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Global Tax Insights

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EDITORIAL

Leaders of the world's richest nations met in Brisbane at the G20 summit and resolved to finish in 2015 work on modernising international tax rules to address the issue of companies shifting profits and reducing government tax bases. In their communique following the meeting in Brisbane, G20 leaders affirmed the principle that *'profits should be taxed where economic activities deriving the profits are performed and where value is created'*. G20 nations would automatically exchange information flowing from banks to tax authorities on a reciprocal basis and using a global common reporting standard by 2017 or end of 2018, the communique said. Further, to address concerns of developing countries, G20 leaders welcomed deeper engagement from them in the base erosion and profit shifting (BEPS) project run by the Organisation for Economic Co-operation and Development (OECD).

Michael Noonan, Irish Finance Minister said *'aggressive tax planning by the multinational companies has been criticised by governments across the globe and has damaged the reputation of many countries.'* Taking a cue from this, Ireland has announced the phasing of its famous double Irish tax structures. Another important development in the tax world has been the Luxembourg tax leaks, highlighting the extensive use of Luxembourg for tax avoidance. In light of all these developments, the coming year will witness many changes at a regulatory level to tackle tax avoidance.

This edition of Global Tax Insights, besides the updates from various countries, incorporates a very important judgement from the Indian Courts. The decision is with regard to a transfer pricing addition made by the tax authorities whereby a demand of INR 13.97 billion was raised on Vodafone. The decision was eagerly awaited not only by Vodafone but by tax authorities across the globe.

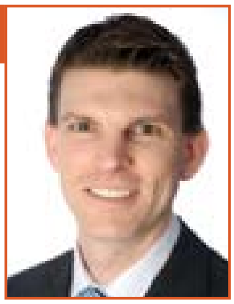
I express my gratitude to all member firms that have contributed to this edition of the newsletter. I sincerely hope that the contents of this newsletter are useful to members and their clients. Feedback and suggestions on the contents are always welcome. Please email your suggestions to sachin@scvasudeva.com. I also take this opportunity to wish everybody a merry Christmas and a very happy and peaceful 2015.

Happy reading!

Sachin Vasudeva

Senior Partner, S.C. Vasudeva & Co., India

AUSTRALIA *Contributed by Michael Carruthers and Corina Treitl, Hayes Knight*



Changes to rules on interest deductions and dividends

Thin capitalisation rules

Significant changes have been made to the Australian thin capitalisation rules, which could have a major impact on both inbound and outbound investors.

At a high level, the good news is that many smaller entities will no longer need to consider the thin capitalisation rules. This is because the rules will not apply where the debt deductions (e.g., interest expenses) of the Australian group do not exceed AUD $2 million in the relevant income year. However, the bad news is that where the AUD $2 million threshold is breached, the debt limits have been tightened, which increases the risk of interest deductions being denied.

The Australian thin capitalisation regime was first introduced in 1987 (and subsequently amended in 2001) to prevent multinationals from profit shifting through excessively debt funding their Australian operations, and claiming excessive debt deductions in Australia, hence reducing their Australian taxable income. The Australian thin capitalisation rules operate separately from the transfer pricing provisions.

The thin capitalisation rules operate so as to deny deductions for interest expenses and borrowing costs (debt deductions) where the entity's average debt for the relevant income year exceeds the maximum level allowed by the legislation.

There are a number of different methods for calculating the maximum debt allowed, including the 'safe harbour debt amount', the 'arm's length debt amount' and the 'worldwide gearing debt amount'. Different tests apply to general business entities, non-bank financial entities and authorised deposit-taking institutions (ADIs) such as banks. The rules also distinguish between inward investors (i.e., Australian entities controlled by non-residents) and outward investors (foreign entities controlled by Australian residents).

