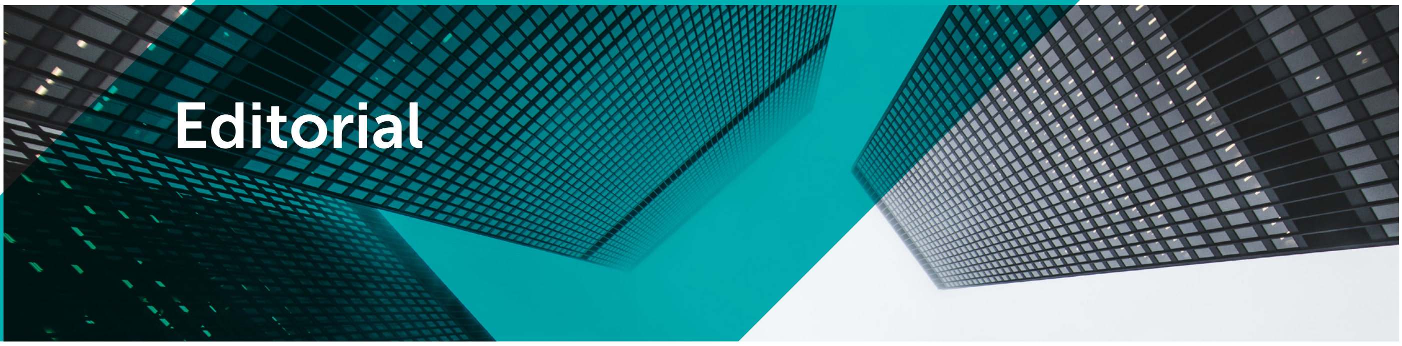
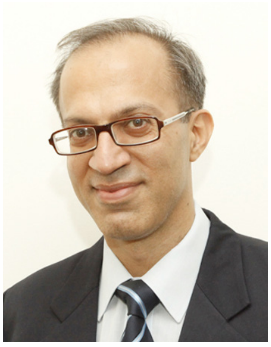
Morison KSi

Global Tax Insights

Q1 – Q2 2019

Editorial





India has ratified the Multilateral Convention to Implement the Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The Union Cabinet, chaired by the Prime Minister, approved the ratification on 12 June 2019. The MLI will modify India's treaties to curb revenue loss through treaty abuse and BEPS strategies by ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created. Ratification is a part of the procedural steps where a country formally agrees to adopt the tax treaty with its counterparts. Currently, India has covered 93 countries pursuant to Article 2(1)(a)(ii) of the convention. Besides India, around 25 other countries have ratified MLIs to change the tax treaties.

The MLI is the outcome of Action Plan 15, which dealt exclusively with development of a multilateral instrument for amending bilateral treaties. MLI will coexist with current tax treaties, so it will be interpreted in a similar manner and requires an ambulatory approach. Further, there are no grandfathering provisions under the MLI.

Application of the MLI is bound to change the way multinational enterprises (MNEs) exploit the taxing statutes. MNEs and tax professionals should therefore take care of the provisions of the MLIs when planning their affairs.

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.vasudeva@scvindia.com.

Happy reading!

Sachin Vasudeva

Country Focus INDIA

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Multilateral instrument: A solution to prevent tax avoidance

Background

The multilateral instrument (MLI) is the most important outcome of the OECD/G20 project to tackle the issue of Base Erosion and Profit Shifting (BEPS). BEPS, as the name suggests, refers to tax avoidance by shifting the profits from a high to a low tax jurisdiction, thereby eroding the tax base of the country. The BEPS strategy was outlined in 2013, with the final report being released in 2015. The report identified 15 Action Plans to address BEPS in a comprehensive manner, and set out deadlines for implementation.

Action Point 15 recommended developing a multilateral instrument (MLI) to modify the bilateral tax treaties – an efficient way to implement the BEPS measures without amending the tax treaties on an individual basis, which would be cumbersome and lead to inconsistency.

Application of the MLI is not akin to amending a single existing treaty by way of a protocol; instead it will be applied alongside the existing bilateral tax treaties, modifying their application in order to implement the BEPS measures. Once applied, the MLI will have to be read in parallel with the existing treaties.

At present, almost 90 countries have signed the MLI. Each signatory is required to notify/list the bilateral tax treaties it seeks to amend through the MLI. Such listed treaties are known as Covered Tax Agreements (CTAs). The MLI will apply only to those countries that have signed the MLI, ratified it in accordance with domestic law and deposited the instrument of ratification with the OECD. India completed this process on 25 June 2019, being one of 28 countries to have done so by 30 June 2019.

Mere ratification and deposit of the MLI along with its positions will not lead to modification of the tax treaties. Only those treaties where the treaty partners have taken a position concurring with India's shall undergo a modification. For each MLI provision, India's position or reservations shall be compared with the positions taken by its counterpart.

Entry into force and entry into effect

The concept of entry into force varies by country, while the concept of entry into effect is determined by each CTA. The MLI shall come into force for a particular country from the first day of the month following the expiry of 3 months from the date of deposit of the ratification instrument. For example, since India deposited its instrument of ratification on 25 June 2019, the MLI shall come into force from 1 October 2019.

The date of entry into force for each country is relevant to determine the timelines for the MLI to come into effect with respect to each CTA (see Tables 1 and 2). Once the MLI has come into force for both countries, the latter date of coming into force becomes the 'relevant date' for determining the date of entry into effect. For example, entry into force for India is 1 October 2019. However, Italy has not yet filed its instrument of ratification, so the provisions of the MLI will not yet come into effect for the India–Italy tax treaty. By comparison, since the UK deposited its instrument of ratification on 29 June 2018 and its entry into force will be 1 October 2018, the relevant date to determine entry into effect for the India–UK tax treaty shall be 1 October 2019.

Table 1. How date of entry into effect for a CTA is determined

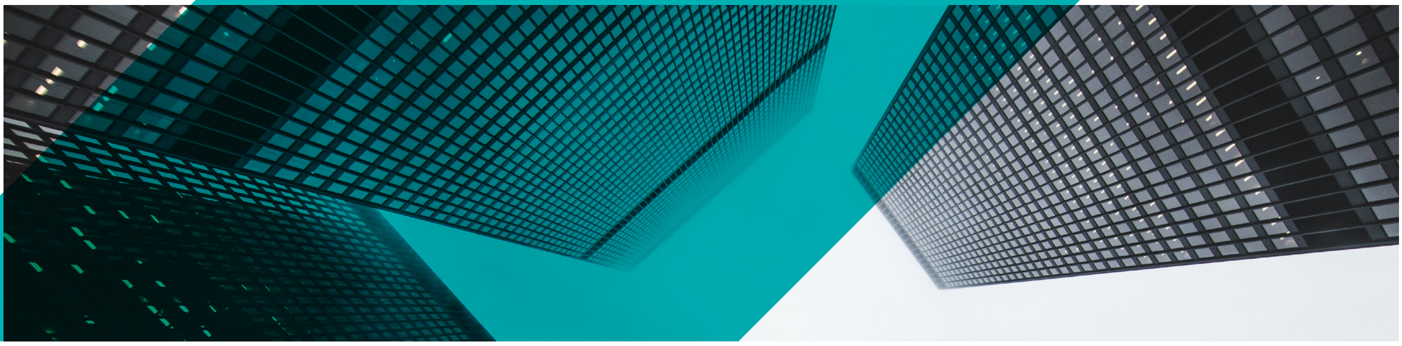
	Entry into effect
For taxes withheld at source on amounts paid to non-residents	First day of the next calendar year[1] that begins on or after the 'relevant date'
For other taxes	Taxable period that begins on or after expiry of 6 calendar months from the 'relevant date'

Table 2. How the 'relevant date' is determined

Entry into force for India	1 October 2019
Entry into force for UK	1 October 2018
Relevant date for determination of entry into effect	1 October 2019
Entry into effect for all withholding taxes	
For India	1 April 2020
For UK[2]	1 January 2020
Entry into effect for other taxes	
For India	Financial year 2020-21 (i.e., from 1 April 2020)
For UK[3]	Calendar year 2021 (i.e., from 1 January 2021)

FOOTNOTES

1. The option is given to use 'taxable period' in place of 'calendar year'. India has opted for this, so for India the term 'calendar year' will be read as 'financial year'.
2. UK follows the calendar year.
3. UK follows the calendar year.



