malta.

The beneficiary shall not make use of artificial and fictitious arrangements in order to benefit from the Rules. In the event that a person claims a benefit to which they were not entitled, they are liable to pay a penalty equal to the amount of the benefit claimed. If the benefit was actually paid, the person would also have to repay the benefit received together with an additional tax equivalent to 7% per month starting from the month in which the benefit was paid in, which continues to accrue until the tax due has been paid.

The Malta Enterprise Corporation and the Commissioner for Revenue shall request any information and documents from the beneficiary as they require to ascertain the validity of the application. The application shall be submitted on the forms as prescribed by the Malta Enterprise Corporation and the Rules shall be applicable and effective until 31 December 2017.

PHILIPPINES *Contributed by Emiliana G. Allayban, Villaruz, Villaruz & Co., CPAs*

Transfer pricing in the Philippines

Among the most challenging facets of Philippine taxation is transfer pricing. As multinational businesses expand their operations internationally, transfer pricing has become one of the key issues for most tax authorities. Different transfer pricing schemes have been used by companies, which alerted tax authorities to the need for strict transfer pricing and documentation guidelines in order to protect their tax revenues.

In order to control the transfer pricing agreements that are not based on the arm's-length principle, the Philippine Bureau of Internal Revenue (BIR) released regulations on transfer pricing on 23 January 2013, with effect from 9 February (15 days after publication). Transfer pricing guidelines are found in Revenue Regulation (RR) No. 2-2013, which explicitly implements the authority of the Commissioner of Internal Revenue, under Section 50 of the Tax Code, to review controlled transactions among associated enterprises and distribute, apportion or allocate their income and deductions to reflect the true taxable income of such enterprises.

Furthermore, RR No. 2-2013 states that the most appropriate arm's-length pricing methodologies are:

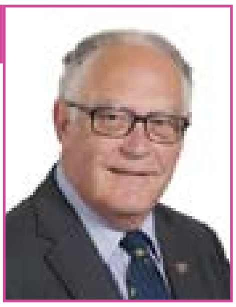
- Comparable uncontrolled price method
- Resale price method
- Cost-plus method
- Profit split method
- Transactional net margin method.

The regulation covers transactions between two or more members of the same group of controlled or related parties. Enterprises are considered related if one participates directly or indirectly in the management, control, or capital of the other, or if the same persons participate directly or indirectly in the management, control, or capital of the entities. A prima facie evidence of control can be observed through an entity holding at least 30% of the company's outstanding shares entitled to vote. Aside from this, a control shall be deemed present if income or deductions have been arbitrarily shifted.

With the implementation of transfer pricing regulations, transfer pricing audits will naturally be triggered. Just recently, several taxpayers (multinationals and local conglomerates) were issued assessments involving transfer pricing issues. Some of these assessments have already been elevated to the courts for resolution. Unlike in most countries with comprehensive transfer pricing rules, the transfer pricing audits by the BIR are conducted as part of their regular audit investigation. Thus, the same rules and procedures on regular audits generally apply.

Against this background, Philippine companies should always be prepared to show that related party transactions are made at arm's length. To reduce the risk of transfer pricing adjustments resulting from audit, companies engaged in transactions with related parties should maintain documentation demonstrating that reasonable efforts have been exerted to uphold the arm's-length principle in setting the transfer prices. Such documentation is essential to comply with the requirements of the BIR regulations.

NEWS FROM THE OECD *Contributed by Nigel Eastaway, MHA MacIntyre Hudson, UK*



Exchange of information under double taxation agreements

Article 26 of the OECD Model Tax Convention and its Commentary on 'Exchange of Information between the Competent Authorities of the Contracting States' has been updated. Information so exchanged may now be used for purposes other than assessment, and collection, enforcement or prosecution, appeals and oversight of all taxes, provided that the competent authority of the supplying State authorises such use.

Article 26 does not allow 'fishing expeditions' (i.e. speculative requests by taxing authorities), but now provides that so long as there is a reasonable possibility that the required information will be relevant, whether it actually proves to be so does not matter. Once the foreseeable relevance has been explained by the requesting authorities, the requested State may not decline a request or withhold requested information on grounds of irrelevance. The requesting State must provide sufficient information to identify the taxpayer, or a detailed description of a group of taxpayers, specifying the facts and circumstances that have led to the request and why there is reason to believe that the group has been non-compliant, explaining clearly how under applicable law this cannot be construed as a 'fishing expedition'.

The requirement of *foreseeable relevance* may be replaced in individual treaties by 'is necessary', 'is relevant' or 'may be relevant'.

Various examples are given in paragraphs 7 and 8 of the Commentary on Article 26, where the convention applies; and in paragraph 8, where the Contracting States are not obliged to provide information in response to a request for information. However, these should be read in the light of the overarching purpose of Article 26: not to restrict the scope of exchange of information, but to allow information exchange to the widest possible extent.