The following changes will apply to income years commencing on or after 1 July 2014:

- The safe harbour debt limit for general entities (non-ADI) has been reduced from 3:1 to 1.5:1 on a debt-to-equity basis
- The safe harbour debt limit for financial entities (non-ADI) has been reduced from 20:1 to 15:1 on a debt-to-equity basis
- The safe harbour capital limit for an ADI has been increased from 4% to 6% of its risk-weighted Australian assets
- The worldwide debt limit for outward investing entities (non-ADI), which previously allowed the Australian operations – in certain circumstances – to be geared at up to 120% of the gearing of the entity's worldwide group, has been reduced to 100% of the gearing of the entity's worldwide group
- The worldwide capital amount for ADIs, which previously allowed the entity's Australian operations to be capitalised at 80% of the capital ratio of the Australian entity's worldwide group, has been increased to 100%
- The minimum threshold for the application of the thin capitalisation limits has been increased from AUD $250,000 to AUD $2 million of debt deductions
- A new worldwide gearing debt limit will be available to inward investing entities (non-ADI).

The changes to the thin capitalisation rules will apply to income years commencing on or after 1 July 2014 and there are no transitional provisions for existing arrangements and structures already in place.

Foreign dividend exemption

For many years, section 23AJ of the Income Tax Assessment Act, 1936 has ensured that dividends received by an Australian company are not subject to Australian corporate tax if:

- The company paying the dividend is a foreign resident company; and
- The Australian company holds shares representing at least 10% of the voting power of the foreign company.

This section has recently been rewritten into Subdivision 768-A of the Income Tax Assessment Act,

Continued over

1997. While the exemption will continue to apply much in the same way that it did previously, amendments have been made to ensure that the exemption is available in a broader range of circumstances.

For example, under the old rules the Australian company was required to hold a direct interest in the foreign company paying the dividend. Under the new rules, the dividend can flow indirectly to the Australian company through interposed entities such as trusts or partnerships.

The new rules contain the following amendments:

- The exemption can apply to returns on instruments treated as 'equity interests' under the Australian debt-equity rules. This also ensures that the exemption cannot apply to returns on instruments that are classified as 'debt interests' for Australian tax purposes (e.g., certain preference shares could be treated as debt interests)
- The exemption can apply in respect of a broader range of equity-like interests, not only voting interests
- The exemption can apply where the distribution is received by an Australian corporate tax entity (previously, the exemption only applied where it was received by an Australian company)
- The exemption can apply where a distribution flows through interposed trusts and partnerships other than corporate tax entities
- The exemption can apply in respect of distributions of a non-share dividend, which is not included in the definition of a distribution (e.g., this could be relevant for distributions received in relation to stapled securities).

The changes to the non-portfolio dividend exemption rules will apply to distributions and non-share dividends made on or after 16 October 2014.

LUXEMBOURG *Contributed by Alhard von Ketelhodt, Fiduciaire Eurolux SA*

Law concerning the compulsory deposit and immobilisation of bearer shares

Following the recommendations of international organisations that promote financial transparency – such as the FATF (Financial Action Task Force) – and implementation of 'appropriate measures to ensure the transparency of shareholder structures of companies limited by shares and limited partnerships who have issued bearer shares', the Luxembourg legislature has adopted a law on the immobilisation of bearer shares (Law of 28 July 2014, published in Mémorial A no. 161 of 14 August 2014).

Although the title of this law may cause some concern at first sight, in practice its implications are limited.

The new provisions are applicable for all limited companies whose capital is partially or fully represented by bearer share certificates. Such companies would have to appoint a professional trustee (e.g. accountant, auditor, notary, bank) who will hold the certificates on behalf of the owner and recorded in a special register.

The board of directors must formally designate the escrow agent before 15 February 2015. Thereafter, in a second step, each owner of a bearer share certificate will have to register with the designated depository, providing all possessed certificates to this trustee. The depositary will maintain the certificates on behalf of its owner, entering their personal data in a register specifically created for this purpose.

OMAN *Contributed by G.S.Sriram, Morison Muscat Chartered Accountants LLC*

Changes in withholding tax provisions in Oman tax law

Charge of withholding tax (WHT)

Under the new Income Tax Law effective from 1 January 2010, WHT continues to be charged at 10% on certain types of income payable to a 'foreign person'. Under the old law, the term 'foreign person' referred to a 'foreign company incorporated outside Oman that did not have a permanent establishment in Oman'.

