

Global Tax Insights

Q1 2020



Editorial

Sachin Vasudeva



In an age where technology drives businesses, tax authorities across the globe are struggling to tax companies that earn significant revenue from a country/jurisdiction without having a physical presence there. To address this issue, in 2018 the Indian government introduced the concept of 'significant economic presence' (SEP) in its domestic law to tax non-residents in line with BEPS recommendations. SEP, which would constitute a business connection, involves:

- Transactions in respect of any goods, services or property carried out by a non-resident in India – including provision of data download or software in India – if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or
- Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India, through digital means.

The transactions/activities shall constitute SEP in India, regardless of whether the agreement for such transactions/activities is entered in India; or the non-resident has a residence or place of business in India; or the non-resident renders services in India.

Budget 2020 proposes to enlarge the scope of this provision by clarifying that income attributable to operations carried out in India shall include income from:

- Advertising that targets a customer who resides in India, or a customer who accesses the advertisement through an internet protocol (IP) address located in India
- Sale of data collected from a person who resides in India, or from a person who uses an IP address located in India
- Sale of goods or services using data collected from a person who resides in India, or from a person who uses an IP address located in India.

The UK government has also announced levy of a new digital services tax on technology companies. The levy, due to take effect from April 2020, seeks to collect £500 million. According to analysts, online transactions in the UK account for more than 20% of all retail sales – second only to China among the large internet markets.

As part of the BEPS project, members of the OECD/G20 Inclusive Framework are seeking a comprehensive, consensus-based solution to the two challenges arising from digitalisation, and have committed to deliver this solution before the end of 2020. Once the final report is out, then steps such as those already taken in India and the UK would be taken by other countries to tax such companies.

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 are always welcome by e-mail to sarah@morisonksi.com

For current and country specific tax information on COVID-19, please refer to the Morison KSi resources page on their website. The GEO are welcoming information from all member firms, so please submit your articles by e-mail to sarah@morisonksi.com

At the time of going to press, the whole world is struggling to cope with the spread of COVID-19. I pray to the Almighty to give strength, courage, wisdom and above all to shower His blessings upon us all, to tide us over this period of uncertainty and difficulty.

Sachin Vasudeva

Country Focus

AUSTRALIA

Contributed by
Chris Wookey,
Melbourne, Australia

E: Chris.Wookey@leebridgegroup.com.au



Australian expats to lose tax exemption on the family home: Action required by 30 June 2020

Australians have enjoyed an exemption from capital gains tax (CGT) on their home (technically on their **main residence**), including where they might have relocated overseas for up to 6 years and rented out their former home.

However, under amendments that received Royal Assent on 12 December 2019, once someone stops being either an Australian tax resident or temporary resident they will no longer be eligible for this CGT main residence exemption if they sell their home after 30 June 2020.

This is a full denial of the exemption without even a time-based apportionment and has been introduced under the misleading guise of reducing pressure on housing affordability.

Consider the case of Simon, an Australian citizen who lived in Australia for 40 years. He bought his home in 2000 for \$500,000 and lived in it until 2018, when he was offered a promotion and posting overseas. Simon relocated with his family to Singapore for an indefinite period of time, ceasing his Australian tax residency. If Simon were to sell his former home after 30 June 2020 for \$1,200,000, he would be liable to CGT on the entire \$700,000 capital gain.

However, if Simon were to sell his main residence before 30 June 2020, he could pay no CGT at all on the gain because of the availability of the CGT main residence exemption.

Special transitional rules apply to protect availability of the CGT main residence exemption, but only if within the first 6 years of ceasing Australian tax residency one of these things happens:

- Assessee or his/her spouse had a terminal medical condition while non-resident
- Assessee's child (aged <18 years at the time of diagnosis) had a terminal medical condition while the assessee was non-resident

- Assessee's spouse or child (aged <18 years at the time) dies
- Assessee disposes of the property to their ex-spouse because their relationship has broken down, e.g. because of a court order.

Australian expats will need to consider carefully whether they should take any action to sell their former main residence before 30 June 2020 in order to maximise the after-tax value of their real estate assets in Australia.

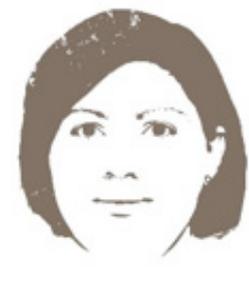
Country Focus

BELGIUM

Contributed
by Christine
Scheepmans and
Ashley Bergmans,
Van Havermaet

E: Christine.Scheepmans@vanhavermaet.be

E: Ashley.Bergmans@vanhavermaet.be



Increased focus of Belgian tax authorities on foreign companies with local activity in Belgium

As a result of amended Belgian and international tax rules, the Belgian tax authorities have recently initiated a large series of tax questionnaires aimed at foreign companies doing business in Belgium. In doing so, the tax authorities are seeking to identify which of these companies might have a taxable presence (so-called 'permanent establishment' [PE]).

Numerous foreign companies are currently confronted with an extensive questionnaire asking where contract negotiations took place, who conducted these negotiations, how long a certain construction/installation project was in place on Belgian soil, and so on.

The tax authorities are also requesting information from third parties, such as Belgian clients of the foreign company.

Broadening of the concept 'permanent establishment'

With various developments at an international level (the OECD BEPS Action Plan), the concept of a PE has been largely broadened. As a result, the fiscal playing field will change and more companies that operate cross-border may now trigger a PE in Belgium.

In most cases, these new rules will apply as from 2020. However, the Belgian tax authorities have already aligned themselves with the new rules. The most relevant changes from a Belgian tax perspective are summarised below.

Personal permanent establishment – dependent agent

Until now, the presence of a dependent agent in Belgium only resulted in a taxable PE if that agent had the authority to conclude contracts. In practice, contracts were often negotiated in a substantial manner by the dependent agent, but finally approved by the foreign company ('rubber stamping').

To prevent this type of situation, a taxable PE will now already be present from the moment a dependent agent has a 'significant influence' on the conclusion of the contract. The authority to conclude contracts is therefore no longer an absolute requirement.

Project permanent establishment – construction activities

Building/construction works performed in Belgium can only give rise to a PE if the project exceeds a duration of 12 months (some double taxation treaties concluded by Belgium state a shorter period).

In practice, agreements relating to construction projects were sometimes deliberately or unconsciously divided into several contracts. Because the contracts were split up, the separate projects did not reach the required duration period and therefore there was no PE present.

To address this kind of potential abuse, it has now been determined that 'related activities' performed by affiliated companies on the same construction site or for the same development should be considered as a single project for the purposes of determining its duration.

Because of this new rule, a group of enterprises can no longer avoid the presence of a PE by splitting up contracts for a construction project. If related activities are carried out for the same construction project by different group companies, this must be justified by business (non-tax) motives.

Consequences for the main contractor

It is important to note that even if they subcontract all parts of a project, the main contractor can still be considered to have a PE present in Belgium. This could be the case because time spent by a subcontractor on a Belgian construction site will be attributed to the main contractor if the main contractor has the site at its disposal during the time the subcontractor executes its work.

Consequences for the subcontractor

Although time spent by a subcontractor is attributed to the main contractor, this does not exclude the potential presence of a PE of the subcontractor. If the subcontractor has the site at its disposal, then this could also trigger the existence of a Belgian PE.



Besides the increased Belgian tax audits, there is a strong focus on foreign companies that are working for a longer period, or on a recurring base over a longer period, for the same client and/or in the same geographic location in Belgium

Material permanent establishment – a fixed place of business at the disposal of the enterprise

Even if a foreign company has a fixed place of business at its disposal in Belgium, this does not automatically mean that it constitutes a taxable PE. The law provides a 'negative list' of exceptions; for example, an establishment used exclusively for the storage, display or delivery of goods or merchandise belonging to the enterprise does not constitute a taxable PE.

What is new is that these exceptions only apply if they are of a preparatory or auxiliary nature. This means that the activity cannot form a substantial part of the activity of the company as a whole.

Other recent developments

Besides the increased Belgian tax audits, there is a strong focus on foreign companies that are working for a longer period, or on a recurring base over a longer period, for the same client and/or in the same geographic location in Belgium.

This applies especially when employees of a foreign subcontractor are working at the premises of a Belgian client within the execution of a service agreement. In such cases, the Belgian tax administration will very quickly take the position that the presence of these temporary foreign employees gives rise to the existence of a material PE. This position has been confirmed multiple times by previous recent Belgian case law, although debate continues regarding whether a foreign company has a material PE.

The Belgian court recently ruled in favour of a foreign service provider in view of the discussion regarding the existence of a Belgian material PE. The case concerned a foreign IT service provider who provided IT consulting services for several years to a Belgian client. In this case, it was not absolutely clear that the foreign IT service provider actually used the client's Belgian offices in view to execute its service agreement. Hence, the Belgian tax authorities could not adequately prove that the foreign IT service provider did have the premises of the Belgian client at his disposal. Consequently, the burden of proof was not satisfied and the Belgian court ruled that

the existence of a taxable PE had not been proved.

Controversy around this issue seems likely to continue, and further Belgian case law can be expected to further elucidate the criteria for determining existence of a (material) PE.

Conclusion

Entrepreneurs performing cross-border activities will need to bear in mind some important upcoming changes in the international fiscal sphere concerning taxation of their global business activities, taking into account the broadened PE definition. Besides the developments at international level, it is important to keep track of developments in local tax rules – including PE rules – in order to correctly monitor the fiscal situation when doing business abroad.

Country Focus

FRANCE

Contributed by
Olivia Lexi,
Tax Manager, Aplitech

E: olivia.levi@groupe-aplitec.com



French finance law for the fiscal year 2020: Tax implications

The finance law was promulgated on 28 December 2019. It makes some changes to the French tax law, the most important of which are summarised below.

Exemption from approval in case of transfer of tax losses on merger

In principle, a merger between companies results in the loss of prior tax losses incurred by the absorbed company.

However, if the merger is placed under a special regime, the tax losses of the absorbed company may be transferred to the acquiring company upon approval by the French tax authorities.