Four additional examples in paragraph 8 indicate that information must be exchanged to identify the person, credit card numbers, banks and companies concerning which further information is requested and must be supplied, with clarification if necessary. The two cases specified in paragraph 8.1 relate to requests from bank account holders in Bank B in State B resident in State A and the names of all shareholders in Company B in State B resident in State A. State B is not obliged to supply this information.

The three forms of exchange of information specified in paragraph 9 (i.e. on request, automatic and spontaneous) are redefined by reference to a standard and revised standard magnetic format for automatic exchange of information, the use of Tax Identification Numbers and the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes.

Paragraph 10.4 of the Commentary suggests a further paragraph 6 to Article 26 where the Contracting States wish to improve the speediness and timeliness of information. This allows the Contracting States to agree time limits for the provision of information. In the absence of such agreement, the information shall be supplied as quickly as possible – except where the delay is due to legal impediments. The default standard, unless otherwise agreed, is within 2 months if the information is already in the possession of the requested Contracting State; 6 months where the requested State is not already in possession of the information requested – although these time limits are not binding and information may be supplied later, as agreed on a case-by-case basis.

The confidentiality provisions in paragraph 2 of Article 26 are reinforced by amendments to the commentary in paragraph 11. Paragraph 12.3 of the Commentary is amended to allow the information exchanged to be used for other non-tax purposes if allowed under the laws of both States and the Competent Authority of the supplying State authorises such use. Paragraph 12.4 provides alternative wording in Article 26 paragraph 2 to use the exchanged information for other (non-tax) purposes.

The principle of reciprocity in the exchange of information is emphasised in changes to paragraph 15 of the Commentary. Paragraph 16 is amended to clarify the meaning of exchange of information 'to the widest possible extent' – in cases of, for example, banking secrecy laws. Paragraph 19.7 is amended to clarify

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that Contracting States must use their information-gathering powers to supply requested information if it exists, whether or not needed for domestic purposes.

These changes to the Model Tax Convention, Article 26 are not automatically incorporated into bilateral treaties; but to the extent that the relevant treaties follow the Model Convention, the Commentary, as amended, will apply to its interpretation.

SC GRAN VIA MOINESTI SRL V. NATIONAL AGENCY FOR FISCAL ADMINISTRATION (ANAF) C-257/11

Contributed by Maria Pascu, Boscolo & Partners, Romania

This is the first European Court Judgement (ECJ) regarding VAT deduction and adjustment in the case of acquisition of land and buildings constructed on that land, with a view to demolishing the buildings and carrying out a construction project on the land.

Facts of the case

SC Gran Via Moinesti Srl (GVM) acquired a plot of land and the buildings constructed on it, and subsequently carried out demolition works with the view to develop a residential complex. Moreover, a planning certificate was issued to GVM, with a view to obtaining a building permit to develop the residential complex on the land. GVM deducted the VAT relating to all of the land and buildings purchased and drew up a VAT return, showing a negative balance with an option for reimbursement.

Contention of the Bucharest Administration of Public Finance

A tax assessment was issued stating that due to demolition of those buildings, it was necessary to adjust the VAT relating to the demolished buildings that had been previously deducted by GVM.

Contention of the GVM

GVM claimed that its intention had been to acquire the land in question solely for the purposes of developing a residential complex on it; therefore, the purchase of the buildings on that land was unavoidable. Consequently, GVM did not adjust the VAT for the purchase of those buildings, which it had initially deducted, since their demolition was part of its investment plan and the residential project was intended to be used to carry out taxed transactions.

The tax authorities rejected the claim of GVM on the ground that GVM had unlawfully deducted the VAT relating to those buildings, since it had purchased them not for the purposes of carrying out taxed transactions, but only in order to demolish them.

Two questions were referred to the Court of Justice for the preliminary ruling:

1) **Whether the purchase by a company of buildings scheduled for demolition (with the purpose of developing a residential complex) can be qualified as an investment activity and thus entails the right to deduct the VAT relating to the acquisition of these buildings?**

Decision of the Court

In this respect, the Court observed that a person who incurs investment expenditure with the intention, confirmed by objective evidence, of engaging in economic activity must be regarded as a taxable person. Secondly, acting in this capacity, the person has the right to immediately deduct the VAT related to the investments and that the destination of such acquisition merely determines the extent of the initial deduction and the extent of any adjustments in the course of the following periods.

In this case, the Court ruled that it was clear that GVM's purchase of land and buildings constituted a preparatory act whose purpose was the construction of a residential complex on the land in the course of GVM's property development activities. In making that purchase, GVM therefore performs an economic activity as a taxable person. Moreover, the acquisition of those buildings and their subsequent demolition with a view to building more modern ones, could be regarded as a series of linked transactions for the purpose of subsequent taxable transactions.

2) **Whether the purchaser is obliged to perform a subsequent adjustment of the previously deducted VAT related to the building scheduled for demolition?**

Decision of the Court

According to the Court, an obligation to make an adjustment of an input VAT deduction would be made where, after the VAT return is submitted, some change occurs in the factors used to determine the amount

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to be deducted. In this case, the demolition did not represent a change, since the demolition was envisaged early on by GVM (upon the acquisition of buildings). Thus, the Court ruled that the demolition of buildings constructed on a plot of land acquired, with a view to developing a residential complex in place of those buildings, does not result in an obligation to adjust the initial deduction of the VAT relating to the acquisition of those buildings.