Structure of MLI

The MLI consists of six parts, each containing articles that address a different BEPS issue. It is a flexible instrument, including opt-out provisions: rather than applying the article in its entirety, a country can choose from various alternatives. The MLI also provides for certain minimum standards (mandatory) to achieve the objective of BEPS Action Plans (see Table 3).

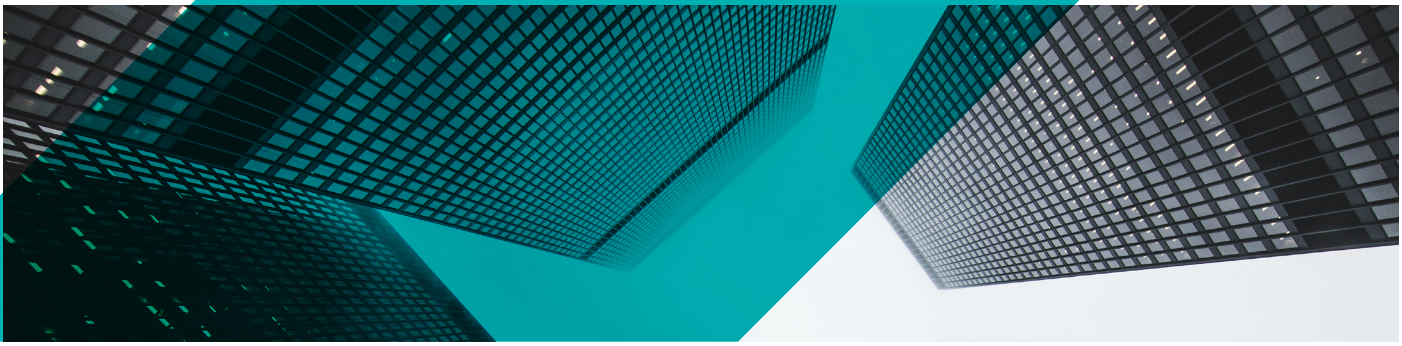
MLI: A flexible instrument

The MLI is a single instrument that aims to modify more than 3,000 treaties between various jurisdictions. It provides considerable flexibility for the jurisdictions implementing its provisions, by offering:

- **Choice of tax treaties to which the Convention applies (CTAs).** Countries are free to choose the bilateral tax treaties to which the MLI applies. Its provisions will apply only to those tax treaties where both parties have conveyed their intention for the treaty to be covered by the MLI.
- **Flexibility with respect to provisions that relate to a minimum standard.** Where a provision reflects a BEPS minimum standard, opting out of that provision is possible only in limited circumstances, such as where a party's CTAs already meet that minimum standard. Where a minimum standard can be satisfied in multiple alternative ways, the Convention does not give preference to a particular way of meeting the minimum standard.
- **Alternatives to provisions with respect to all/specific CTAs.** Countries are given the flexibility to opt out of certain provisions entirely (or, in some cases, out of a part of that provision). This is accomplished through the mechanism of reservations. A particular article of MLI will apply to a treaty unless the country

Table 3. Outline of the MLI structure

Part	MLI article no.	MLI article name	Mandatory/Optional
Part I – Scope and interpretation of terms	1	Scope of the convention	Applies to all CTAs
	2	Interpretation of terms	–
Part II – Hybrid mismatches	3	Transparent entities	Optional
	4	Dual resident entities	Optional
	5	Application of methods of elimination of double taxation	Optional
Part III – Treaty abuse	6	Purpose of a covered tax agreement	Mandatory
	7	Prevention of treaty abuse	Mandatory
	8	Dividend transfer transactions	Optional
	9	Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property	Optional
	10	Anti-abuse rule for permanent establishments situated in third jurisdictions	Optional
	11	Application of tax agreements to restrict a party's right to tax its own residents	Optional
Part IV – Avoidance of permanent establishment status	12	Artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies	Optional
	13	Artificial avoidance of permanent establishment status through the specific activity exemptions	Optional
	14	Splitting-up of contracts	Optional
	15	Definition of a person closely related to an enterprise	Optional
Part V – Improving dispute resolution	16	Mutual agreement procedure	Mandatory
	17	Corresponding adjustments	Optional
Part VI – Arbitration	18–26	Arbitration-related provisions	Optional



reserves the application of the article using the opt-out provision. Where one contracting party has notified while the other has reserved the application of a particular article of the Convention, the article in the treaty will remain unchanged.

Conclusion

The MLI is an innovative mechanism to implement BEPS Action Plans in a more coordinated manner; however, its flexibility has allowed some important treaty partners (such as the United States and Brazil), as well as some major treaties, to stay outside its purview. Initially, it was expected that the existing 3,000 bilateral treaties would be modified. However, among the agreements notified, around 1,100 tax treaties will be covered by the MLI. Because of its flexibility (allowing for opt-outs and alternate provisions, etc), interpretation of the MLI is going to be a tedious task. Time will tell how effective this entire BEPS project will be in preventing the tax avoidance it aims to address; nevertheless, the MLI is a commendable effort, allowing for unique interpretation of treaties by individual countries.

Country Focus
MALTA

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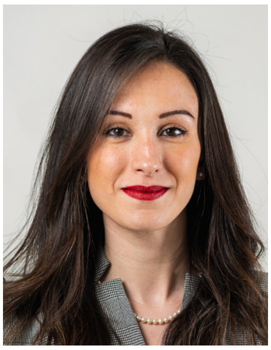


We are against the abuse of our tax system and I will declare that we did not create nor shall we create any opportunities for tax evaders or foreigners to live in Malta under one scheme or another to avoid tax here.[1]

Professor Edward Scicluna

The new ATAD (Anti-Tax Avoidance Directive) Implementation Regulations in Malta

Malta has always taken pride in having one of the most favourable tax regimes in Europe. However, it is by no means a country where aggressive tax planning is allowed. Its determination to curb tax abuse is evidenced by the implementation of the provisions of Directive 2016/1164,[2] which lays downs rules against tax avoidance practices that directly affect the functioning of the internal market. The establishment of these new provisions brings about some considerable tax policy changes to Maltese law, since they cater for a number of norms that were not previously contemplated within the Maltese tax legislation.

At the forefront of the new regulations, there is the **interest limitation rule** (which came into force on 1 January 2019), whose aim is to 'limit deductibility of taxpayers' exceeding borrowing costs' since companies tend to engage in base erosion and profit shifting (BEPS) through excessive interest payments. Essentially, this rule establishes a capping on the amount of borrowing costs[3] that a taxpayer may claim as deductible; these are capped at 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBIDTA). To soften the impact of these new regulations and avoid overburdening small and medium-sized enterprises, some exceptions apply to this general rule. A taxpayer may fully deduct exceeding borrowing costs

- if these amount to up to €3 million; and
- if the taxpayer is a standalone entity (i.e., an entity that is not part of a consolidated group for financial accounting purposes and has no associated enterprise[4] or permanent establishment [PE]). If the taxpayer forms part of a consolidated group, it may, subject to certain conditions, fully deduct its borrowing costs only if it can demonstrate that the ratio of its equity over its total assets is equal or higher than the equivalent ratio of the group.