For approval to be granted, the following conditions must be met:

- The transaction is economically justified and has main non-tax purposes.
- The activity that has resulted into the tax losses for which the transfer is requested has not been the subject of significant change by the absorbed company.
- The acquiring company must continue the activity, for a minimum period of 3 years, without subject to significant change.
- The tax losses must not result from asset management or real estate management.

However, for restructuring operations carried out from 1 January 2020, companies can transfer their prior tax losses to the absorbing company without requesting the approval of the French tax authorities if these tax losses do not exceed the ceiling of €200,000.

Transposition of rules to tackle hybrid mismatches

These measures stem from Council Directives (EU) 2016/1164 of 12 July 2016 (Anti-Tax Avoidance Directive 1) and (EU) 2017/952 of 29 May 2017 (Anti-Tax Avoidance Directive 2).

Hybrid mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities, and those differences surface in the interaction between the legal systems of two jurisdictions. The effect of such mismatches is often a double deduction (i.e. deduction in both states) or a deduction of the income in one state without inclusion in the tax base of the other.

To neutralise these effects, the new measures lead to:

- Refusing the deduction in France of a charge corresponding to a payment that will not be included in the taxable income of the foreign beneficiary.
- Adding to the taxable income in France a payment corresponding to an expense deducted from the income subject to tax in the foreign debtor's state of residence.

These measures exclusively concern hybrid mismatches that arise between associated companies, between the head office and permanent establishment, or among two or more permanent establishments of the same entity.

The entry into force of these measures is accompanied by the abolition of the rule that allowed the deduction of interest paid to an associated lending enterprise, on condition that the lending enterprise be taxed in its state of residence, on the same interest, for an amount at least equal to one-quarter of French corporate income tax.

Compliance of withholding taxes with European Union law

As of 2021, foreign companies can claim a temporary restitution of the withholding taxes paid on income distributed to them for a fiscal year, if the company is in losses. The Finance law establishes a deferred taxation. This tax deferral will end when the company makes profit.

In order to be authorised to claim this temporary restitution, the company must have its headquarters in a state of the European Union or in a state of the European Economic Area, which has concluded with France an agreement on administrative assistance against tax evasion and tax avoidance and an agreement on mutual assistance for the recovery of taxes.



As part of their measures against VAT avoidance, the government wants to introduce mandatory electronic billing between taxable persons. This new obligation could be introduced in 2023 at the earliest

The claim for refund must be made within 3 months following the end of the fiscal year in which the loss is incurred. Nevertheless, the withholding tax is subject to a tax deferral, until the foreign company makes a beneficial result.

In addition, the law requires foreign companies to comply with two reporting obligations:

- To declare their identity and the amount of their losses.
- To supply a follow-up statement of deferred income for the withholding taxes.

These reports must be sent to the French non-resident tax office. In the event of a breach of reporting obligations, the company will lose the deferral of taxation.

Mandatory electronic invoicing between taxable persons

As part of their measures against VAT avoidance, the government wants to introduce mandatory electronic billing between taxable persons. This new obligation could be introduced in 2023 at the earliest, and in 2025 at the latest.

France will submit a request to the European Commission; it will then be forwarded to the Council of the European Union, which is the institution empowered to authorise or reject the implementation of this new obligation.

Quick fixes

France has transposed into domestic law the measures of the EU/2018/1910 Directive of 4 December 2018, to make certain improvements to EU VAT rules.

These measures result in:

- strengthening conditions of exemption for cross-border supplies of goods
- clarification of chain transactions and the proof of transport for the purposes of the exemption for intra-Community transactions
- the introduction of a simplification measure for call-off stock arrangements.

Corporate tax trajectory

See table below.

Corporate income tax rates, 2020–2022

TURNOVER (€ MILLIONS)	TAXABLE PROFITS (€)	FISCAL YEAR BEGINNING IN:		
		2020	2021	2022
<7.63	0 to 38,120	15 %	15 %	15 %
	38,120 to >0.5 million	28 %	26.5 %	25 %
7.63–250	0 to >0.5 million	8 %	26.5 %	25 %
>250	0 to 0.5 million	28 %	26.5 %	25 %
	>0.5 million	31 %	27.5 %	

Country Focus

GERMANY

Contributed by
Dr Simone Wick,
Dierkes Partner

E: swick@dierkes-partner.de



Tax changes for employees working across borders in 2020

For the purpose of job-related border crossing, employees and their employers must deal with quite a number of regulations and their consequences. Changes regularly arise in this field, including with the German Annual Tax Act of 2019 and the Third Bureaucracy Reduction Act.

Obligation to deduct wage tax in case of secondments to Germany

According to the previous wording of the German law, the obligation to deduct wage tax depended on whether a German host company was actually bearing the salary of the seconded employee – either by paying directly or through a recharge from the home company. In case the seconding company did not charge the host company for the wage expense although it should have done regarding the arm's length principle, there was no obligation to deduct wage tax for the latter.

But from this year onwards, the arm's-length principle must be applied additionally. Therefore, it now also matters who should have borne the wage! In other words, the question is: Who would have borne the expenses if the companies concerned were not affiliated but independent entities?

Example: French company A seconded an employee to the affiliated German company B. The employee only works in the interest of the host company. Company A continues to bear the employee's wage costs and does not recharge them to company B, even though this would be common practice for other businesses. According to the new regulation, B is nonetheless considered the worker's employer for German wage tax purposes and is obliged to withhold wage tax.

The arm's-length principle has been used for some time to determine the employee's tax liability in Germany, so that the wage has already been subject to income tax. The new ruling now ensures that when an employee is seconded to Germany and becomes liable for income tax as a result, there is an obligation to deduct wage tax.

Tax identification number for employees with limited tax liability

As of 1 January 2020, the procedure to retrieve the necessary data for the monthly payroll Elektronische LohnSteuerAbzugsMerkmale (ELStAM) can also be used for employees with limited income tax liability. Apart from exceptional cases, the application and issue of certificates on paper will be abolished. In future, employers will be obliged to retrieve the wage tax deduction characteristics in the ELStAM procedure for employees with limited income tax liability.

A prerequisite for the employer retrieval is the assignment of an identification number (IdNr). This must always be applied for at the employer's local tax office. If authorised to do so by the employee, the application can be taken over by the employer. Whether the employee has already been assigned an ID number can be clarified by the tax office on request.

In cases where a tax-free allowance within the meaning of § 39a of German Income Tax Act (EStG) exists for employees with limited tax liability, the tax office will not allow electronic retrieval, and will issue a paper certificate for wage tax deduction as before. This applies accordingly if the wage is exempted or the tax deduction is reduced/restricted on application due to existing regulations in double taxation agreements.

Annual wage tax adjustment by the employer also for employees with limited tax liability

The words 'persons subject to unlimited income tax liability' have been dropped from § 42b, Subsection 1, Sentence 1 of the German income tax act. This means that an employer can now carry out an annual adjustment of wage tax for employees with limited income tax liability. A prerequisite is that the respective employee is engaged by the employer for the entire calendar year. However, this option will only be of limited use, as only a few people are subject to limited tax liability for year-round employment in Germany (such as cross-border commuters under the respective double tax treaties with France, Austria and Switzerland).



German tax law makes a significant distinction between unlimited and limited tax liability. Individuals with domicile or habitual abode in Germany are subject to unlimited taxation, which means that their whole income, regardless of where it is earned, can be basically taxed

Tax assessment of employees with limited tax liability

German tax law makes a significant distinction between unlimited and limited tax liability. Individuals with domicile or habitual abode in Germany are subject to unlimited taxation, which means that their whole income, regardless of where it is earned, can be basically taxed (the domestic tax right may be restricted by DTT). Individuals without domicile or habitual abode in Germany are limited taxable if they obtain certain kinds of income from Germany. In this case, only the relevant income from Germany is subject to taxation.

In general, the wage tax deduction is final for employees with limited tax liability: personal circumstances are not taken into consideration, and taxpayers do not have to file a tax return at the end of the year. However, in certain exceptional cases (e.g. switch between unlimited and limited tax liability in a calendar year), the final tax to be paid is determined in the course of a tax assessment. As of this year, this also applies if

- an employee receives wages from multiple employers;
- the wage tax was calculated on a compensation for work spanning several years or on a severance payment under the 'one-fifth rule' (*Fünftelregelung*); or
- the employer has calculated the wage tax from other income and the wage from previous employment relationships in the calendar year has not been taken into account.

The employees concerned must submit an income tax declaration. It should be noted that the progression clause is applicable as a result of the assessment. Therefore, foreign income is also taken into account in order to determine the effective tax rate on domestic income. As a consequence, the new regulation could lead to a significantly higher tax burden.

Flat-rate wage tax for employees with limited tax liability

For work carried out in Germany, taxpayers subject to limited taxation who are seconded to a foreign permanent establishment of the employer and whose activities do not

exceed 18 consecutive working days are now subject to the following provisions under § 40a, paragraph 7 EStG: by not retrieving electronic wage tax deduction details, the employer may deduct wage tax at a flat rate of 30%.

Country Focus

GERMANY

Contributed by
Dr Michael Hoheisel
and **Martha Klink**,
GKK Partners

E: m.hoheisel@gkkpartners.de

E: m.klink@gkkpartners.de



VAT quick fixes: New regulations on cross-border trading

On 1 January 2020, new VAT rules – commonly referred to as ‘quick fixes’ – regarding cross-border supplies of goods came into force, introducing changes that will affect:

- Simplification of call-off stocks
- Cross-border chain transactions
- VAT ID number verification for EU cross-border supplies
- Proof of intra-Community transport of goods.

These ‘quick fix’ rules intend to simplify and unify the VAT rules for B2B cross-border supplies of goods within Europe, and should be applicable in all member states as of 1 January 2020.

Simplification of call-off stocks

To shorten delivery times, it is common for suppliers to transfer goods to a warehouse of a regular customer in another member state. The goods remain the supplier’s property until they are picked up by the customer (‘call-off stock’).

Up to and including 2019, at the time the supplier transferred the goods to the call-off stock, it qualified as an intra-Community supply in the member state of departure and as an intra-Community acquisition in the member state of arrival. When the customer took the goods out of the call-off stock, the supplier performed a domestic supply. Generally, the supplier had to register for VAT purposes in the country where the call-off stock was located. Some EU member states had VAT simplification rules for call-off stocks, but these varied by country.

