Morison KSi

Q1, 2016
(Issue 15)

Global Tax Insights

CONTENTS

EDITORIAL

February is the month of celebrating love; and two of the world's fastest-growing professional associations, Morison International and KS International, were not to be left out. On 8 February 2016, MI and KS International announced their merger to form a US$ 1 billion association. The merged entity would be known as Morison KSi. Both associations are well known for their focus on personal relationships and highly selective approaches to membership recruitment; both share a commitment to maintaining their association status. The merger is built on a shared culture that is dynamic, ambitious and client focused. What it means for our respective clients is that member firms have access to more resources, skills, experience, depth, breadth and reach, ultimately enabling member firms to improve their international services to clients. The merger is effective from 1 April 2016.

Global Tax Insights, now in its fourth year, will continue to provide member firms with the latest global news and information from the tax world. As more firms join the association, we will strive to ensure that the content is relevant and adds value for member firms and their respective clients.

In October 2015, the OECD published 13 final reports and an explanatory statement outlining consensus on 15 Actions under the Base Erosion and Profit Shifting (BEPS) project. Countries that have collaborated in this project have agreed to continue working together until at least 2020. While there will be further policy developments in 2016 and 2017, the main focus for now is on monitoring adoption of the agreed measures.

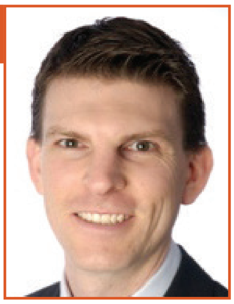
Besides the usual country updates, this edition of the newsletter covers two articles on Action Plans 1 and 8 of the BEPS project. Two international tax cases, one from Israel and the other from India, are also included.

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

Happy reading!

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

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



New withholding tax on sales by non-residents

On 3 December 2015, the Australian government introduced the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill into Parliament. Among other things, the Bill will introduce a new form of withholding tax that will apply when foreign residents sell certain assets that relate to real property located in Australia. If the Bill becomes law, the new rules will apply from 1 July 2016.

In very broad terms, non-residents are only subject to Australian capital gains tax (CGT) on specific types of asset. This means that any capital gains or losses made by a non-resident are ignored for Australian CGT purposes unless the asset falls within certain categories, including:

- Real property situated in Australia (i.e., land and buildings as well as certain mining, quarrying or prospecting rights)
- Shares in companies and interests in trusts where the taxpayer holds at least 10% interest in the company or trust, and more than half of the gross market value of the entity's assets is attributable to real property in Australia
- Assets used in carrying on a business in Australia through a permanent establishment
- Rights or options relating to the assets listed above.

When a non-resident sells any of these assets and makes a capital gain, they are required to lodge a tax return in Australia and pay the appropriate tax liability. However, the government has found that the level of voluntary compliance with these rules is currently very low. As a result, the government is introducing the new withholding tax to assist in the collection of the tax liability that arises on the sale of certain assets by non-residents.

From 1 July 2016, the purchaser will be required to pay 10% of the purchase price to the Australian Taxation Office if the vendor is a non-resident and the transaction involves any of the following assets:

- Real property situated in Australia (i.e., land and buildings as well as certain mining, quarrying or prospecting rights)
- Shares in companies and interests in trusts where the taxpayer holds at least 10% interest in the company or trust, and more than half of the gross market value of the entity's assets is attributable to real property in Australia
- Rights or options relating to the assets listed above.

The purchaser will be permitted to withhold the tax at the rate of 10% from the sale price, and in many cases it is expected that this would occur.

This is a non-final withholding tax, which means that the non-resident vendor will still be required to lodge an Australian tax return to declare the capital gain or loss made on the transaction. They will receive a credit for the 10% withholding tax amount and should receive a refund if the amount that has been withheld exceeds the tax liability relating to the transaction.

The main exception to these rules is where the property involved has a market value of less than AU$ 2 million. It will also be possible to apply to the Commissioner to seek a variation of the withholding amount. This might be relevant when the non-resident vendor will not make a capital gain from the transaction (e.g., where they will be selling the property at a loss).

BRAZIL *(Contributed by Marcello Karkotli Bertoni, MHM Advogados, MI InterAct)*

Brazilian amnesty program for undeclared offshore funds

On 13 January 2016, the Brazilian government sanctioned Law No. 13,254 providing for an amnesty programme to waive taxes, criminal and regulatory penalties to Brazilian individuals who currently have or have had undeclared funds abroad by 31 December 2014.

Such an amnesty programme is part of a series of measures enforced by the Ministry of Finance to repatriate funds to Brazil and raise the collection of taxes to balance the public accounts.