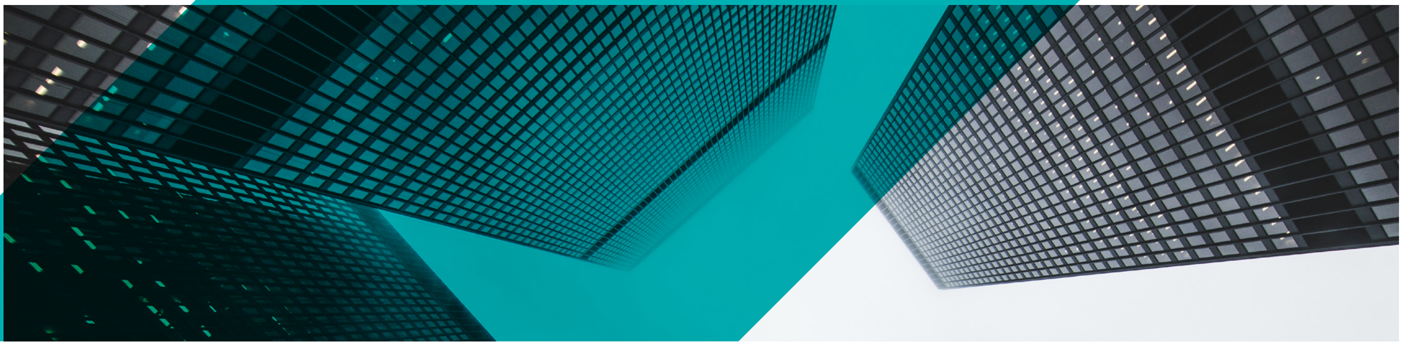
Moreover, financial undertakings, and costs incurred on loans concluded before 17 June 2016 or used to fund a long-term public infrastructure project, are excluded from the scope of such rules. Apart from these exemptions, any exceeding borrowing costs that cannot be deducted may be carried forward by the taxpayer and be deducted in future periods; furthermore, any unused interest capacity that cannot be deducted in a tax period may be carried forward for a maximum 5-year period.

The second innovative concept introduced in Maltese law is that of **exit taxation** (which will come into force on 1 January 2020), which is triggered when

- a taxpayer transfers assets from its head office or PE in Malta to a foreign PE or (as applicable solely to a Maltese PE) to its foreign head office, with the word 'foreign' here encapsulating both EU member states (MS) and third countries; similarly, when a taxpayer transfers the business carried on by its PE from Malta to a foreign state; and
- a taxpayer transfers its tax residence from Malta to a foreign state, except for those assets which remain effectively connected with a PE in Malta.

With regards to the first two scenarios, it is obligatory that Malta would no longer have the right to tax capital gains from the transfer of such assets due to the transfer.

The implementation of such rule, as found in the ATAD, may be viewed as controversial since it indirectly limits the fundamental movement of taxpayers within



the European Union; however, it also serves as an assurance that the latent gains that arise within a MS's jurisdiction are taxed accordingly. In Malta, such capital gains are calculated at an amount equal to the market value of the transferred assets, at the time of the exit of such assets, minus their value for tax purposes. Moreover, to lessen the burden this could place on certain companies, a taxpayer may defer the payment of such tax by paying it in instalments over 5 years – subject to the payment of interest and to the condition that, in the case of third countries, these must be party to the Agreement on the European Economic Area ('EEA Agreement'). However, if there is an actual risk of non-recovery, taxpayers may be required to provide a guarantee to secure the payment. Additionally, in certain cases, the deferral of payment is discontinued, and the tax debt becomes recoverable immediately.

Another ground-breaking rule introduced within Maltese law is the **controlled foreign company (CFC) rule** (which came into force on 1 January 2019). Essentially, such rule has the effect of reattributing deferred tax to the tax base of the controlling shareholder (in this case, Malta). The term 'controlling shareholder' here refers to the taxpayer who, by itself or together with its associated enterprises

- holds a direct or indirect participation of more than 50% of the voting rights; or
- owns directly or indirectly more than 50% of capital; or
- is entitled to receive more than 50% of the profits of that entity.

This definition is significant, as it achieves a certain level of fairness by omitting from the ambit of the rules minority shareholders who do not have real ability to influence a foreign company.

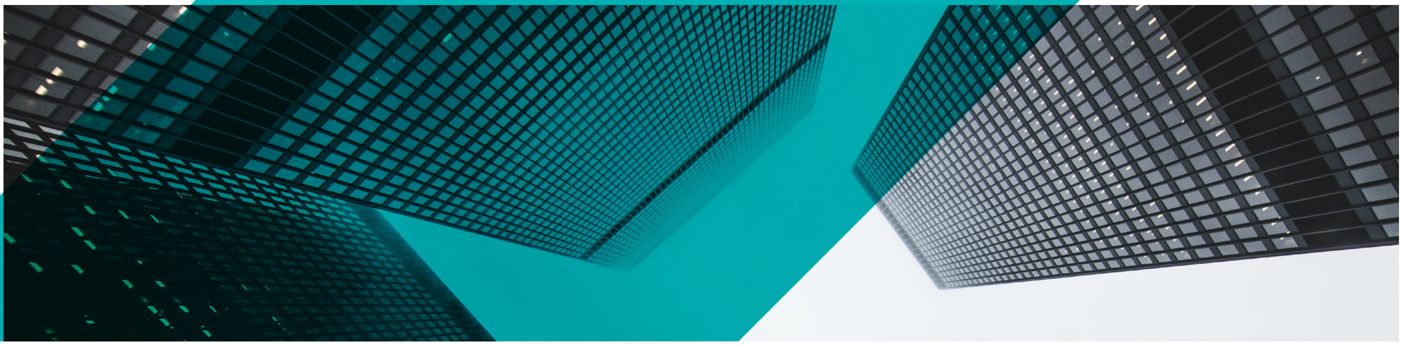
Following the prerequisite of control, a low tax threshold requirement is also established clarifying that in order for CFC rules to come in play, the corporate tax paid by the entity or PE must be lower than the difference between the corporate tax that it would have been charged with under the Maltese Income Tax Act[5] and the actual corporate tax it has paid on its profits. In other words, the actual tax paid must be less than half of what the taxpayer would have been obliged to pay in Malta. Moreover, a quantitative threshold is also implemented by which an entity or a PE would be excluded from the CFC rule, if

- its accounting profits amount to €750,000 or less, and its non-trading income add up to €75,000 or less; or
- if its accounting profits amount to 10% or less of its operating costs for the tax period.

After establishing that a foreign company is a CFC, the question that naturally follows is: Which income of the controlled entity is to be included in the tax base of the controlling shareholders at the end of the entity's tax year? Here, Malta has opted for the transactional approach and thus, a CFC has to include in the tax base of the taxpayer the non-distributed income of the CFC arising from 'non-genuine arrangements' that have been executed with the objective of obtaining a tax advantage. Notably, an arrangement can only be regarded as non-genuine to the extent that CFC 'would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people functions' take place, which functions are fundamental in generating the controlled company's income. With this approach, the income to be included in the tax base of the taxpayer is to be limited to those amounts generated through the said assets and risks which are attributed to the significant people functions of the controlling company; these amounts then have to be calculated in accordance with the arm's length principle.

Lastly, there is also the **general anti-abuse rule (GAAR)** (which came into force on 1 January 2019), which overlaps and enunciates the existing GAAR in Article 51 of the Maltese Income Tax Act. In simple terms, where a scheme that reduces the amount of tax payable by the company is deemed to be artificial, the Commissioner of Inland Revenue may disregard it and the taxpayer shall be subject to tax accordingly. An arrangement, or series thereof, shall be considered to be non-genuine to the extent that they are not put into place for valid commercial reasons that reflect economic reality.

In order to determine the effect that these rules are going to have on the Maltese



economy and on the internal market in general, one should adopt a 'wait and see' approach. We are very much in unchartered waters; and to worsen matters, no formulation of an ATAD impact assessment was made by the European Commission, with the reason that it gave being that there was 'an urgent current demand for coordinated action in the EU on this matter of international political priority'.[6] However, notwithstanding the uncertainty revolving around the impact of these rules, Malta and the other MS should strive to work in harmony with each other, taking each other's interests into consideration as well as the interests of the internal market. The implementation of such a Directive is already a big step forward, as it represents an acceptance among MS of sovereignty limitation over certain tax issues. Coordinated action among MS is all that is needed for such laws to bear fruit and to achieve their aim of restricting tax avoidance, without creating any loopholes.