To avoid the obligation for VAT registration, the quick fixes include harmonised simplified rules for call-off stock arrangements. Where the conditions are met, the transfer of goods to the call-off stock in another EU member state will no longer be deemed an intra-Community supply/acquisition. Instead, when the acquirer takes ownership of the goods, an intra-Community supply and an intra-Community acquisition will

take place, provided the call-off is made within 12 months after arrival of the goods. However, to apply for these simplification rules, the supplier must keep a register that complies with specific conditions. In addition, the supplier must report on the EC sales list the transport of goods to a foreign stock.

Cross-border chain transactions

EU cross-border chain transactions concern supply chains involving three or more parties and that entail the shipment of goods from one EU country to another. In the event of EU chain transactions, the intra-Community transport can only be attributed to one link in the chain. As a result, the zero-rate applies to just one of the supplies; the other supplies must be taxed at the local VAT rate. In practice, it was questionable which supply qualified as the zero-rated intra-Community supply of goods, since country regulations differed.

Under the new rules, the intra-Community supply takes place in the link in which the goods are supplied to the taxable person that arranges the intra-Community transport or has this arranged. If, for example, B arranges the transport, then the intra-Community goods transport is attributed to the supply in the ‘A–B’ link. If C is responsible for the transport, then the intra-Community goods transport is attributed to the supply in the ‘B–C’ link.

An exemption is possible if the intermediary operator (B) arranges the transport and provides the supplier (A) with a VAT ID number of the EU member state of dispatch of the goods; in this case, the intra-Community goods transport is attributed to the link between the intermediary operator and the ‘B–C’ customer link.

VAT ID number verification for EU cross-border supplies

According to the previous legal situation, the customer’s valid VAT ID number was a formal requirement for applying the zero VAT rate to intra-Community supplies of goods. Thus, a taxable person only needed to comply with the material conditions in order to use the zero VAT rate. Under the new rules, the use of a valid VAT ID number



To qualify for the zero VAT rate, the supplier of an intra-Community supply must be able to prove that goods have been transported from one member state to another

will be regarded as a material requirement for applying the zero VAT rate. If a supplier fails to have the customer's valid VAT ID number and to state it on the invoice, the zero VAT rate will not be applicable.

Additionally, as of 1 January 2020, submitting a correct EC sales list is condition for exemption. As a result, the exemption may be refused as long as the transaction is not reported correctly on the EC sales list for the relevant period.

Proof of intra-Community transport of goods

To qualify for the zero VAT rate, the supplier of an intra-Community supply must be able to prove that goods have been transported from one member state to another. In the past, member states maintained different rules to prove this transport, which led to uncertainty and significant administrative effort for cross-border business.

According to the new rules, it is presumed that the goods were transported to another member state if the supplier can provide at least two non-contradictory evidential documents that were prepared independently from one another. This can include signed CMR documents, together with a copy of payment for transport issued by the bank.

If the transport is performed by the acquirer or on his behalf, the supplier will also need a written statement from the acquirer stating that the goods have been transported by them (or a third party on their behalf) to the member state of destination.

Within Germany, the previous regulation (e.g. the Entry Certificate [*Gelangensbestätigung*]) will continue to apply; so this new regulation is unlikely to affect business significantly.

Impacts of the new regulation

Clients involved with cross-border transactions need to consider how the new VAT rules could affect their business. Adjustments to the administrative and order processes, as well as to ERP systems, might be necessary.

Country Focus

INDIA

Contributed by
Padmini Khare-Kaicker
and **Viksit Bhargava,**

B. K. Khare & Co.

E: pbkhare@bkkhareco.com

E: viksitbhargava@bkkhareco.com



Taxation of dividends: Renewed regime

Background: Pre-Budget 2020 scenario

In India, every year (sometimes even twice in a year), the Income-tax Act, 1961 ('IT Act') undergoes numerous amendments – generally through what is popularly referred to as the Budget. One such change was the introduction of Dividend Distribution Tax (DDT) in 1997.

Until 1997, dividends were taxable in the hands of the shareholders. In 1997, with the introduction of DDT, the government shifted the burden of paying tax on dividends to the company (Section 115-O) and dividends received by shareholders became exempt from tax (Section 10(34)).

Over time, numerous changes have been carried out under the IT Act in the context of DDT – including:

- Abolishment and introduction of DDT (2002–2003)
- Increase in the DDT rate, from 10% to 15%
- Removal of the cascading effect of dividends
- Grossing up of DDT
- DDT to be charged at an effective tax rate of 20.56% as of 2019.

In 2017, the government also introduced an additional tax of 10% on dividend income in the hands of specified resident shareholders – those who received dividends in excess of INR 1 million during the financial year.

Budget 2020 has sought to roll back the regime of dividend taxation to make it taxable in the hands of the shareholders. In the case of resident shareholders, the rate of tax would be the same as applied to their level of income; the additional tax of 10% introduced in 2017 is proposed to be withdrawn.

Important tax aspects and litigation in the DDT regime

Where dividends were taxable in the shareholder's country of residence, no credit was allowed against this unless specific

provisions were made to this effect in a Double Taxation Avoidance Agreement (DTAA) with India. Some of these DTAA's (e.g. with Singapore and the USA) provided for elimination of double taxation; some provided for conditional exemption (e.g. Finland); others provided for limited DDT credit (such as Hungary, with 10% credit). In a sense, this resulted in double taxation with reference to the same income.

If multinational groups were unable to obtain DDT credit, they would invoke the 'most favoured nation' (MFN) clause in the DTAA to claim credit in their home country.

Another controversy has concerned the extent to which the DTAA could limit the rate at which DDT can be imposed – based on the notion that effectively DDT paid was the tax on the shareholder, which was discharged by the Indian company. This issue is pending resolution before the Authority for Advance Rulings (AAR).

Budget 2020: DDT abolished and shareholders liable to pay tax

The proposed reintroduction of tax on dividends directly in the hands of shareholders should resolve such ongoing controversies. Subject to certain conditions, the government has also proposed to introduce a provision to remove the cascading effect of tax on dividends received by corporates from domestic companies.

Budget 2020 proposes that dividends will be taxed in the hands of non-residents, including foreign companies, at the applicable rate – which ranges from 10% to 40% (plus applicable surcharge and cess), depending on the status of shareholder and nature of the transaction. Such a rate would further be reduced where the DTAA provides for a beneficial rate of 5% to 20% (available only to the 'beneficial owner' of the dividend income).

Regarding dividend tax payable by resident shareholders, there is talk of providing for a lower tax rate than the relevant slab-rate that is currently payable.

Satisfaction of 'beneficial owner' test

A DTAA provides for concessional tax rates for taxing dividends if the beneficial



With the introduction of Indian GAAR (General Anti Avoidance Rules), the issue of establishing beneficial ownership may once again assume importance so as to discourage treaty shopping

owner of the dividend is a resident of the other contracting state. Establishment of beneficial ownership has been the subject of substantial controversy across the globe, including India. The OECD's rationale behind the concept of 'beneficial owner' is to prevent abuse of DTAA's by undertaking treaty shopping and primarily applies to passive incomes such as dividends, interest and royalties. In this, legal ownership is distinguished from economic or beneficial ownership. Various aspects need to be considered when determining beneficial ownership.

With the introduction of Indian GAAR (General Anti Avoidance Rules), the issue of establishing beneficial ownership may once again assume importance so as to discourage treaty shopping.

Withholding tax and compliance

Budget 2020 also proposes that the dividend income will be subject to withholding tax, which increases the compliance burden on the company declaring dividend income. The withholding tax rate on dividends would also depend upon the availability of a permanent account number (PAN)¹, TRC, declaration regarding permanent establishment and submission of form no. 10F (a specified form required to claim treaty benefits). Without a PAN, taxpayers may not benefit from the lower rate provided in the DTAA and the dividend could be subject to higher tax withholding. However, the government is expected to frame rules that will mitigate against hardship in these matters.

Foreign shareholders receiving dividend income have been exempted from the requirement to file a tax return, if appropriate taxes have been withheld on such dividends and the shareholder has no further tax liability. If the foreign shareholder is subject to higher withholding tax, they can claim a refund by filing the tax return.

Conclusion

The government's proposal to abolish the DDT is welcomed, especially by foreign shareholders who could receive credit for taxes paid on dividend income. However, the tax authorities would allow benefit of the DTAA only upon proper verification of

documentary evidence substantiating factors such as the beneficial ownership of the dividend recipient.

There could also be a risk of the Indian company being treated as a 'representative assessee' of the foreign shareholder. This would require the Indian company to support its position by maintaining all the relevant contemporaneous documents (e.g. TRC, document showing beneficial ownership). All that remains to be seen is whether the abolition of DDT will meet the expectations of the foreign shareholder, the government, and the Indian company distributing dividends. Only time will tell!

FOOTNOTE

- PAN is a unique tax identification number allotted by the Indian tax authorities to individual taxpayers.*

Country Focus

INDIA

Contributed by
Ms. Aditi Gupta



Finance Act 2020: Significant amendments for non-residents

The Indian government is usually prompt in aligning the provisions of its domestic law with the technological advancements and strengthening the international tax principles. Vide Finance Act, 2020, various amendments have been introduced that will impact non-residents. Some of the most significant changes are explored in this article.

Inclusion of income from advertisement and sale of data under income attributable to business connection in India

In this world of digital economy, the conventional manner of doing business has changed significantly. We are in the age of technological advancement, and traditional boundaries no longer exist. Internet, e-commerce, smartphones, cloud computing and many more digital technologies have transformed our way of life and how we do business.

The Finance Act, 2020 has inserted an explanation in section 9 of the Income Tax Act, 1961 ('the Act') to expand the meaning of income arising from business connection, to include the income attributable to operations carried out in India from:

- an advertisement that targets a customer who resides in India, or a customer who accesses the advertisement through an internet protocol (IP) address located in India; or
- sale of data collected from a person who resides in India, or from a person who uses an IP address located in India; or
- sale of goods or services using data collected from a person who resides in India, or from a person who uses an IP address located in India.