Under the new law, a person is considered as a 'foreign person' if such person is:

- A natural person residing or domiciled abroad; or
- A juristic person established, incorporated or constituted according to any law outside Oman; or
- A joint venture or non-Omani partnership, which does not assume the form of a company, and is constituted under an agreement entered into outside Oman.

Income subject to WHT

Originally, WHT was charged on sums received towards royalties, fees for management services, and rentals for equipment, appliances and machinery, sums in exchange to technical expertise or in consideration of research and improvements, from companies or establishments based in Oman. There was no specific definition of 'royalty' under the old law; and according to the traditional interpretation, 'royalty' could only refer to copyrights; but under the new law, it has a broader meaning *(see Box 1)*.

As per Article 52 of the new law, incomes arising in Oman to a foreign person that are subject to WHT are:

- Royalties *(see Box 1 for definition)*
- Consideration for research and development
- Consideration for the use of or the right to use computer software
- Management fees.

It may be noted that under the new law, consideration for the use of, or the right to use, computer software is subject to WHT. Consideration for the use of computer software, where full or partial ownership rights in the computer software are retained by the original owner, is always treated as 'royalty' under the new Oman income tax law and is subject to WHT.

Conclusion

Consideration for the use of or the right to use the ownership rights means payments for the use of, or the right to use, any of the rights that an owner or proprietor can exercise in relation to the specified property; it is hence treated as royalty.

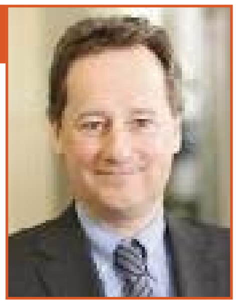
This is different from payments for rights that someone other than the owner can exercise in relation to those properties in respect of any product, which are generally not treated as royalty. However, even in such situations, if the consideration is 'for the use or the right to use of computer software', then such consideration is treated as royalty under the new income tax law.

Box 1. Definition of 'royalty' under Oman income tax law

Consideration for the use or the right to use of:

- Intellectual or proprietary right either for artistic, literary or scientific work, including computer software, cinematograph films, or films or tapes or discs or any other means used for radio or television broadcasting
- Patents, trademarks, design, drawing, models and secret process or formula
- Industrial, commercial or scientific equipment
- Consideration for information concerning industrial, commercial or scientific experience
- Consideration for granting rights of exploitation of mining or any other natural resources.

SWITZERLAND *Contributed by Bernhard Madörin, Artax Fide Consult AG*



Changes in the procedure of tax deducted at source

This regulatory amendment is technical in nature and does not result in the comprehensive revision of the taxation at source. The amendment requires standardisation of the tax at source rates both for federal and for cantonal level *(Table 1)*. This should enable the electronic wage reporting procedure (ELM).

What has been announced as harmonisation and basis for a more efficient processing of payroll data has tax implications for foreign employees whose families stay abroad (so-called 'international commuters' or 'quasi-residents') from 1 January 2014 onwards, especially in the northwestern part of Switzerland. With the new consideration of the foreign income for the tax at source, there is a change in status for this population from 'Married/Single Earner' to 'Married/Double Earner' for the tax rate.

Thus part of the reform has been tacitly carried out – even though it should not have taken place now but at a later stage, and should have been in conformity with the international obligations of Switzerland, in particular to guarantee the free movement agreement with the European Union (EU).

This change, carried out under the disguise of a technical adjustment but leading de facto to a substantial tax increase for this specific group of people, is enormous.

Table 1. Tax implications for international commuters coming into effect as of 1 January 2014 in Basel-Stadt.

Gross annual salary	Current tax	New tax	Increase
100,000	10,670	17,045	60%
150,000	22,350	31,763	42%
200,000	37,360	47,820	28%

OECD UPDATE *Contributed by Carlos Camacho, Grupo Camacho S.A.*

Ministers of finance from 137 countries met in Berlin in the last week of October 2014 to agree upon the need of setting up a global standard for relevant tax interchange of information based on an automatic basis. Relevant information is a key driver for any tax department, to minimise abusive tax practices and aggressive tax planning; it is therefore important that such information reaches the tax administration in a timely and legal fashion, so as not to defeat the purpose for which the information is sought.