REFERENCES

1. Professor Edward Scicluna is an economist and is the current Minister for Finance and a Member of the Maltese House of Representatives.
2. Directive 2016/1164 was adopted by the Council of Europe on 12 July 2016 and was transposed into Maltese law in December 2018 by means of Legal Notice 411. The title of these new regulations is the 'European Union Anti-Tax Avoidance Directives Implementation Regulations, 2018'.
3. Borrowing costs are broadly defined in the new Regulations and include, among others: interest expenses on all forms of debt; payments under profit participating loans; and imputed interest on instruments such as convertible bonds and zero coupon bonds. For a full list, see Article 3 of the new regulations at http://justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=29405&l=1.
4. As defined in the ATAD and in Maltese legislation, an 'associated enterprise' is: '(a) an entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25% or more or is entitled to receive 25% or more of the profits of that entity; or (b) an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in a taxpayer of 25% or more or is entitled to receive 25% or more of the profits of the taxpayer'.
5. Chapter 123 of the Laws of Malta.
6. 'Proposal for a Council Directive Laying Down Rules Against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market' (COM (2016) 26 – 2016/011 (CNS)) 6.

Country Focus NIGERIA

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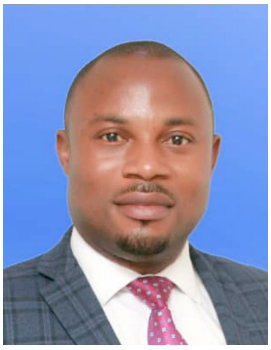


Nigeria issues guidelines for cross-border tax disputes resolution

Background

The Organisation for Economic Cooperation and Development (OECD) published Base Erosion and Profit Shifting (BEPS) Action Points in 2013. The 15 Action Points are aimed at providing solutions to the global problem of double non-taxation arising from various anti-avoidance strategies of multinational entities, enabled by the inadequacies of traditional principles of international taxation. These traditional principles include the use of double tax avoidance treaties signed by two countries.

BEPS Action Point 14 calls for effective dispute resolution mechanisms and provides a minimum standard that requires all member states to publish Mutual Administrative Procedure (MAP) guidance. The MAP guidance would identify the specific information and documentation required of a taxpayer for MAP assistance.

To ensure that taxpayers have access to MAP, Action Point 14 requires each jurisdiction to ensure that their tax treaties contain a MAP provision which provides that when a taxpayer considers that the actions of one or both of the contracting parties result or will result in taxation not in accordance with the provisions of the tax treaty, the taxpayer may, irrespective of the remedies provided by the domestic law of those contracting parties, make a request for MAP assistance; and that the taxpayer can present the request within a period of not more than 3 years from the first notification of the action resulting in taxation not in accordance with the provisions of the tax treaty. In compliance with this requirement, the Nigerian Government through the Federal Inland Revenue Service (FIRS) issued guidelines on MAP on 21 February 2019. These were issued to provide guidance to all taxpayers, taxpayers' representatives or advisers, tax officers, all other stakeholders and the general public on the procedure for accessing MAP as a means of dispute resolutions, pursuant to the double taxation agreements (DTAs) between Nigeria and other countries, and to provide guidance to any taxpayer intending to explore the provisions of Article 25 of the Nigerian – OECD/UN model tax treaties.

Fulfilling Article 25 of Nigerian Tax Treaties

Nigeria currently has tax treaties with 13 countries: Belgium, Canada, China, Czech Republic, France, Italy (air and shipping), the Netherlands, Pakistan, the Philippines, Romania, the Slovak Republic, South Africa and the United Kingdom.

Article 25 of Nigerian Tax Treaties provides for MAP. The Article on MAP allows a person who is affected by the wrong decision of a competent authority (CA) of a treaty state to present an objection to the CA of either state. Where the objection is valid and the CA cannot arrive at a satisfactory solution, the two CAs are allowed by the Article to resolve the case by mutual agreement with a view to avoid double taxation.

Who can apply for MAP

The categories of people/taxpayers who can explore MAP include Nigerian residents and non-residents affected by the applicable tax treaty provisions.

Instances requiring assistance of competent authority in Nigeria

- **Transfer pricing (TP).** Due to TP adjustments, a taxpayer resident in Nigeria or its related party in a treaty country may be subject to additional tax; thus, the CA may grant a corresponding adjustment to the taxable income to prevent double taxation.
- **Dual residence status.** In order to avoid double taxation on the same income in two contracting states, a taxpayer may request MAP to trigger discussions between the CAs to determine the proper application of relevant Articles that deal with residency in the tax treaty.
- **Permanent establishment.** Where a taxpayer is taxed on income earned in a treaty country despite not having a permanent establishment in that country, it may apply to the Nigerian CA to address such an issue to avoid double taxation.

MAP negotiation is a country-to-country process and does not directly involve a taxpayer. The taxpayer's role in the MAP process is limited to presenting its views and assisting in the fact-finding without participating in the negotiation process.

- **Classification of income.** The Nigerian CA may be approached for clarification in cases where there are ambiguities as to whether a specific type of income arising in another jurisdiction is covered under the treaty.

Procedure for assessing MAP

Pre-filing consultation

A taxpayer seeking MAP is required to first carry out a pre-filing consultation with the CA, either in person or via written correspondence. At the pre-filing consultation stage, the taxpayer needs to present documents providing a summary of the taxation in question, describing the facts that led to such a tax and explaining the reasons for the MAP request. The document must be in English.

Where the outcome of the pre-filing consultation is successful and merits MAP, the authorised CA then informs the taxpayer to submit a formal request. All formal requests for MAP should be made in writing, within the specified time limit in the MAP Article of the tax treaty under which the MAP is invoked. Where the time limit for presenting a case to invoke MAP is not specified in the relevant tax treaty, the CAs of the contracting states will agree the applicable time limit. Nonetheless, the case must be presented to the Nigerian CA within 3 years from the first notification of the action resulting in the tax dispute.

Submission of a formal request

The formal request for MAP in writing is to be addressed to the Executive Chairman or Director of Tax Policy of FIRS. The request should contain information about the taxpayer, the Treaty Article(s) in dispute, the period involved and other relevant information that will assist the CAs in the MAP. The Nigerian CA may deny the request where the taxpayer failed to provide complete and accurate information or has made any misrepresentation.

Review and acceptance of request:

After receiving a request for MAP, the authorised CA or their representatives will evaluate the request and where there are deficiencies in the request, the authorised CA may request the taxpayer to take remedial action. Where the deficiencies cannot be remedied, the authorised CA shall reject the request, stating the reason, and notify the taxpayer in writing.

The Nigerian CA accepts the MAP request where

- the issue in dispute relates to a foreign country with which Nigeria has a tax treaty;
- it is clear that the actions of one or both countries deviated or will deviate from the provisions of the Treaty;
- the request for MAP is submitted to the CA within the time allowed in the relevant tax treaty; and
- the issue is not one that had already been decided by Nigerian CA or the treaty partners.

Notification and commencement of MAP negotiation

The Nigerian CA notifies the CA of the treaty partner when unable to resolve the issue independently and a MAP is required to be initiated. Where the two CAs have accepted the case for MAP consideration, the authorised CA notifies the taxpayer of the commencement of MAP negotiations.