EDITORIAL COMMENT

This ECJ ruling has major importance, especially for real estate companies, because the VAT from such acquisitions will no longer represent a cost for them. This decision, which has been implemented into Romanian legislation, provides companies with an important tool allowing them to avoid abuses from tax authorities in similar cases.

ADIT (IT) V. MARK & SPENCER RELIANCE INDIA (P.) LTD.

38 Taxmann.com 190 (ITAT, Mumbai – Bench 'L') (2013)

Contributed by Divya Bhargava, S.C. Vasudeva, India

Reimbursement of salary of seconded employees is not in the nature of fees for technical services.

Facts of the case

The assessee company was a Joint Venture company between Marks & Spencer PLC (M&S Plc) and Reliance Retail Limited. The assessee entered into an agreement with Marks and Spencer PLC, a UK based company, whereby the assessee was provided personnel to carry out the functions in the area of management, the setting up of business, property selection and retail operation, product and merchandise selection and the setting up of a merchandise team. The assessee paid an amount to M&S Plc towards salary expenditure of employees deputed under the seconded agreement.

Contention of Assessing Officer (AO)

The assessing officer contended that the remittance in question was paid for services rendered by the payee through its employees; therefore, the payment was in the nature of a fee for technical services (FTS). The services rendered were in the area of management, selection of property and retail operations, which were in the nature of business strategies and advisory. Thus, the gross revenue received by the payee, being FTS, was liable to tax in India and expenses cannot be allowed as deduction.

Aggrieved by the order of AO, the assessee filed an appeal before the Learned Commissioner of Income Tax Appeals [CIT(A)]. It was held that the remittance was only part reimbursement of expenses and could not be treated as income deemed to accrue or arise in India as income under the definition of FTS as per the Indo-UK DTAA. The revenue filed an appeal against the order of the Learned CIT(A) before the Appellate Tribunal.

Contention of assessee

The amount paid was not in the nature of income in the hands of the payee, as it was only a reimbursement of cost. The assessee referred the terms of the agreement between the parties and submitted that the parties agreed to provide employees to the assessee and the amount will be charged without any mark-up.

The assessee also contended that in the absence of making available any technical knowledge and knowhow, the payment does not fall within the ambit of Article 13(4) of the Indo-UK DTAA. As per clause (c) of Article 13(4), FTS means payments of any kind to any person in consideration for the rendering of any technical or consultancy services that make available technical knowledge, experience, skill, knowhow or processes, or consist of development and transfer of a technical plan or design. Thus, to bring any payment within the parameters of FTS, it is of paramount importance that such technical knowledge, experience/skill, or plan/design is made available.

'Make available' means to provide something that can be used, either once only or on a continuous basis – i.e., technical information or advice is transmitted by the non-resident to the assessee, which remains at its disposal for potential benefit from use. Even the one-off use of such technical services by the recipient will satisfy the test of making available the technical services to the assessee. If the non-resident uses all the technical services at its own end, even though the benefit of that directly and solely flows to the payer of the services, this cannot be characterised as the making available of technical services to the recipient.

Decision of the Tribunal

The Tribunal held that merely providing employees or assisting the assessee in the business and in the area of consultancy, management, etc. would not constitute 'making available' services of any technical or consultancy nature. As per the definition for FTS, 'services' means payment of any kind to any person in consideration for a service or services of a technical or advisory nature if such services make available any technical knowledge, experience, skill, knowhow or process that enables the person acquiring the services to apply and benefit from these. Thus, the expatriation

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of an employee under a seconded agreement without transfer of technology would not fall under the term 'make available' as per Article 13(4)(c) of the Indo-UK DTAA.

The Hon'ble Tribunal referred the decision of Karnataka High Court in the case of *CIT* v. *De Beers India Minerals (P.) Ltd*. [2012] 346 ITR 467 and the Special Bench decision in the case of *Mahindra & Mahindra Ltd. v. Dy. CIT* [2010] 122 ITD 216 (Mum.) and held that the payment in question did not fall under the term 'fees for technical services' as per the provisions of the Indo-UK DTAA.

It was further held that the entire amount of salary received by the personnel has been subjected to tax in India at the highest average rate of tax. Therefore, there is no question of any default on the part of the assessee.

EDITORIAL COMMENT

Cross-border secondment of personnel between affiliates is not uncommon in multinational groups. The presence of seconded employees in India poses various tax challenges under Indian tax laws and treaties. The Indian tax authorities have been contending that by sending employees to India, the foreign entities are actually rendering services to the Indian companies or carrying out business in India in the form of a permanent establishment in India.

In the present ruling, Tribunal has ruled favourably on the facts under consideration and held that merely providing employees or assisting the taxpayer in the business and in the area of consultancy, management etc. would not constitute 'making available' any technical or consultancy services under the India–UK tax treaty.