Thus, any non-resident earning income through advertisement, sale of data or e-commerce activities from a person residing in India or a person using an Indian IP address shall constitute business connection in India. Accordingly, such income would be taxable in India.

Levy of withholding taxes on e-commerce transactions

Another significant amendment in relation to taxing e-commerce transactions is the applicability of withholding tax on such transactions. According to the amendment, **a tax of 1% is to be withheld by the 'E-Commerce Operator' on the amount paid or credited by such Operator to the 'E-Commerce Participant'**. This would be levied on the sale of goods or services, including digital products, over a digital or electronic network (where the gross amount of sales or services, or both, exceeds INR 5 Lakhs) by the E-Commerce Participant using the e-commerce platform operated, owned or managed by the E-Commerce Operator.

- **E-Commerce Operator** is defined as any person who owns, operates or manages a digital or electronic facility or platform for electronic commerce. Further, it has been provided that an E-commerce operator shall be deemed to be the person responsible for paying to E-Commerce Participant.
- **E-Commerce Participant** is defined as a person resident in India selling goods or providing services or both, including digital products, through a digital or electronic facility or platform for electronic commerce.

In view of the definition of the term 'E-Commerce Operator', there is a possibility that the amendment could be applicable to a non-resident E-Commerce Operator and they would be liable to withhold taxes on payments to be made to the E-Commerce Participants, thus increasing compliance burden on the non-resident operators.

Amendment in the provisions of thin capitalisation and equalisation levy

As a member of G20, India has been proactive in adopting the recommendations of Base Erosion and Profit Shifting (BEPS). Earlier, some action points in the BEPS reports – such as equalisation levy (BEPS Action Plan 1), country-by-country reporting, lower rate of taxation for income from patents – had been introduced into the statute through the Finance Act 2016. Subsequently, the Finance Act 2017 took



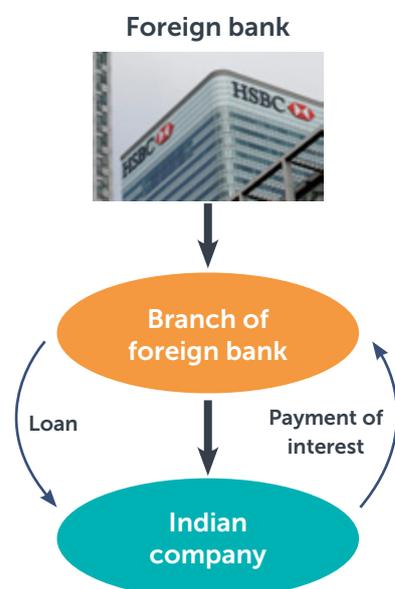
another step towards implementation of BEPS Action Plan 4, 'Limiting Base Erosion Involving Interest Deductions and Other Financial Payments'. Finance Act 2020 has further amended the provisions related to Thin Capitalisation and Equalisation Levy. The same is explained hereunder:

Thin Capitalisation

As per the amendment brought in vide Finance Act 2017 in relation to thin capitalisation, interest expense claimed by a taxpayer, which was paid to its associated enterprise(s), is restricted to 30% of Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) or interest paid/ payable to associated enterprise, whichever is less.

Section 92A of the Act, which defines the term 'associated enterprise' (AE), deems an enterprises as an AE where a loan granted by one enterprise constitutes 50% or more of the total assets of the other enterprise. The term 'enterprise' includes a Permanent Establishment (PE).

Thus, if a branch¹ of a foreign bank grants a loan to an Indian company which constitutes more than 50% of the total assets of that company, then the company constitutes an AE as per section 92A of the Act. This would trigger restricted allowability of interest expenses under the existing section 94B of the Act (as mentioned above), as illustrated in the graphic.



To curb such hardship in case of genuine transactions of Indian branches of foreign banks, the Finance Act 2020 has amended the provisions of section 94B of the Act to provide that **interest paid in respect of a debt issued by a PE of a non-resident engaged in the business of banking and insurance shall be outside the scope of Section 94B of the Act**. Accordingly, in such cases no restrictions would apply to allowability of interest expenses.

Equalisation Levy

As per the amendment brought in vide Finance Act 2016 in relation to Equalisation levy, it was provided that a levy of 6% will be charged on the consideration paid/ payable to a non-resident for online advertisement services. The scope of such equalisation levy has now been expanded vide Finance Act 2020 to also cover the transactions in respect of e-commerce supply or services made or facilitated by an e-commerce operator (being a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both). Such levy will be at 2% on the amount of consideration received/ receivable by an e-commerce operator from e-commerce supply or services made/ provided/ facilitated to:

- (i) a person resident in India, or
- (ii) a non-resident in respect of:
 - sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India
 - sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India, or
- (iii) a person who buys such goods or services using internet protocol address located in India.

However, Equalization levy shall not be charged if the sale, turnover or gross receipts of the e-commerce operator from e-commerce supply or services is less than INR 20 million during the year or where the E-commerce operator has a Permanent Establishment in India or where equalisation

FOOTNOTE

1. A branch of a foreign company is considered a PE in India.



Presently, any Indian citizen or person of Indian origin who comes to India on a visit is considered resident if they reside in India for a period exceeding 182 days in the relevant year and more than 365 days in the preceding 4 years

levy is leviable @ 6% under the existing provisions related to online advertisement services.

It has further been provided that income arising from e-commerce supply or services, chargeable to Equalisation levy, would be exempt from tax.

Modification of residency provisions for individuals

The Finance Act, 2020 has made certain amendments to the residency rules for individuals who come to India on a visit, provisions related to Deemed Residency and provisions related to determination of 'Not Ordinarily Resident'. The same is explained below.

Indian citizen or person of Indian origin visiting India and Provisions related to determination of 'not ordinarily resident'

Presently, any Indian citizen or person of Indian origin who comes to India on a visit is considered resident if they reside in India for a period exceeding 182 days in the relevant year and more than 365 days in the preceding 4 years. Once a person is considered as a resident as per the provisions of the Act, the next step is to determine whether they are 'resident and ordinarily resident' (ROR) or 'not ordinarily resident' (NOR). This categorisation of ROR or NOR determines the scope of the total income which is taxable in India.

Instances had come to notice where the above period of 182 days specified in respect of an Indian citizen or person of Indian origin visiting India during the year, was being misused. Individuals who were actually carrying out substantial economic activities from India were found to be managing their period of stay in India, so as to remain a non-resident in perpetuity and avoid declaring their global income in India. To curb such abuse of a beneficial provision, **the period of stay has been reduced from 182 to 120 days in respect of an Indian citizen or person of Indian origin whose total income other than income from foreign source² exceeds INR 1.5 Million.** However, **such person shall be considered as NOR**, thereby implying that their income earned outside India will not be taxed in India unless it is derived from a business or profession controlled from India.

Deemed Residency of Indian Citizens

The issue of stateless persons had been bothering the tax world for quite some time. It is entirely possible for an individual to arrange their affairs in such a way as to escape liability for tax in any country or jurisdiction during a year. This arrangement is typically employed by high net worth individuals (HNWI), to avoid paying taxes to any country/jurisdiction on the income they earn. The current rules governing tax residence make it possible for HNWIs and other individuals, who may be Indian citizens, to not to be liable for tax anywhere in the world. Therefore, another anti-abuse amendment that has been made is to tax such Indian citizens who are not tax residents of any country.

Accordingly, the residency rules have been amended to provide that **an Indian citizen who is not liable to tax in any other country or territory by reason of his domicile or residence (or any other criteria of similar nature) shall be deemed to be resident in India. However, such resident person shall be considered as NOR**, thereby implying that their income earned outside India will not be taxed in India unless it is derived from a business or profession controlled from India.

Removing dividend distribution tax (ddt) and taxing dividend in the hands of shareholders/unit holders

At present, dividends distributed by Indian companies are subject to dividend distribution tax (DDT), payable by the Indian company. The provisions have been amended to provide that the domestic companies shall not be required to deduct and pay DDT; instead, the dividend will be taxed in the hands of the shareholders. Accordingly, the Indian company will withhold taxes at the time of payment of dividend to the foreign shareholders. It has further been provided that the rate of withholding tax on dividend income in respect of a non-resident shall be 20%. However, where such dividend income is chargeable to tax at a reduced rate as per the provisions of the applicable tax treaty between India and the country of which such person is a resident, then tax shall be withheld as per the rate provided under the said tax treaty.

FOOTNOTE

2. Income from foreign sources means income which accrues/ arises outside India except income derived from a business controlled in/ profession set up in India



Based on these amendments, it is clear that India recognises that apart from strengthening international tax principles, there is a need for policies to provide a stable business environment

This shifting of taxability into the hands of the shareholders creates a beneficial scenario for non-resident shareholders. One of the most significant impacts would be that tax deducted by the Indian company at the time of dividend payment will be available as a credit to the non-resident in its country of residence, which will depend on the respective tax treaty and domestic laws of the country concerned.

Key points

Based on these amendments, it is clear that India recognises that apart from strengthening international tax principles, there is a need for policies to provide a stable business environment. On one hand, the government is tightening residency provisions for non-residents; on the other hand, shifting taxability of dividends into the hands of shareholders comes as a beneficial provision for non-residents. Also, the amendments of taxing income from advertisement and e-commerce transactions (including equalisation levy on e-commerce transactions) indicate the Indian government's intention to tax non-residents who benefit from the Indian economy via e-commerce and related transactions.

Country Focus

NIGERIA

Contributed by
**Fidelis Chukwu and
Sanmi Ogunsanwo,**
Pedabo Professional
Services

E: fchukwu@pedabo.com
E: sogunsanwo@pedabo.com



The Finance Act 2019: Effect on foreign companies and cross- border transactions

Introduction

In Nigeria, 2020 has already been an eventful year with changes in the sphere of taxation—especially with the enactment of the Finance Act, 2019 ('the Act').

The Act was signed into law by the President on 13 January 2020, and became effective on 1 February 2020. The Finance Bill was put forward to support implementation of the Federal Budget for 2020. Notably, the Act is the first of its kind since the end of military rule in 1999; we hope that this commendable development will be sustained on a yearly basis.