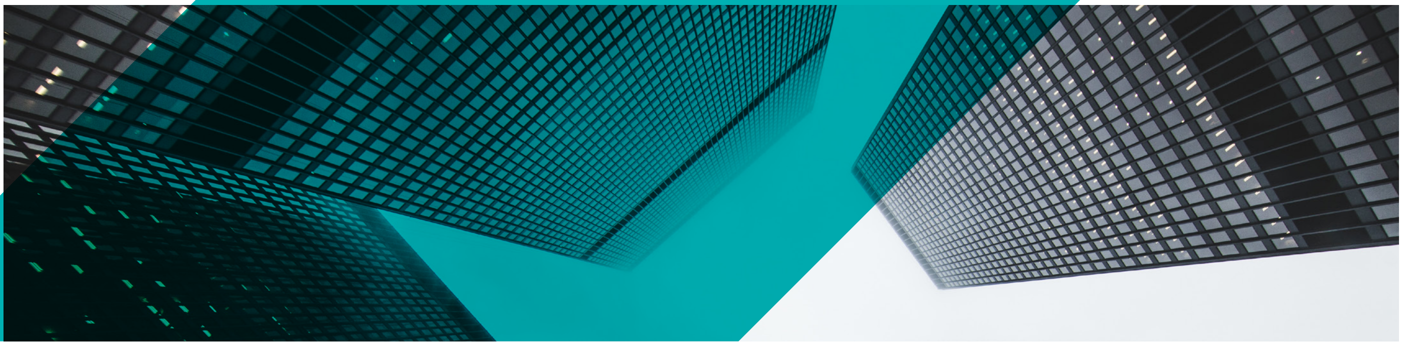
Roles and responsibilities of taxpayer in MAP process

MAP negotiation is a country-to-country process and does not directly involve a taxpayer. The taxpayer's role in the MAP process is limited to presenting its views and assisting in the fact-finding without participating in the negotiation process. However, the taxpayer may be invited by the CAs to make a presentation on common understanding of the facts of a case.

An affected taxpayer is responsible for providing the Nigerian CA with accurate information and documentation needed for the MAP negotiation. Timely provision of these is very important for equitable and expeditious conclusion of the case.

Termination of MAP

Nigerian CA may propose to the CA of a treaty partner that the MAP process be terminated. The termination may be as a result of non-cooperation from the taxpayer in providing information necessary for MAP, the issue not being within MAP scope or any



other reason that is deemed sufficient by the authorised CA to discontinue the process.

Alternatively, a taxpayer who has instituted a case for MAP may withdraw voluntarily by informing the Nigerian CA in writing of their decision to discontinue the MAP process. The Nigerian CA shall notify the CA of the treaty partner of the withdrawal of the MAP by a taxpayer.

MAP statistics

The 2017 statistics show that Germany had the highest number of MAP cases, with 1,241 cases as at the end of 2017. A few African countries, such as Angola and the Democratic Republic of Congo, recorded zero cases resolved through MAP.

As evident from the statistics, transfer pricing cases account for most of the issues resolved through MAP. On average, such cases take around 30 months to resolve, while other cases are estimated to be resolved within 17 months.

In 2016, statistics show that more than 85% of issues sought to be resolved through MAP were concluded. Out of these concluded cases, 60% were resolved with an agreement fully resolving the taxation not in accordance with the tax treaty, almost 20% were granted a unilateral relief, while about 5% were resolved via domestic remedies. On the other hand, 5% of the unresolved MAP cases were withdrawn by taxpayers, while about 10% remained unsolved for various reasons.

Conclusion

The introduction of MAP as an alternative tax dispute resolution mechanism has evidently facilitated the settlement of tax disputes between two or more countries without resort to the judicial method. This has consequently encouraged foreign investments between countries that have tax treaties, since issues that may arise therein could easily be resolved through MAP.

It is anticipated that taxpayers will rely on the provisions of the recently issued guidelines to resolve disputes arising from tax treaties through MAP, thus giving investors the certainty required for investing in Nigeria. This in turn puts the country at the forefront while harnessing its potential in the global community.

It is also expected that Nigeria, as the largest economy in Africa, will enter into tax treaties with more countries in order to develop its economic standpoint, as well as ratify those treaties which have been signed, such as with South Korea and Mauritius.

The tax dispute resolution mechanism is also expected to be fully operational considering the aggressive tax drive by the Nigerian CA and with the full implementation of the Transfer Pricing and Country-by-Country Reporting Regulations that became effective from 2018 financial year.

Country Focus
UNITED STATES

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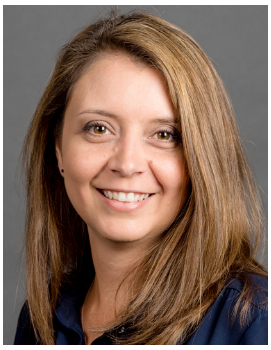


California's new use tax collection requirements: What the Wayfair ruling means for retailers

With online retail becoming the preferred method of shopping in America, it was only a matter of time until states would start demanding their share of the sales pie. Unlike purchases in a physical store location, loopholes let bargain buyers purchase online goods from out-of-state or out-of-country retailers without having to immediately pay state and local taxes.

However, in the wake of a sweeping United States Supreme Court case, the State of California has announced that as of 1 April 2019, out-of-state and out-of-country retailers will be required to collect and remit sales tax for goods sold online to customers within California.

What changed

California's new rule materialised shortly after the US Supreme Court ruled in favour of South Dakota collecting taxes from the online retail giant, Wayfair, in the June 2018 case of *South Dakota v. Wayfair, Inc*. Prior to the ruling, states were limited in their ability to collect tax on transactions with businesses that did not have a physical presence in the state.

While the new tax rule does not create or increase taxes, it will require more businesses to collect and remit taxes in the same way that traditional brick-and-mortar retailers have always done.

As of 1 April 2019, certain out-of-state and out-of-country retailers are required to register with the California Department of Tax and Fee Administration (CDTFA), collect California sales tax and remit taxes to the CDTFA regardless of having a physical presence in the state. The new rule is effective for all taxable sales on or after 1 April and is not retroactive.

It's important to note that the new rule expands the requirement to collect and remit taxes into the local districts. The rule will not only impact out-of-state and out-of-country sellers, but also California-based sellers, who will now have to comply with the sales tax collection and remittance for the hundreds of different city, county and local sales and use tax jurisdictions in California.

Who is affected?

The new rule mimics South Dakota's ruling and applies to businesses with more than $100,000 in annual sales from California, or businesses with more than 200 transactions in the state within the preceding or current calendar year. California district taxes will be triggered when these thresholds are met in a particular jurisdiction. Impacted retailers include all those selling tangible goods into California from anywhere in the world, including via internet, mail-order catalogues and telephone.

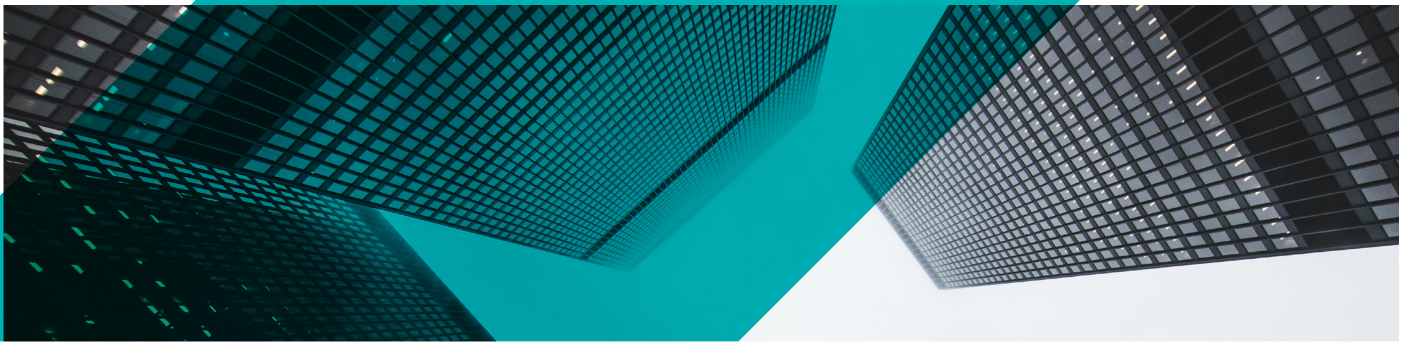
What retailers need to know

With as many 30 states having proposed (or having already passed) similar tax changes, retailers will have to pay attention to the particular nuances outlined by each state in which they sell. Many of the states have varying thresholds, including different values and definitions of key metrics.

For example, Georgia mandated a $250,000 annual sales threshold or 200 transactions, while Massachusetts set a threshold of $500,000 in annual sales plus at least 100 individual transactions. Retailers will need to know every state's individual rules and accurately track their sales within each state to know where their numbers stand. Failure to comply opens up the potential of audits, interest and even penalties.