All countries, including non-OECD members *(see Box 2)*, will be obliged to implement the standard agreed for capturing critical tax information on individuals or corporations deemed to be subject to tax in either jurisdiction by the force of attraction principle, instead of whatever is deemed most convenient for the tax administration.

The scope of the information to be exchanged via this system covers all types of financial account (including bank deposits, negotiable securities, holdings in investment funds, insurance policies, incomes, etc.) and will include data on balances, amounts received from incomes or transfers, and identification of the person or entity holding and effectively controlling the account.

The automatic exchange of information will begin in 2017, with data on financial accounts that are open at the end of 2015 and those that are opened subsequently. Caution should be exercised, given that 2015 is just around the corner: monies in accounts or investment vehicles that have never been disclosed may be subject to taxation.

The information will be exchanged on an annual basis and automatically, i.e. without the need to file a request with the foreign tax authorities for information regarding an individual case after a possible fraud has been detected.

It is expected that this standard may turn into a worldwide version of FATCA (Foreign Account Tax Compliance Act); while the main responsibility seems to lie with financial institutions, it will also concern financial and tax advisers, who are categorised at the same level as banks and other financial agents under the tax system established by the 2008 Seoul declaration of the OECD on the role of tax intermediates.

The era of tax advisers having only a local focus and limited understanding of the international arena has come to an end; it is time for them to decide whether to move with the times or become obsolete. Taxpayers should be alert to this new challenge, as a tax adviser who has failed to make this transition could be something of a liability.

Box 2. 54 countries and jurisdictions that have committed to exchanging relevant tax information, as from 2017

Anguilla	Estonia	Italy	Romania
Argentina	Faroe Islands	Jersey	San Marino
Barbados	Finland	Latvia	Seychelles
Belgium	France	Liechtenstein	Slovakia
Bermuda	Germany	Lithuania	Slovenia
British Virgin Islands	Gibraltar	Luxembourg	South Africa
Bulgaria	Greece	Malta	South Korea
Cayman Islands	Greenland	Mauritius	Spain
Colombia	Guernsey	Mexico	Sweden
Croatia	Hungary	Montserrat	Trinidad and Tobago
Curacao	Iceland	Netherlands	Turks and Caicos Islands
Cyprus	India	Norway	United Kingdom.
Czech Republic	Ireland	Poland	
Denmark	Isle of Man	Portugal	

Vodafone India Services Private Limited v. Union of India and others [2014] 368 ITR 1 (Bom)

Contributed by Ashish Gupta (top right) and Sachin Vasudeva (bottom right), S.C. Vasudeva & Co.

The Hon'ble Mumbai High Court has recently held in the said case that issue of shares at a premium by the Indian company to its non-resident holding company does not give rise to any income from an international transaction and is a capital receipt in the hands of the Indian company and hence shortfall in the consideration received by an Indian company on account of issue of shares to its non-resident holding company at a price which is less than the fair market value of the shares cannot be treated as income of the Indian company.

Facts of the case

M/s Vodafone India Services Pvt. Ltd (herein referred to as the 'Indian company') is the wholly owned subsidiary of M/s Vodafone Tele-Services (India) Holdings Ltd (herein referred to as the 'non-resident company'), therefore these are associated enterprises as per section 92A of the Income Tax Act, 1961 (the Act).

On 21 August 2008, the Indian company issued 289,224 equity shares at a face value of INR 10 each at a premium of INR 8,509 per share to the non-resident company for meeting its requirement of funds. The fair market value of the share of INR 8,519 per share was determined by the Indian company in accordance with the methodology prescribed by the Government of India under the Capital Issues (Control) Act, 1947.

The Indian company filed its return of income for Assessment Year 2009–10 and Form 3CEB in accordance with section 92E of the Act, in which the chartered accountant had declared the above-mentioned transaction as an international transaction but had appended a note making it clear that this transaction does not affect the income of the Indian company.