The Act introduced the tax framework for emerging transactions while elucidating previously ambiguous issues, to align with current realities and international best practices. The Finance Act amended seven of the country's extant tax statutes:

- Companies Income Tax Act, 2004 (CITA)
- Personal Income Tax Act, 2011 (PITA)
- Value Added Tax Act, 2007 (VAT Act)
- Petroleum Profits Tax Act, 2004 (PPTA)
- Capital Gains Tax Act, 2007 (CGTA)
- Customs and Excise Tariff (Consolidation) Act, 2004 (CETA)
- Stamp Duties Act, 2004 (SDA).

Although the Finance Act amended different provisions in our tax laws, which of course has implications for the various business sectors in our economy, this article's focus is essentially on the amendments that may have implications for international investors wishing to do business in Nigeria.

Increase in value added tax (VAT) rate

The increase in VAT rate from 5% to 7.5% is certainly the most important feature of the Act, as the intention of the government to increase the rate was widely reported around the globe. This is especially because

there have been a number of failed attempts by previous administrations to increase the VAT rate; one such attempt was made in 2007–2008 to increase the rate from 5% to 10%, which was jettisoned almost immediately following protests by labour and the general polity.

Unlike in many other jurisdictions where tax rates are occasionally reviewed upward or downward based on the current or desired economic outlook, the Nigerian VAT rate has been static since its introduction in 1993. The previous rate of 5% ranked among the lowest in the world. In fact, the new rate of 7.5% still ranks low when compared with the rates in other African countries. A far more important reason for increasing the VAT rate, however, is the need to shore up government revenue in view of the heavy dependence on revenue from crude oil sales, which has demonstrated negative growth in the last few years.

In consideration of the potential effects of the rate increase on the populace, especially the low-income earners, the government via the Act has put in place measures to cushion the effect of the increase. These measures include expansion of the scope of exempt goods and services, as well as the introduction of a threshold of N25 million (c. US\$70,000) in annual sales to qualify an entity for participation in VAT collection. This way, most micro and small enterprises are saved the trouble of charging and accounting for VAT. However, this means they cannot recover VAT paid on their purchases.

Imported and exported services

The Finance Act attempts to clarify the previously contentious provisions regarding the treatment of imported and exported services for VAT. The provisions in the VAT Act before these amendments were quite ambiguous regarding the levying of VAT on services provided to Nigerian businesses by non-resident entities. This led to a few litigations at the Tax Appeals Tribunal and even up to the Courts of Appeal. The amendments have now, to a large extent, recognised the application of the destination principle in levying VAT on imported and exported services. Thus, imported services are subject to VAT while exported services



are exempted. There are, however, some exceptions to the recognition of exported services rule, such as services provided to a fixed base or permanent establishment of a foreign entity in Nigeria, which will be deemed consumed and liable to VAT in Nigeria.

Registration for VAT by foreign companies and the reverse charge rule

A foreign company that carries on business in Nigeria is required to register for VAT, using the address of the person with whom it has a subsisting contract as its address, for purposes of correspondence relating to VAT. Foreign companies are now explicitly required to include VAT on invoices issued to a Nigerian company. However, the Nigerian company is still mandated to self-account for the VAT payable on the transaction and remit the VAT to the government, even where the foreign supplier fails to include VAT on the invoice.

Limitation on interest deductions

A fundamental amendment to the CITA by the Finance Act is the introduction of a Seventh Schedule, which provides for a restriction to the amount of interest expense a Nigerian company can deduct in a year. This is triggered where the company has a loan from an offshore related party. The limit has been set at 30% of Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) of the Nigerian company. Excess interest expense can be carried forward for a maximum of 5 years. Banks and insurance companies have, however, been exempted from this thin capitalisation rule. The implication is that it is capable of denying companies affected by the rule from deducting even part of the interest on unrelated party loans.

This new provision is apparently an implementation of the 'fixed ratio' rule recommended in the OECD's Base Erosion and Profit Shifting (BEPS) Action 4.

Exemption of interest on foreign loans

Interest paid to foreign companies on loans to Nigerian companies have enjoyed

tax exemption since the enactment of the Companies Income Tax Act (CITA) in 1993. The exemption table has now been amended to restrict the exemption to a maximum of 70%, from the previous 100%.

TABLE: Interest exempt on foreign loans (Fifth Schedule of CITA)

Repayment period	Moratorium	Tax exemption allowed
>7 years	Not less than 2 years	70%
5–7 years	Not less than 18 months	40%
2–4 years	Not less than 12 months	10%
<2 years	Nil	Nil

Taxation of online activities

Foreign companies are now liable to income tax in Nigeria if they deliver services electronically to Nigeria. The Finance Act amended the CITA to make specific provisions to tax foreign companies having 'significant economic presence' (SEP) in Nigeria. Therefore, activities such as e-commerce, app stores, high-frequency trading, electronic data storage, online adverts, participative network platform, online payments, and so on will give rise to taxable income in Nigeria in the hands of NRC. Such NRC are expected to file returns of their income attributable to their activities in Nigeria. However, the taxation thereof is to the extent that the foreign company has SEP in Nigeria. This provision is evidently an adoption of the OECD BEPS Action 1 ('Tax Challenges Arising from Digitalisation').

Significant economic presence

The liability to tax in Nigeria of companies providing digital, consultancy, technical and professional services will no longer be based on physical presence, but on SEP. Withholding tax at 10% is expected to be deducted and treated as final tax on such income of the NRC in Nigeria. The definition of SEP is not provided in the Act, but the Minister of Finance has been empowered to provide a suitable definition – which is expected to resemble those adopted by countries with a similar social and economic outlook.



The Finance Act has enabled Nigeria to introduce amendments to CITA that help to promote the country as an investor-friendly territory

Modification of excess dividend tax provision

A rather welcome amendment of the CITA is Section 19, which is the provision on excess dividend tax. Until now, dividends paid or payable by a company in any assessment year represented the lowest taxable profit for such a company, even if the profit was inclusive of non-taxable incomes or taxed profits retained from prior years. Many unsuccessful attempts were made in courts by a few companies to contest the application of the provision. However, with the Finance Act, this controversial provision has been amended: excess dividend tax will no longer apply on the portion of the dividends paid out of profits on which adequate tax had previously been paid, franked investment incomes (dividends) or exempted profits.

Other amendments

The Finance Act has enabled Nigeria to introduce amendments to CITA that help to promote the country as an investor-friendly territory, especially by removing provisions previously seen as anti-investments and introducing provisions that help promote new investments.

- **Payment of minimum tax:** The previous provisions that required computation of minimum tax using variables such as the paid-up share capital and net assets of companies, which made companies pay tax out of their shareholders funds, have been amended. Minimum tax is now pegged at 0.5% of the gross turnover. The amendments have, however, removed the former exemption granted to companies with at least 25% imported equity or foreign participation.
- **Regulated securities lending transactions:** The regulatory framework for these transactions has been introduced into the tax laws by the Act. Manufactured/substitute interest and dividend payments are now recognised as transparent for tax purposes, thereby eliminating the risk of double taxation.
- **Real estate investment companies (REICOs):** The risk of double taxation previously faced by REICOs and similar special-purpose vehicles has now been

eliminated. Dividends and rental income received by REICOs on behalf of their shareholders are now exempt from income tax if at least 75% is distributed within 12 months of the financial year. Income received by shareholders of a REICO is, however, subject to withholding tax.

- **Agricultural production companies:** The agricultural industry has witnessed a surge in government interest in the last 4 years. This interest has now been further boosted with the grant of a 5-year tax holiday to companies in the sector, with opportunity to renew for another 3 years upon satisfactory performance.

Country Focus

ROMANIA

Contributed by
Adrian Simionescu,
Soter & Partners

E: adrian.simionescu@taxwise.ro



New EU rules on cross-border tax arrangements

In 2018, the EU took a new step towards increasing tax transparency: on 25 May, the Council of the European Union issued Directive 822/2018, also known as the Directive of Administrative Cooperation 6 (DAC 6), which requires mandatory reporting of certain cross-border arrangements and also the automatic exchange of information between member states for such agreements.

The directive came in response to Action 12 of the OECD's Base Erosion and Profit Shifting (BEPS) strategy, and represents a tool for the tax authorities to minimise BEPS and increase transparency in the internal market. Moreover, DAC 6 provide tax authorities with a warning mechanism regarding the risk of tax evasion, so that they can carry out much more efficient controls.

The primary scope of the directive is to increase transparency on cross-border transactions that involve EU member states, and to discourage taxpayers from entering into particular tax optimisation schemes that can be considered harmful.

Besides taxpayers, the provisions of the directive also target intermediaries such as tax consultants, lawyers, accountants and auditors.

Implementing DAC 6 has established a set of uniform and common rules in the EU tax environment, to reduce the scope for harmful tax practice. Many EU companies and multinational groups are affected by the provision of DAC 6, requiring them to invest resources and time in strengthening the transparency and fairness of cross-border tax arrangements.

Sanctions established by member states in local legislation associated with failure to comply with DAC 6 could be financially significant, and might also involve some risk to reputation for businesses, intermediaries and individuals.

Status of implementation at EU level

The provisions of the directive will take effect from July 2020. Member states have

been required to take action and transpose the DAC 6 provisions into their domestic tax legislation by 31 December 2019.

Since the beginning of 2020, rapid progress has been made on this front: as of February, 18 member states (Austria, Belgium, Bulgaria, Croatia, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Lithuania, Malta, the Netherlands, Poland, Romania, Slovakia and Slovenia) have adopted rules in this regard.

A further eight member states, including the UK (which recently laid final regulations before Parliament), have issued draft laws requiring taxpayers/intermediaries to report information on certain tax arrangements; the implementation process should be finalised soon. Only two member states, Greece and Latvia, have yet to take any initiative.

Key aspects related to DAC 6

The scope of DAC 6 is very wide-reaching. It imposes a primary disclosure obligation on intermediaries (e.g. lawyers, law firms, accountants, auditors, banks), including anyone who provides aid, assistance or advice with respect to designing, marketing, organising, making available for implementation or managing the implementation of a reportable cross-border arrangement. There is a secondary reporting obligation on taxpayers. The directive provides a set of hallmarks to be used to identify the reportable cross-border agreements. In this sense, it presents five categories of hallmark, some (not all) of which are associated with the 'main benefit test', which seeks to establish whether 'the main benefit or one of the main benefits which, having regard to all relevant facts and circumstances, a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage'.