Depending on the state, retailers could be required to begin collecting sales tax the moment they surpass the designated threshold. Retailers should ensure their numbers are up-to-date and they have the means to immediately comply with the rules. Automated tax technology could be a huge asset for collecting, remitting and filing sales taxes in multiple states.

Although many states have responded with similar rules after the Wayfair ruling, California's adoption is especially significant because it is the fifth-largest economy in the world and home to a whopping 40 million



residents. Some state officials estimate that the state could collect as much as $1 billion of taxes a year from out-of-state and out-of-country retailers.

Ultimately, the Wayfair ruling has created the opportunity to level the tax playing field between traditional retailers (brick-and-mortar) and online retailers. As more states continue to adopt rules similar to South Dakota, we can expect to see more clarification and guidance coming from tax authorities as the year unfolds.

International Tax Cases

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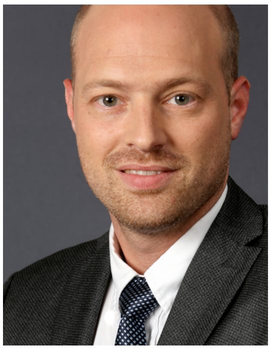

Tax Assessor for Large Enterprises v. Rosebud Real Estate Ltd and Rosebud Assets (Europe) Ltd – Civil Appeal Number 10241/17 (25 February 2019)

Facts of the case

Rosebud, a public company, heads a group of companies that invest in real estate outside Israel. The public company held foreign companies that held real estate assets abroad and sold the same real estate assets.

The issue in dispute is whether the revenue from the sale of assets is income of a business nature, or alternatively capital gains.

If this is a capital gain, then there is an impact on the taxation method of the companies because then the income will be taxed as passive revenues that meet the tax conditions of a foreign controlled company (CFC).

Contention of the taxpayer

The company claimed that this is a business activity of holding real estate and therefore is not a CFC. Sales of assets through the subsidiaries constitute income from a business and are not passive income, and the entire structure of the companies must be examined as one group and not to look at each company on its own.

Contentions of the tax assessor

In the opinion of the income tax authority, all sales of the assets through the subsidiaries constitute passive income and each company must be examined on its own as a capital gain that should be classified as passive income; therefore, the tax authorities sought to apply the applicable tax regime to a CFC.

Supreme Court decision

The Supreme Court ruled on this matter and reversed the ruling handed down by the District Court earlier. The Court's ruling was as follows:

- A fundamental principle of Israeli corporate taxation is that a company is a separate tax unit. For this reason, the group of companies cannot be viewed as a single business venture.
- Each company must be examined in its own; therefore the sale of the assets is a sale that generates capital gains for tax purposes, which are passive income and therefore a CFC tax regime applies.

International Tax Cases

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Administrator of Estate of Lt. Edulji Framroze Dinshaw v. CIT, Mumbai [ITA No. 1033/Mum/2018] reported in 103 taxmann.com 452

Facts of the case

In 1972, Mr Nusli Wadia was appointed administrator of an estate that had an NRI beneficiary, and since then has regularly complied with the income tax requirements, including filing the tax return. The estate (the assessee) regularly followed the cash system of accounting in respect of the income earned by it, reporting this under 'Income from Other Sources'; and this was accepted by the tax office in all the assessments, including the assessment for the assessment year (AY) 2013–14 conducted by the assessing officer (AO) under section 143(3) of the Act.

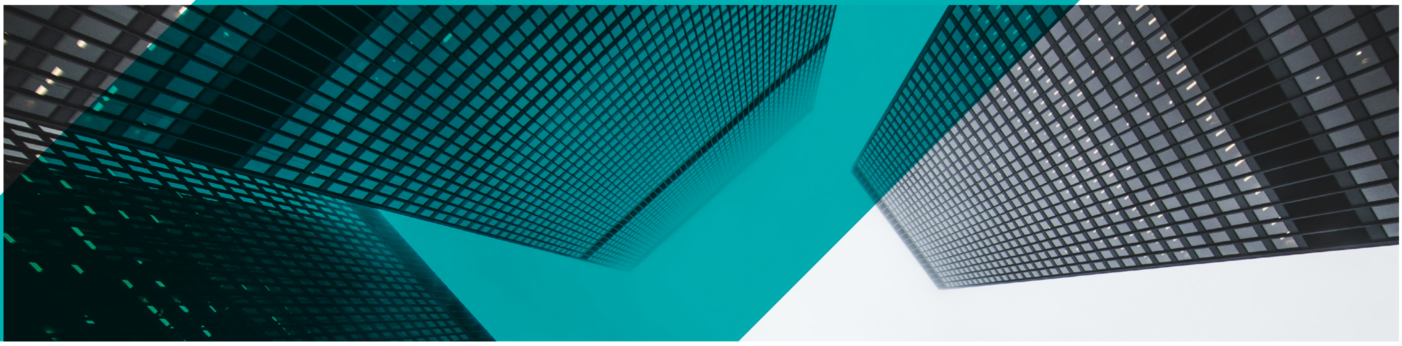
This estate possessed vast tracts of land in Northern Mumbai. In 1995, the estate decided to develop a large land parcel via a joint development agreement (JDA) with M/s Ferani Hotels Pvt. Ltd. It was agreed that, in consideration of the estate granting rights of development in favour of Ferani, the estate would receive 12% of the sale price that would be realised upon sale of spaces constructed by Ferani on the demarcated land. The JDA anticipated that the sale of constructed spaces would be carried out by Ferani to independent third parties and not to parties that were related to, or acted as fronts for, Ferani to depress the actual sale price.

Pursuant to a specific audit conducted after the construction commenced and Ferani started conducting sales of developed areas, it came to the knowledge of the estate that in many cases, the sale of constructed spaces was not made to genuine third parties, but rather to companies closely connected with or promoted by Ferani. Since the JDA became tainted with this fraudulent act committed on the part of Ferani, the estate filed a suit before the Bombay High Court seeking reliefs *inter alia*, including restitution of the property in the original form. This suit was pending verdict as of AY 2013–14.

Despite the fact that that the estate terminated the JDA and filed suit in the Bombay High Court in 2008, Ferani continued to construct new buildings on the demised land. Ferani also continued to execute registered Agreements for sale of the constructed spaces on behalf of the estate administrator, even though the registered power of attorney granted in favour of Ferani was revoked by the administrator. Prior to termination of the Agreement in 2008, when Ferani was entering into Agreements for sale with prospective flat purchasers, 12% share of the sale value was being deposited in an account with ICICI Bank, which was maintained by estate for collection purposes. Upon termination of the JDA in May 2008, the administrator had instructed ICICI Bank not to accept deposits being 12% share of the sale proceeds receivable under the JDA. Since neither the estate nor its banker (ICICI Bank) was receiving or accepting the payment of 12% share of the sale proceeds, Ferani *suo motu* opened a current account with Indian Bank (Bandra Branch, Mumbai) in the name of 'Ferani Hotels Pvt. Ltd – NN Wadia share' and operated this account with its signatories. The administrator was never informed of this, and only discovered the account existed in 2012 when statements were supplied from it to the Bombay High Court.

The Annual Information Report (AIR) data available with the AO indicated that the impugned Indian bank account contained 10 entries during AY 2013–14, totalling INR 40 million indicating payment of interest and Tax Deducted at Source (TDS) thereon. The Commissioner of Income Tax (CIT) therefore concluded that the interest of INR 40 million paid by Indian Bank should have been assessed in the assessee's hands for the AY 2013–14. Owing to the AO's failure to include such interest in the total income of the assessee, the CIT treated the AO's order as erroneous and prejudicial to the interest of the Revenue, and revised the order accordingly.

It is against this order that the assessee filed an appeal before the Mumbai Income Tax Appellate Tribunal (ITAT).