The Assessing Officer (AO) referred the said transaction to the Transfer Pricing Officer (TPO) for computation of the arm's length price (ALP). The TPO in his order computed the ALP at INR 53,775 per share. On the basis of the order of TPO, the learned AO passed the draft assessment order treating the shortfall in the security premium of INR 13.08 billion to be in the nature of income taxable in the hands of the Indian company.

In addition to this, the AO deemed the said shortfall to be in the nature of a loan given by the Indian company to the non-resident company and calculated the interest deemed on such loan at 13.50% for 6 months at INR 0.89 billion. The AO therefore raised a total demand of INR 13.97 billion.

Contention of the assessee

A plain reading of section 92(1) of the Act clearly highlighted that any income arising from an international transaction shall be computed having regard to the arm's length price. Therefore, it can be said that for applying the provisions of Chapter X of the Act, there should arise an income from an international transaction; but in the instant case, receipt of money through share capital is a transaction on 'capital account', hence the provisions of Chapter X are not applicable in this transaction.

Even though the definition of income as given in section 2(24) of the Act is an inclusive definition, then all capital receipts cannot be subjected to tax unless there is a specific charging section to that effect. If this were the case, then all the transaction of issue of shares should be chargeable to tax.

Issue of shares is a process of creation of shares, not a transfer of shares. Therefore, there is no transfer of shares so as to make section 45 of the Act (capital gains) applicable as contended by the Revenue Authority.

The Indian company further submitted that Explanation (i)(c) to section 92B of the Act only states that capital financing transactions, such as borrowing money and/or lending money to an associated enterprise, would be an international transaction. However, what is brought to tax is not the amount of money lent and/or borrowed, but the impact on income due to such lending or borrowing.

There is no occasion to re-characterise a *bona fide* transaction of issue of shares as a loan under the Act.

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Contention of the Revenue Authority

Chapter X of the Act is a separate code by itself, and the difference in the valuation between the arm's length price and the transaction price would give rise to income.

The Revenue Authority placed reliance on the definition of income as given in section 2(24) of the Act, which is an inclusive definition that does not prohibit the taxing of capital receipts as income.

Foregoing of premium on the part of the Indian company amounts to extinguishment/relinquishment of a right to receive fair market value. Therefore, the issue of shares is a transfer within the meaning of section 2(47) of the Act.

The meaning of 'international transaction' as given in subclauses (c) and (e) of Explanation (i) to section 92B of the Act would include capital account transactions within its scope.

Any shortfall on account of the share premium will be considered as a loan given by the Indian company to its non-resident holding company, and notional interest on such a loan would be chargeable to tax in the hands of the Indian company.

What is brought to tax is not the share premium, but the cost incurred by the Indian company in passing on a benefit to its non-resident holding company by issue of shares at a price below the fair market value of the shares.

Decision of the Court

The shortfall on account of consideration received by the Indian company from its non-resident holding company for issue of shares due to the reason that the issue price of the shares is less than their fair market value cannot be treated as income of the Indian company within the meaning of the expression 'income' as defined under the Act.

The reliance placed by the Revenue Authority upon the definition of 'international transaction' in subclauses (c) and (e) of Explanation (i) to section 92B of the Act, to conclude that income has to be given a broader meaning to include capital receipts and notional incomes, is not correct. It is held that the transaction on capital account or on account of restructuring would become taxable to the extent that it impacts income. It is the income that is to be adjusted to the arm's length price.

The Revenue Authority's contention that if the arm's length price were received by the Indian company, then it would have invested it and earned income on it, is a mere assumption. This could not be the basis of taxation.

EDITORIAL COMMENT

This is a landmark judgement in the area of transfer pricing and puts an end to any doubt as regards taxability of share premium received at the time of issue of shares. In a similar case involving the Indian arm of the Royal Dutch Shell Plc, the Bombay High Court has ruled in favour of Shell India by rejecting the claim of the Revenue that the underpricing of the shares issued had resulted in income in the hands of the Indian company.

Morison International

The Next Step

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