In other words, this test weighs the amount of all benefits expected to be obtained as tax advantage with any other benefits that are likely to be obtained from the agreement.

For the categories of hallmark that are linked to the main benefit test, it is crucial to perform a comprehensive analysis of all relevant aspects and circumstances that might indicate whether the main benefit (s) was the obtaining of a tax advantage.



It is fair to anticipate that the evaluation of potential reporting obligations under DAC 6 will become an integral part of all tax analyses

The directive presents the generic and specific hallmarks linked to the main benefit test, which refers to various types of agreements:

- Arrangements that generate performance fees or involve 'mass-marketed' schemes
- Transactions involving the acquisition of companies that record losses, in order to reduce tax obligations
- Transactions aimed at converting debt into share capital
- Loans that aim to finance the distribution of dividends, capital contributions or the acquisition/extension of participants in other companies
- Transactions between related companies when the beneficiary of the payments is not essentially subject to any tax (the taxation is zero, or close to zero)
- Deduction of the depreciation of an asset is required in several jurisdictions
- Arrangements that may have the effect of undermining the reporting obligation or any agreement regarding the automatic exchange of information regarding the financial accounts, etc.

Reporting under the main benefit test does not generally mean that the taxpayers engage in illegal conduct, or that the tax set-up of a cross-border arrangement can be challenged. However, it is fair to assume that the tax authorities involved will be more focused on the reported cross-border arrangements.

The provisions of DAC 6, as transposed in the local legislation of each member state, is expected to enter into force on 1 July 2020 and applies to cross-border arrangements implemented since 25 June 2018. Agreements that meet the reporting requirements are to be reported by 30 August 2020.

It is fair to anticipate that the evaluation of potential reporting obligations under DAC 6 will become an integral part of all tax analyses, as both intermediaries and taxpayers will need to carefully consider potential reporting obligations.

Specific domestic approaches

The reporting area includes all taxes, except value added tax (VAT), excise duties, compulsory contributions to social insurance and customs duties.

However, some countries – such as Poland and Portugal – have expanded the reporting area, adding to the reporting obligation and the VAT sphere:

- **Poland** imposes the most severe penalties for non-compliance – these can reach up to €5 million. In addition, Poland implemented in its local legislation the reporting of the domestic arrangements and additional hallmarks have been included.
- A similar situation exists in **Portugal**, where reporting is also mandatory for domestic arrangements. In addition, its local tax law specifies two additional hallmarks; there is a penalty of up to €80,000 for non-compliance.

Estonia is another example where the domestic law includes some additional hallmarks. However, in this country, non-compliance will lead to a penalty of up to €3,300.

The Netherlands imposes severe penalties, with a single tax of €800,000; the authorities can even start criminal prosecution in certain cases.

In **Austria, Belgium, Slovakia** and **Sweden**, the penalty is up to €50,000, or €25,000 in countries such as **Cyprus, Czech Republic, Germany, Hungary** and **Slovenia**.

The **UK** did not include domestic arrangements and no new hallmark has been specified. However, non-compliance will lead to a penalty of up to £1 million.

In the specific case of **Romania**, the directive was transposed in the domestic legislation by Ordinance no. 5/2020 for the modification and completion of Law no. 207/2015 regarding the Fiscal Procedure Code.

The reporting obligation rests primarily with the intermediaries, as well as with any taxpayers who implement a cross-border scheme.



Failure to report, or delayed reporting, by intermediaries or taxpayers is sanctioned with a penalty up to 100,000 lei (about €20,000). In addition, any intermediary who fails to meet their obligation to notify another intermediary or the relevant taxpayer is sanctioned with a fine of up to 30,000 lei (around €6,500).

In conclusion

Given that the provisions of the directive will have a retroactive effect, it is important for tax contributors to be prepared with an evaluation of the reportable agreement. Taxpayers and intermediaries alike must stay informed about how the directive is transposed into domestic tax law, taking into consideration that there are no thresholds regarding the materiality of the transactions and even an immaterial transaction can be subject to reporting.

Country Focus

THE NETHERLANDS

Contributed by
Albert de Jager,
Hoek en Blok

E: a.dejager@hoekenblok.nl



New obligation to notify Dutch government of posted workers

In 2014 the European Union adopted the Posted Workers Enforcement Directive in an effort to improve the protection of posted workers' rights and to prevent companies from circumventing applicable terms and conditions. One of the ways to support these goals was the introduction of a mandatory notification requirement for temporary assignment/secondment activities. The Netherlands implemented the directive in its 2016 Terms of Employment Posted Workers in the European Union Act (WagwEU). The notification requirement, however, was put on hold, until now.

As of 1 March 2020, the Dutch government requires all foreign employers and foreign self-employed persons (limited to certain sectors) from other countries within the European Economic Area (EU member states, Norway, Iceland and Liechtenstein) or Switzerland to keep them informed of temporary assignment/secondment activities via the online notification portal.

The WagwEU makes a distinction between employers abroad, self-employed persons, and clients (service recipients).

Employers abroad are foreign employers who:

- come to the Netherlands temporarily with their own personnel to carry out work;
- second employees temporarily from a multinational company to its own branch in the Netherlands; or
- as a foreign temporary employment agency, make temporary agency workers available in the Netherlands for a limited time.

Self-employed persons who come to the Netherlands on a temporary posting are obliged to notify in some cases.

Clients (service recipients) are the clients or companies for whom the employer abroad or self-employed person works.

Subcontracting

If a company abroad or self-employed person contracts a third company to perform all or part of the work for a Dutch client, this involves subcontracting. In that case, the employer abroad or self-employed person functions as a client (service recipient). The third company notifies its own personnel, and the employer abroad or self-employed person reviews the notification.

Notifying online

When notifying, employers abroad should provide at least the following details:

- The identity of the person submitting the notification
- The details of their company
- The contact person, as referred to in the WagwEU
- The identity of the client (service recipient)
- The sector in which the activities will be carried out in the Netherlands
- The address/place where the work will be performed
- The expected duration of the work
- The identity of the person responsible for payment of salary/wage
- THE identity of the employees coming to the Netherlands to work
- the presence of an A1 declaration or other type of evidence that shows where the social security contributions are paid for the employee(s), because of the contribution for the relevant social security scheme.

Self-employed persons

Self-employed persons with a duty to notify must among other things notify their identity, the identity of the client, the sector in which the activities will be carried out, the address/place where the work will be performed, the duration of the work, and information about where social security contributions will be paid.

The duty to notify applies only to self-employed persons working in various



For small businesses and self-employed persons with a duty to notify, located within 100 km of the Dutch border, the notification per individual posted worker may, under certain conditions, be replaced by a single annual notification

designated sectors. The sector in which the self-employed person works is assessed based on the following criteria:

- The nature of the work actually carried out
- The activities and work as described in the assignment contract, service agreement or transport contract
- The SBI code¹ assigned to the self-employed person based on their economic activities
- The location where the work is carried out.

Which sector the self-employed person works in is determined by the activities they perform in the Netherlands, based on the above criteria. A full list of sectors is provided on the website of the Dutch Chamber of Commerce.

Any self-employed person working in the following (sub)sectors (with the SBI classifications indicated below) has a duty to notify:

- **A** = Agriculture, forestry and fishing
- **C** = Manufacturing
- **F** = Construction
- **H** = Transportation and storage
- **I** = Accommodation and food service activities
- **N** = Renting and leasing of tangible goods and other business support services like cleaning
- **Q** = Human health and social work activities.

One-year notification

For small businesses (up to nine workers) and self-employed persons with a duty to notify, located within 100 km of the Dutch border, the notification per individual posted worker may, under certain conditions, be replaced by a single annual notification. The 1-year notification also applies to international transport companies or to self-employed persons based abroad who make cabotage trips within the Netherlands or load/unload cargo in the Netherlands. However, 1-year notifications do not apply to the construction or temporary employment sectors.

No duty to notify

There is no notification requirement for certain types of occasional work over a limited time frame, such as:

- Participation in business meetings
- Initial assembly or the first installation of goods, carried out by qualified or specialised workers
- Carrying out urgent maintenance or repairs
- Participation in sports competitions
- Attendance of academic conferences in the Netherlands.

Check on notification

The client (service recipient) is obliged to check whether a notification has been made and review whether this notification is correct. The client will be notified when the employer abroad or self-employed person notifies their arrival, and can inspect and review the notification online. If there are any errors in the notification, the client must notify them through the online notification portal, after which the client must request the employer abroad or the self-employed person to amend the notification.

Monitoring

The SZW Inspectorate checks whether employers abroad, self-employed persons and clients comply with the terms of WagwEU. Along with the Dutch Tax and Customs Administration and the Sociale Verzekeringsbank (SVB), the SZW Inspectorate has direct access to all notifications. The Dutch Immigration and Naturalisation Service (IND) can request information from the notification portal if a posted foreign national requires a residence permit. The social partners can request information from the notification portal to check compliance with collective agreement conditions.

Fine

If a check or a visit to the address/place where the work will be performed reveals that the arrival was not notified beforehand or was notified incorrectly, a fine with a maximum of €12,000 per violation may be imposed on the company abroad or the self-employed person with a duty to notify, as well as on the client (service recipient).

FOOTNOTE

1. SBI (Standard Bedrijfsindeling) is the Dutch version of the General Industrial Classification of Economic Activities within the European Communities, or NACE.

International Tax Cases

Contributed by
Parul Jolly



Pike v. Commissioner of Taxation [2019] FCA2185 [Federal Court of Australia]

Facts

Mr Pike was born in 1972 in British colony of Southern Rhodesia (which became the Republic of Zimbabwe in April 1980). Until 2005, he worked in Zimbabwe in the tobacco industry. He was married to Ms Thornicroft, who was also born in Rhodesia.

His wife got a job in Australia and migrated there with her two sons in 2005. Mr Pike stayed in Zimbabwe to complete his terms with the current employer before joining her in Australia later that year. However, he could not get a job because the tobacco industry no longer operated in Australia.