Contentions of the assessee

The assessee made the following key submissions:

- Ferani had admitted before the High Court that Ferani had opened the current account with Indian Bank and that it had collected and deposited the sum of INR 570 million into the account. In its interim order, the High Court had directed that pending hearing and final disposal of the preliminary issue, Ferani would maintain the accounts and continue depositing an amount equivalent to 12% of the gross sale consideration in the designated bank account.
- The moot suit filed by the assessee was pending disposal before the High Court.
- Nowhere in the interim order had the High Court, in any manner, expressed any opinion or made any observation that the moneys deposited by Ferani in the designated account could be appropriated by the estate or that the estate could exercise contract or domain – either over the amounts deposited in the designated account or over the fixed deposits made by Ferani out of the sums deposited in it. Nowhere had the Court even indicated that in its opinion, the estate could have any access to the sums collected by Ferani. Thus, as the assessee had sought restitution of the property in its original form, the court had categorically directed that the amounts invested by Ferani in fixed deposits would abide by the further orders of the judge trying the moot suit filed by estate.
- Even the CIT had acknowledged in the show cause notice under section 263 of the Act, as follows: 'Even though the amount is not accessible to assessee, as per Court Order it is paid/accrued to assessee in his bank account'.
- Hence, once the CIT admitted that the amount deposited in the designated account, or fixed deposit made out of it, was not accessible to the assessee, then he could not record a conclusion that the assessee was liable to account the amount received in its books.
- The CIT was factually and legally wrong in holding that, as per the Court Order, the amount was paid to the assessee in his bank account. The interim judgment of Bombay High Court nowhere even suggested that the sums deposited in the designated account, or the fixed deposits made out of it, constituted the amount paid to the assessee. Accordingly, the CIT concluded that the decision that interest on fixed deposits was chargeable to tax in the hands of the estate was wrong.
- Even from the perusal of the assessment order under section 143(3) of the Act, it was apparent that the AO had conducted an enquiry before completion of the assessment. The AO had issued notices under section 133(6) of the Act to Ferani, as well as Indian Bank, and obtained the required information.

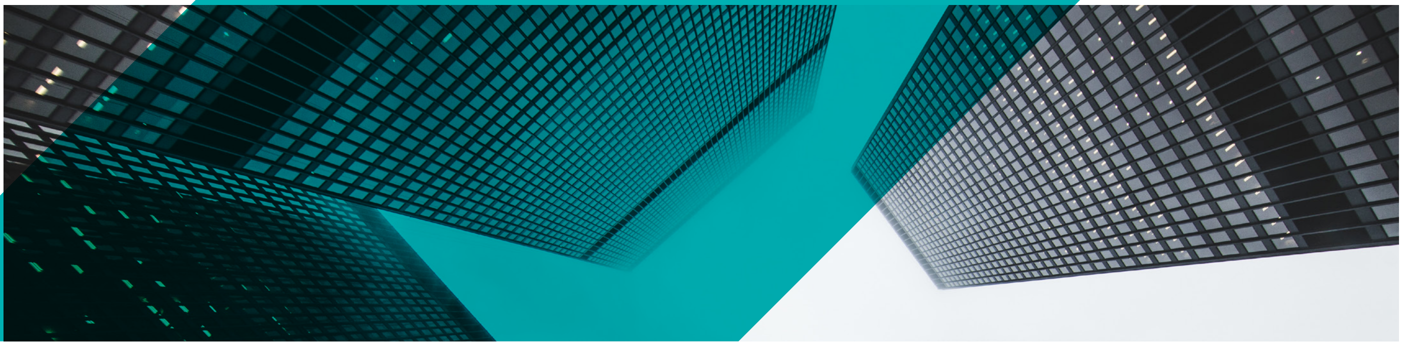
Therefore, the assessee contended that the impugned interest income derived from the Indian bank account was not exigible to tax in its hands.

Contentions of the Revenue

Per contra, the Revenue vehemently canvassed from the CIT's order and argued that the details received from Indian Bank, Bandra Branch under section 133(6) of the Act revealed that the interest received from the said bank account was as per the directions of the High Court opened by Ferani because the account was in the name of 'Ferani Hotels Pvt. Ltd – NN Wadia share'. Since this interest income was not brought to tax in the assessment order of the AY 2013–14, there had been under-assessment of the total income of the assessee by INR 40 million and hence, the assessment order was erroneous and prejudicial to the interest of the Revenue. Further, the Revenue argued that even in AY 2014–15, similar additions were made in regular assessments. Crucially, the Indian Bank deducted TDS from the impugned interest payments and credited the same to the PAN of the Estate, based on Ferani's directions.

Observations and ruling of the ITAT

The ITAT stated that an amount/receipt was assessable as income of an assessee only on the basis of charging provisions of sections 4



In its landmark ruling in the case of UCO Bank v. UOI [reported in 369 ITR 335], the Apex Court held that where interest on FDRs were paid to the Registrar General of a High Court, TDS under section 194A did not apply

and 5 of the Act. Section 4 was the charging provision of the Act, and it was therefore necessary for the AO/CIT to prove that the receipt – though received by some other person – constituted income chargeable to tax in the hands of the person sought to be charged. If, under the provision of section 4, an amount did not bear the character of income and was therefore not exigible to tax, then the same could not be converted into an 'income' just because the payer of the sum deducted tax under misconception of law.

The ITAT also noted that the directions of the Bombay High Court made it clear that the deposits kept with the bank essentially constituted funds in *custodia legis*.

Also, in view of the fact that the AO had issued notices under section 133(6) of the Act to Ferani as well as Indian Bank and obtained the required information, there was no failure on the part of the AO to conduct proper enquiries and gather relevant information before completion of assessment. The CIT had not brought on record any cogent and conclusive material that would prove or show that the course followed by the AO (of not taxing the impugned interest income in the estate's hands, since the bank account was in Ferani's name) was unsustainable in law.

Therefore, the ITAT concluded that it was not open for the CIT to treat the assessment order as being erroneous within the meaning of section 263 of the Act, and thus set aside the order passed by CIT – i.e., holding in favour of the assessee.

Comments

We consider that the correct way to resolve such cases would be to tax such interest in the hands of the person *who was entitled to demand and to receive the income*. The conclusion reached by the ITAT would seem appropriate, given that

- the assessee had no enforceable demand on the Indian bank account and its contents
- the estate administrator could not operate the bank account
- the account was being maintained under the court's custody.

In its landmark ruling in the case of *UCO Bank v. UOI* [reported in 369 ITR 335], the Apex Court held that where interest on deposits were paid to the Registrar General of a High Court, TDS under section 194A did not apply, since the Registrar General was merely the custodian of the funds on behalf of the High Court and the Registrar General *per se* was neither an assessee nor a beneficiary entitled to receive any interest on the fixed deposits. The Apex Court held that the Bank had no obligation to deduct tax at source because

- the Registrar General was not the payee of the interest, since the deposits kept with the Bank under the court's order essentially were the funds in *custodia legis*;
- therefore, even interest credited to the Registrar General formed part of the funds under the custody of the court; so
- the funds were not liable to be taxed as income of the Registrar General in whose name the fixed deposit was made.

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Equalisation levy

Introduction

The digital economy in India is growing at a rapid pace, significantly faster than the global economy as a whole. Every individual as well as corporation is in receipt of some kind of digital service provided by non-resident entities. The various evolving business models include e-commerce, online advertising, app stores, online payment modes and social media. Online advertising forms an integral part of the expeditious growth of the digital economy. While new technological developments have brought about great innovation, they have also created a whole new set of challenges for the purpose of taxation.

The digital business fundamentally challenges the current manner of levy of taxes which are based on the presence-based permanent establishment rules in India. Taxing digital business becomes complex due to its intangible nature and catering to customers who may be located anywhere in the world.

A paradigm shift is taking place as the income tax authorities grapple to tax the income of companies engaged in providing digital advertising space for online ads, where this is held to be not chargeable to tax in India.

The dawn of equalisation levy

Equalisation levy was introduced through the Finance Act, 2016 in light of the report on Action Plan 1 of the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) project and was made applicable in India with effect from 1 June 2016.