He therefore moved to Thailand in 2006 and began work there; his salary was paid into a Thai bank account. Though he intended to return to his family in Australia, circumstances required that he spent most of his time working and living in Thailand. Between 2006 and 2014, he rented an apartment in Thailand.

He and his wife jointly held a rented accommodation in Australia. Mr Pike and his wife also had a joint bank account in Australia, to which he regularly transferred funds to support his wife and children after she left her job in 2011.

In 2009, Mr Pike's wife and children obtained permanent residency visas from Australia; they became Australian citizens the following year. His own application for Australian citizenship was approved in 2013, at which time he obtained an Australian passport.

In 2014, he was relocated to Tanzania, where he had a bank account and rented a home. Then in 2016, he was promoted and moved to Dubai. He rented an apartment there, and also opened a Dubai bank account.

In June 2017, he received a notice of assessment from the Australian tax authorities with respect to income tax years 2009–2016.

Issue

Whether Mr Pike was a resident of Australia for tax purposes for the years 2009–2016,

or a resident of Zimbabwe from 2009–2014 and then a resident of Tanzania (2014–2015) and UAE (2016).

Decision

The court observed that Mr Pike was a resident of Australia according to the ordinary meaning of the word 'resident', in each of the relevant years. Further, he was also a resident of Thailand between 2006 and 2014. Further, after leaving Thailand, he became successively resident of Tanzania and then Dubai.

These foreign residential statuses were in addition to his Australian residential status; thus, this was considered a case of dual residency and hence to be tested for tie-breaker rule. The court observed that Mr Pike continued to travel on his Zimbabwe passport. He retained Zimbabwe citizenship and ownership of his home in Zimbabwe. His 'domicile of origin' was Zimbabwe; he obtained 'domicile by choice' of Australia under Section 6(a)(i) only in 2014, not in the year of his arrival (2005). The court further observed that 'the tie of citizenship or domicile is not necessarily the tie of residence', and therefore applied the DTAA tie-breaker rule.

The court held that the assessee only rented premises wherever he worked; considering that the assessee did not own a 'permanent home' in both countries, the court inferred that the first and second tests of 'permanent residence' and 'habitual abode' failed.

Thereafter, the court evaluated the third test under Article 4(3) (i.e., the country to which the assessee's personal and economic relations are closer), and held that though the assessee had a closer personal relationship with Australia (as his family resided there), the economic relationship with Thailand was much closer as he supported his family financially out of his earnings from Thailand.

Accordingly, the court held that the personal and economic relations were closer to Thailand than Australia, between 2009 and 2014. That being so, he was, in each of these



income years, deemed only to be a resident of Thailand for tax purposes.

Editorial comment

The court weighed the assessee's 'economic relationship' over 'personal relationship'. Although Mr Pike's personal relations were closer to Australia, he never seemed to really settle with his family in Australia; he never purchased a home in Australia; and his economic interests were held closer to countries where he worked and earned income. This is a classic case illustrating the application of DTAA over domestic law.

International Tax Cases

Contributed by
Parul Jolly

ABC Proprietary Limited v. Commissioner (No. 14287) (South Africa Tax Court in Cape Town)

Facts of the case

A South Africa-resident company (appellant), which was the shareholder of a Dutch company, received dividend income from a Dutch company. The Dutch company withheld taxes at 5% as per the South Africa–Netherlands Double Taxation Avoidance Agreement (DTAA). The South African company requested a refund of taxes so deducted by invoking the ‘most favoured nation’ (MFN) clause under the South Africa–Netherlands DTAA.



Contention of the appellant

- Article 10 of the South Africa–Netherlands DTAA provides for 5% withholding tax rate for dividends.
- The MFN clause in Article 10(10) provides that if under any convention for the avoidance of double taxation concluded after the date of conclusion of this convention between South Africa and a third country, South Africa limits its taxation on dividends to a lower rate, including exemption from taxation on a reduced taxable base than the rate/base provided in the South Africa–Netherlands treaty, then the same rate, same exemption or same reduced taxable base as provided for in the convention with that third party shall automatically apply in both contracting states under the South Africa–Netherlands convention.
- The above protocol came into force in 2008. South Africa has DTAA with Kuwait that provides for nil withholding tax rates on dividend income; however, that convention was concluded in 2006. As the MFN clause of the South Africa–Netherlands DTAA has a time limit to its applicability, only those conventions signed after the signing of South Africa–Netherlands DTAA can be invoked to gain the benefit of the MFN clause. Hence direct reference to the South Africa–Kuwait DTAA was not possible.
- However, the appellant contended that in the case of the South Africa–Sweden

DTAA, the MFN clause is similar to that in the South Africa–Netherlands DTAA, but with one crucial difference: the clause applies irrespective of when the DTAA with the third country was concluded.

- The South Africa–Sweden DTAA does not provide for a lower withholding tax rate for dividend income. However, the appellant contended that the protocol of the South Africa–Sweden DTAA that incorporated the MFN clause came into force in 2012; therefore, by applying the MFN clause of the South Africa–Sweden DTAA, the rate given under the South Africa–Kuwait DTAA can be taken into account.

Contentions of the tax authorities

The tax authorities denied the benefit, stating that the benefit of the South Africa–Kuwait DTAA is not available directly to the South Africa–Netherlands DTAA. The MFN clause should be read literally, and not be open to interpretation based on the MFN clause in other DTAA's.

Decision of tax court

The court upheld the application of the MFN clause in the DTAA concluded between South Africa and the Netherlands, which implied that the South African Revenue Service had to refund the dividend withholding tax imposed on the Dutch taxpayer. The court held that although the MFN clause is to be interpreted based on its plain meaning, it cannot be contended that the MFN clause is not intended to be triggered by the MFN clause in any treaties concluded thereafter. Concerning the South Africa–Netherlands DTAA, the total tax effect must be seen while applying the beneficial effect of the MFN clause.

Editorial comments

This is a very important ruling in terms of applying the MFN clause given in the DTAA's, because the MFN clause when applied through the protocol is assumed to have automatic application. This decision of the Supreme Court of South Africa should have a persuasive value in other jurisdictions.

International Tax Cases

Contributed by
Ariel Zitnitski,
Zitnitski Weinstein &
Co., Tel Aviv, Israel

E: az@zw-co.com



Tax assessor Netania v. Delek Hungary Ltd Civil Appeal Number 8511/18 (26 January 2020)

Facts of the case

The taxpayer ('the company'), incorporated in 2000 in Hungary, became a resident of Israel from 2011 for tax purposes. The company's principal asset was shares of Delek US Holdings Inc. (Delek US), a US-resident company for tax purposes, which was founded by the taxpayer in 2001. The taxpayer sold its shares in Delek US in 2012–2013.

In reporting the capital gain filed to the tax authorities in Israel for the sale of these shares, the company has reduced amounts that it claims constitute its proportionate share of Delek US's 'distributable profits' so that in accordance with the provisions of section 94B of the Tax Ordinance in Israel, it will be taxed at the rate applicable if the profits had been received as a dividend.

Explanation: Since a dividend between Israeli companies is tax exempt, an Israeli company that sells its holdings in another Israeli company to the extent that there are surpluses for distribution can therefore see these surpluses as tax-exempt gain (subject to few conditions). This is to create indifference between the alternative of dividend distribution before the taxable sale and the sale of the company before the dividend distribution. Section 94B states that the exemption will be granted when a corporate tax is paid for those profits, and the question is whether the tax is paid in Israel.

The district court accepted the company's position for a number of reasons, most notably the principle that the purpose of section 94B legislation is to bring about 'tax indifference' of the tax between the withdrawal of profits from the company held by dividends and the sale of the company's shares before the distribution of profits. The District Court further held that there is no basis for the pedantic interpretation on which the tax assessor's claims were based as to the definition of the term 'tax' and reference existing in section 94B of section 126(b) of the Ordinance; and that a meaningful interpretation of the section

should be provided, that is, in fact, corporate tax in Israel.

Contention of the taxpayer

The company argued that the tax arrangement should also be applied:

- a. when it comes to holding a foreign company that paid a foreign corporate tax and creating a broad interpretation of the section is correct; and
- b. that the interpretation that distributable profits are tax deductible only if tax paid before in Israel is incorrect.

Contentions of the tax assessor

Section 94B provides for a specific arrangement intended to prevent double taxation when it comes to profit generated in Israel and paid for in Israeli corporate tax. Therefore, distributable earnings from Delek US should be taxed as ordinary capital gain, and no tax benefits can be given for the share sale.

Supreme Court decision

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

From the language of section 94B and the grouping of the relevant definitions in the Tax Ordinance, it is clear that the legislature exempted the sale of shares of a company whose income was not received in Israel from the scope of section 94B and the tax benefit contained therein. Accordingly, in that case the distributable profits should not be tax exempt and must be taxed according to the position of the tax assessing officer.

International Tax Cases

Contributed by
Stefan Huang and
Roger Lai,
Wetec International
CPA, Taiwan

E: shanehua@cpawetec.com.tw

E: roger.lai@cpawetec.com.tw



E-commerce and VAT: Taiwan's Uber tax decision

Uber's operation and issues in Taiwan

Since 2013, Uber Technology, Inc., has extended its taxi platform business into Taiwan through its subsidiaries, Uber BV (registered in the Netherlands) and Uber Taiwan, Inc. (100% owned by Uber BV). Taiwanese consumers and drivers have contracted with Uber BV to access the online taxi-matching service; cash flow is also routed to Uber BV. Uber Taiwan provides services to Uber BV by handling the local customer relationship, driver recruitment, public relations and advertising. Uber Taiwan has been compensated by Uber BV on a cost-plus basis.

As in many other countries, Uber's business model was challenged in Taiwan for violating taxi license control and not paying VAT on revenues sourced from Taiwan. In 2017, the Taiwanese tax authorities had assessed 50 million NTD (about US\$1.7 million) VAT payable to Uber Taiwan for the period from September 2013 to June 2016, when Uber ceased its former operational model in Taiwan. Besides the VAT payable, Uber Taiwan was fined 1.5 times the tax amount for tax non-compliance.