Notably, in BEPS Action Plan 1, equalisation levy was proposed as one of the modes of taxation of digital transactions, but the same was not covered in the final BEPS Action Plan 1 released by the OECD. Nevertheless, India introduced 'equalisation levy' through Chapter VIII of the Finance Act of 2016. It does not form a part of the Income Tax Act, 1961: it is a levy introduced to bring to tax payments made for online advertisement services.

In India, equalisation levy has also come to be known as 'Google tax' – mainly due to the bulk of online advertising income earned by the search engine giant, Google, but also because the levy is expected to impact the bottom lines of giants like Google, Facebook, Twitter and other overseas companies providing digital services in India. These companies generated huge tax revenues to the Indian government, through taxes collected on their income earned from local advertisers in India during the financial year 2017–18.

Timeline of introduction

July 2013	OECD published Action Plan 1 on BEPS
Sept 2013	The Task Force on Digital Economy with representatives of OECD & G-20 countries was established
Sept 2015	Task Force issued the Final report that was endorsed by OECD & G-20 countries
Feb 2016	Committee on taxation of ecommerce, constituted by CBDT, issued its report
Feb 2016	Finance Bill, 2016 proposing EL was introduced
May 2016	EL was made effective w.e.f. 1st June 2016 and Rules were announced

Taxation under equalisation levy

Charge of equalisation levy

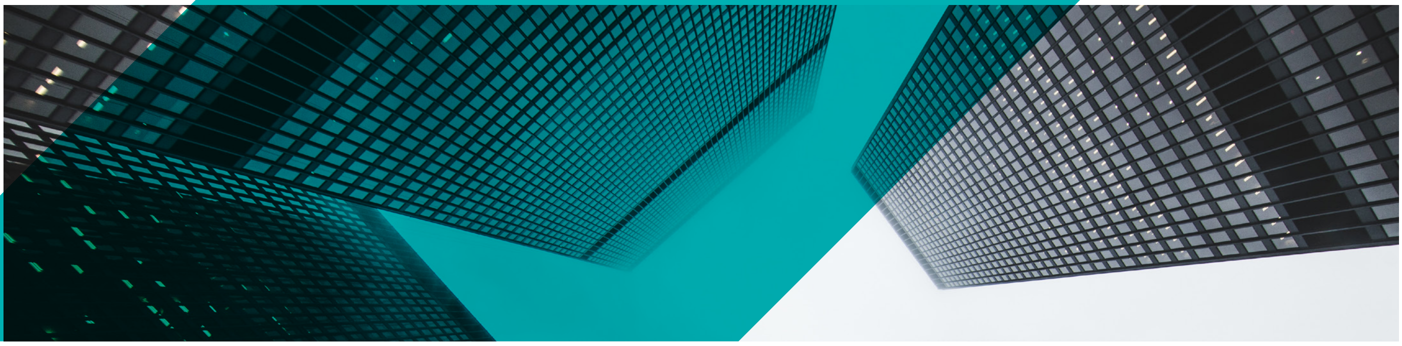
Section 165 deals with the provisions related to the charge of equalisation levy. Equalisation levy shall be charged at 6% of the amount of consideration payable, for any specified service received or receivable from a non-resident, by

- a person resident in India carrying on any business or profession; or
- a non-resident having permanent establishment in India.

'Specified services' (i.e., the services covered under equalisation levy) here are

- online advertisement,
- any provision for digital advertising space or any other facility or service for the purpose of online advertisement, or
- any other service declared by the central government.

The imposition of equalisation levy is exempt when



- the non-resident providing a specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment; or
- the specified service utilised in India is not for the purpose of carrying out business or profession (i.e., it is used for a personal purpose); or
- the aggregate amount of consideration payable for the specified service received or receivable does not exceed INR100,000.

Procedural aspect

Equalisation levy is required to be deposited by the 7th day of the immediately following month. A statement containing details of equalisation levy is also required to be supplied on or before 30 June following the end of the relevant financial year.

Penalties

Particulars	Penalty
Delay in payment of equalisation	Simple interest at 1% per month
Failure to deduct equalisation levy	Amount equivalent to equalisation levy
Failure in payment of equalisation levy after deduction	INR1,000 per day during which failure continues } Whichever is lower Amount of equalisation
Failure in furnishing the statement	INR100 per day until such failure continues

Other tax implications

- A new sub-clause (ib) has been inserted in section 40(a) of the Income Tax Act stating that if the consideration paid for a specified service on which equalisation levy was leviable is not deducted, or has not been paid, before the due date of filing the return of income after deduction, those expenses shall not be allowed as deduction.
- Income that is subject to equalisation levy shall not be included in the total income of the payee (such as Google, in the above example) in terms of section 10(50) of the Income Tax Act – that is, they shall be exempt in the hands of the payee.

Interesting facts that would merit consideration

- The reference of threshold limit of INR100,000 is applicable to both payer and payee in each financial year.
- The equalisation levy rate should not be increased by surcharge or education cess in the absence of any such provision.
- In case of composite contracts, the payer must make a fair and reasonable allocation of the consideration for determining which part is liable for equalisation levy.
- No exemption will be provided for the services used outside India, if the payment is made by a resident.

Issues currently surfacing

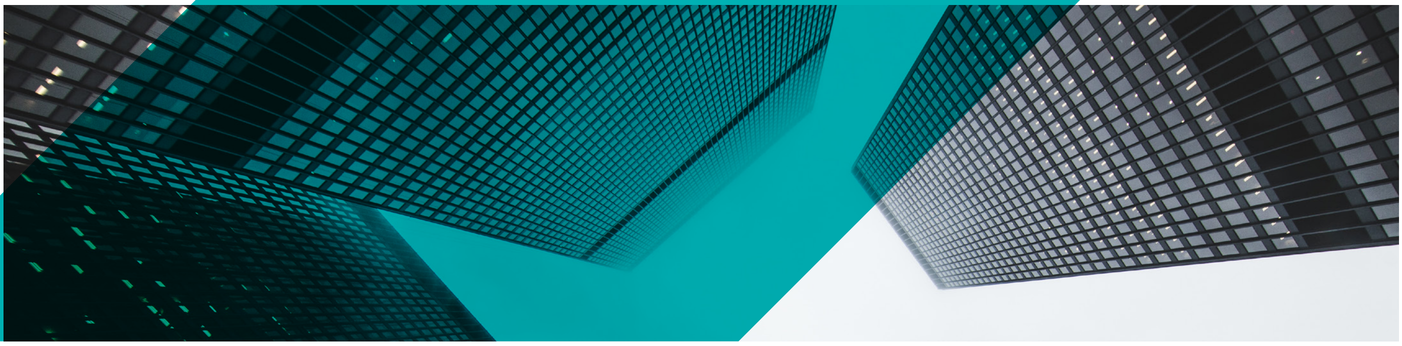
- The person paying the consideration is under obligation to pay tax. The burden of payment of tax might get shifted towards the remitter, as the non-resident payee might demand consideration net of tax.
- Advertising is essential if new businesses are to become profitable. As tax is imposed on online advertisement, new businesses might incur higher break-even levels.

No foreign tax credit available

Equalisation levy was introduced to collect taxes from certain specified digital services, such as online ads. It was introduced as a separate chapter in the Finance Act, administratively linking it to direct tax laws. But there is lack of clarity regarding whether equalisation levy is direct tax, so a non-resident online advertisement service provider cannot claim foreign tax credit in respect of the equalisation levy deducted and deposited by an Indian payer. Consequently, the Indian payer might in some cases (where grossing up is required) have to bear the economic burden of equalisation levy.

Conclusion and the road ahead

The institution of equalisation levy is a step by the Indian government to tax digital transactions, and it will help the Indian government considerably to increase its tax revenues – especially when the digital economy in India is targeted to smash the US$ 1 trillion mark by 2025. On the surface, the impact of the levy on the domestic economy may be less as it is targeted



at foreign players who derive significant revenues from India without having a tax base. The levy still has the potential to impact Indian businesses, as foreign players may simply shift the burden onto the Indian payer (requiring grossing up the invoice). What could be significant in the future is the inclusion of new categories of services to this levy, and the government's approach to resolving the issues arising on actual implementation.

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The Next Step

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