Arguments and results of this case

Uber Taiwan argued that it only provided auxiliary services to Uber BV and assisted Uber BV to perform matching services between consumers and drivers. Uber Taiwan was not itself a party involved in the triangular relationship of customers, drivers and Uber BV. It also claimed that 'services' rendered under the Uber business model were not transporting services, but matching consumers with drivers. The tax authorities applied the 'substance over form' (General Anti Avoidance Rules; GAAR) provision and regarded Uber Taiwan as a *de facto* taxi service provider, who should be responsible as taxpayer for all taxi fares received by Uber BV.

Uber Taiwan finally appealed to Taiwan's Supreme Administrative Court ('the Court'), which in April 2018 ruled that the VAT assessment was correct and legal; however, it reduced the penalty from 1.5x to 1x VAT.

The Court's reasoning

The Court ruled in favour of the tax authorities' application of the GAAR provision: the Uber business model was regarded as an abusive 'tax avoidance scheme', which authorised a tax adjustment in accordance with economic reality and ordinary transaction. The Court found several irregularities in Uber's business and transaction model, such as the contract and cash-flow arrangements as well as compensation of Uber Taiwan from Uber BV:

- Local customers and drivers were required to contract with Uber BV rather than Uber Taiwan, which is geographically much closer to them.
- The cash flow is routed to Uber BV, with online payment methods accordingly.
- Uber Taiwan was responsible for driver recruitment and customer relations, which are vital functions in the overall business model. However, Uber Taiwan's compensations are based on costs and expenditure incurred in Taiwan, rather than on actual contributions or revenues.

These irregular arrangements had no substantial economic justification, but produced large tax benefits by shifting the sales revenue from Uber Taiwan to Uber BV. Therefore, the sales revenue from taxi services or taxi-matching services should be attributed to Uber Taiwan and taxable for Taiwan VAT.

Although the Uber business model and arrangements were deemed as tax abusive, the Court did not consider Uber Taiwan's VAT non-compliance to be deliberately evasive: since its first day of operation in Taiwan, Uber Taiwan has disclosed its business model and structures to the public. However, during the period 2013–2016, tax authorities had failed to notify Uber Taiwan of its non-compliance.

E-commerce taxation in Taiwan: Future prospects

Many globally respected e-commerce multinational companies are now registered in Taiwan, and have been subject to the



simplified e-commerce VAT regime since May 2017. Uber BV, as one such business, still operates with the same contract and cash-flow arrangements as before. Though similar practices are common among other big E-commerce businesses, Taiwan's tax authorities have not challenged them with the GAAR provision. In other words, if an e-commerce business chooses a compliant policy to deal with tax matters, like issuing electronic invoices and reporting sales bi-monthly, then its operation is unlikely to provoke Taiwan's tax authorities. However, the cost-plus basis as a transfer pricing method between a foreign HQ and Taiwan's e-commerce subsidiary could arouse suspicion regarding corporate taxation.

Since mid-2019, Taiwan tax authorities have started to exchange tax information, including CbC reports, with treaty partners. Against this background, cost-plus arrangements may warrant closer attention to ensure compliance.

International Tax Cases

Contributed by
Angela Sadang,
Marks Paneth LLP, USA

E: asadang@markspaneth.com



Intangibles in a transfer pricing context: Reflections on the Ninth Circuit's decision in *Amazon.com, Inc. v. IRS Commissioner*

A unanimous decision by the US Court of Appeals for the Ninth Circuit on 16 August 2019 affirmed the decision of the US Tax Court in *Amazon.com, Inc. v. IRS Commissioner*, 148 TC 108 (2017). The court held that intangible assets under the US transfer pricing regulations under Section 482 in effect in 2005 and 2006 do not encompass residual-business assets such as the value of workforce in place, goodwill, going concern value and other similar components that are not discrete items of intellectual property. The Ninth Circuit, using 'traditional tools', favoured Amazon's interpretation and definition of 'intangibles' as 'limited to independently transferable assets'.

Background and case specifics

Amazon set up a subsidiary in Luxembourg ('Lux') as a holding company to ensure lower tax liabilities for the bulk of Amazon's European business. In 2005 and 2006, Amazon transferred to Lux three groups of intangible assets through a cost-sharing arrangement (CSA) pursuant to applicable regulations:

- Website-related technology
- Marketing intangibles, including trademarks, trade names and domain names relating to the European business
- Customer lists and related customer information.

Under the terms of the CSA (and under the applicable transfer pricing regulations), Lux had to make an upfront 'buy-in payment' for the pre-existing intangible property (IP). Amazon determined a buy-in payment of \$255 million to Lux based on an estimated 7-year life for the transferred intangibles. Amazon did not include the value of any residual-business assets in the determination of the buy-in payment.

The IRS performed its own calculation: applying a methodology that identified all non-routine/non-benchmarkable income as the income associated with the transferred IP, they valued the buy-in at \$3.6 billion. The IRS argued that the definition of intangibles under the 1994 transfer pricing regulations was broad and thus did not specifically exclude residual-business assets from the scope of the buy-in requirement.

For the privilege of building out Amazon throughout Europe, the IRS required Lux to pay for Amazon's US IP, including

'residual-business assets' such as the value of Amazon's workforce in place, culture of innovation, going concern value, goodwill and growth options.

Amazon disagreed, and petitioned the Tax Court.

The core argument of the case and its subsequent appeal stems from each party's interpretation of what qualifies as an intangible under Section 1.482-4(b) and as referenced in the cost-sharing regulations (Section 1.482-7A(a)(2)) at the time of Amazon's 2005–2006 CSA. Amazon argued that the IRS's calculation of the buy-in payment included residual items (e.g., workforce in place, going concern value, goodwill and certain 'growth options' such as company culture) that were outside the scope of what constitutes an intangible as defined in Section 1.482-4(b).

On 23 March 2017, the Tax Court, in a landmark decision, sided with Amazon and opined that the IRS's determination of the cost-sharing buy-in payment was arbitrary, capricious and unreasonable, and agreed with Amazon that residual-business intangibles were not subject to the buy-in requirements at the time of Amazon's 2005–2006 CSA.

However, the IRS took the matter to the Ninth Circuit, arguing that the Tax Court's interpretation of Section 1.482-4(b) conflicted with the overall purpose of the arm's-length standard and that its own interpretation of 'intangibles' was supported by the Tax Cuts and Jobs Act (TCJA).

On 16 August 2019, the Ninth Circuit issued its opinion in favour of Amazon.



The Amazon case has far-reaching implications for many multinational enterprises (MNEs) with an abundance of IP and CSAs going back more than a decade

Key take-aways

Definition of 'intangibles' versus the valuation of intangibles

The Ninth Circuit was laser focused on one key issue: Did Treas. Reg. § 1.482-4(b), which was in effect for this case, require Amazon to include the value of residual-business assets in its buy-in valuation?

The IRS argued that the arm's-length standard itself means that residual-business assets are compensable because 'it is undisputed that a company entering into the same transaction under the same circumstances with an unrelated party would have required compensation'.

The Ninth Circuit panel addressed that argument in a footnote, holding that the IRS's argument 'misses the mark' and that while the arm's-length standard 'governs the valuation of intangibles, it doesn't answer whether an item is an intangible'.

The implication of the Ninth Circuit's statement is that, without showing that the transfer within the CSA was done through a limited licence that is the substantive equivalent of a sale of the business, the IRS cannot characterise the assets transferred as if the licence transfer were a sale. The key point in the Ninth Circuit's analysis involved recognition that the transfer of assets in a CSA is not necessarily the economic equivalent of a sale of business.

Cost-sharing regulations – timing matters

The Ninth Circuit pointed out that its opinion interprets the definition of 'intangible property' under Treas. Reg. 1.482-4(b) promulgated in 1994 and 1995, and not the subsequently issued 2009 regulations or the statutory amendment introduced with the TCJA in 2017.

Temporary cost-sharing regulations were issued by the US Treasury to replace the 1994 and 1995 regulations, and in 2017 Congress amended the definition of intangible property as part of the TCJA. The temporary regulations effectively expanded the definition of intangibles for cost-sharing purposes to include residual assets such as going concern value and goodwill. The TCJA expanded the definition of intangibles in Section 482 to include residual-business assets when such intangibles are transferred to a related party. Thus, if the question is:

'What are intangibles for the purposes of determining what a transferee must pay for?' the newly expanded definition would be applied, consistent with the IRS's attempt to retroactively expand that definition. However, where a transfer would not, at arm's length, include such intangibles, then the transferee should not be required to pay for them.

The Ninth Circuit also noted that the cost-sharing regulations in effect in 2005 and 2006 identified intangibles that were the product of research and development efforts, which indicated that the regulations contemplated a meaning of 'intangible' that excluded items that are generated by earning income, not by incurring deductions, such as goodwill and going concern value.

The Ninth Circuit's opinion is limited to issues arising under the 1995 cost-sharing regulation. The subsequent cost-sharing regulations replaced the reference to buy-in payment with the concept of a platform contribution transaction, which includes any resource, capability or right that is reasonably anticipated to contribute to developing cost-shared intangibles. The TCJA amended the definition of intangible property to include workforce in place, goodwill and going concern value. It remains unclear how courts might decide a similar case involving a post-2009 transaction. Nonetheless, US practitioners and taxpayers alike should familiarise themselves with this case because its consequences for the relevant time period are significant.

Implications going forward

The Amazon case has far-reaching implications for many multinational enterprises (MNEs) with an abundance of IP and CSAs going back more than a decade, and that took similar approaches to the definition of intangibles and the determinations of buy-ins when they entered into (or augmented) similar CSAs. Many MNEs with similar IP structures as Amazon and CSAs established between 1994 and 2009 may breathe a sigh of relief. However, the definition of intangibles has changed post-2009 and post-2017, and this means certain IP structures face greater scrutiny and litigation than in the past. The Amazon case will have a large impact on



the scope of the IRS's discretion in making adjustments based on its interpretation of broad language within the US Tax Code. Not only will the IRS be emboldened, but the US courts will likely be less forgiving for post-2017 structures.



Morison KSi

The Next Step

Contact Morison KSi to discuss your needs

E: info@morisonksi.com

T: +44 (0)20 7638 4005

www.morisonksi.com

Morison KSi
6th Floor
2 Kingdom Street
Paddington
London, W2 6BD
United Kingdom