The funds and/or assets subject to regularisation will be those directly or indirectly (e.g., trusts, foundations, insurance contracts) held in offshore accounts by 31 December 2014 and the tax, criminal and regulatory amnesty will be granted to Brazilian individuals who fulfil the following requirements:

- Not convicted by any court decision of a felony or crime related to the funds kept abroad
- Funds must derive from legal activities
- File statement declaring the funds to Brazilian IRS and Central Bank
- File rectification of tax returns related to year 2014 onwards to report funds and related income
- Pay 15% income tax and 15% penalty upon the amount of the funds converted to Brazilian Reais according to the exchange rate of 31 December 2014 (BRL/USD 2.66).

Enrolment in the amnesty programme must be made within 210 days after the issuance of regulations to the Amnesty Law by the Brazilian IRS, which in turn will have to be enacted up to 15 March.

GERMANY *(Contributed by Maja Güsmer and Simone Wick, DIERKES PARTNER)*

The new double taxation agreement between Germany and the Netherlands from a German perspective

Finally, the double taxation agreement (DTA) between Germany and the Netherlands has come into force. The DTA has been adapted to the latest OECD (Organisation for Economic Co-operation and Development) standards in general and provides fundamental changes for taxpayers engaged in both countries. This article discusses the main changes of the revised agreement from a German perspective.

Although the DTA was originally signed in April 2012, the Dutch parliament has taken until the end of 2015 to ratify the agreement. The DTA is now applicable from January 2016 onwards. Interestingly, it provides a 1-year transition period: for the tax year 2016, taxpayers can opt for the old regulations if those are more favourable in their special case.

In the field of international assignments, significant changes have been made to the 183-day rule. So far, the old regulation referred to the calendar year. Under the new regulation, a 12-month-period is decisive. From now onwards, a continuous observation of the foreign working days is inevitable when applying the 183-day rule. Up to and including 2015, it was possible in some cases for a German employee to stay in the Netherlands for nearly 1 year without causing Dutch taxation. This was achieved by making use of the turn of the year, and therefore the 183-day period in 2 years consecutively. Because of higher Dutch income tax rates, it is in many cases preferable to avoid taxation in the Netherlands while being resident in Germany. With the new treaty, the taxation right might shift in more cases to the Netherlands. Both employer and employee must thoroughly check their arising options and possible duties.

Within the new treaty, directors´ remunerations as well as compensations for members of the supervisory board are now regulated separately in Article 15, which assigns the taxing right to the company's state of residence. For example, this leads to Dutch taxation for a member of the supervisory board if an entity is residing in the Netherlands. As a result, there might be a significant tax disadvantage for residents of Germany, since the Dutch tax rate level is comparatively higher than German tax rates.

Another noteworthy change is the new Article 17, which deals with the treatment of pensions. Those are taxed in the state of residence as a matter of principle (Article 17 section 1). Pensions paid based on the national social security system will be taxed in the country of origin according to section 2. However, the new DTA (Article 17 section 3) provides both states with right of taxation, if income deriving from pensions exceeds T€ 15 in total. As a consequence the residence country is obliged to avoid double taxation. It is also to be noted that Germany as country of residence no longer grants tax exemption in this case, but rather avoids double taxation by tax credit (according to Article 22 section 1 lit. b DTA). This might be one of the main cases to make use of the postponing option in Article 33 section 6 DTA.

While advising on cross-border client-issues, the DTA regulations dealing with dividends are of high interest as repatriation of invested capital is a driving factor in nearly every entrepreneurial decision. As a matter of principle, the shareholders' state of residence is provided with the (general) right of taxation for dividends while Article 10 section 2 DTA provides the source country with the opportunity to withhold taxes at source. Generally speaking, the source states' right of taxation, however, is limited to 15% in total. If the beneficial owner is a pension fund residing in the Netherlands, Germany may only withhold 10%. Withholding taxes are limited even further to 5%, if the participation exemption (investment ≥10%) can be used.

Furthermore, extensive subject-to-tax and switch-over clauses (Article 22 DTA) have been agreed, demanding further attention in upcoming cross-border issues. Germany as state of residence will only avoid double taxation (e.g. for employment income) by tax exemption provided that the actual taxation in the host country is proven (subject-to-tax clause). In other

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cases, double taxation in Germany will no longer be avoided by tax exemption but by giving a tax credit for actual paid taxes. Taking account of the issues discussed above, this is especially relevant for directors´ remunerations.

To sum up, from a German perspective, it should be noted that the DTA regulations have become stricter. Especially near the German–Dutch border, there are plenty of cross-border activities. German residents may face a higher tax burden with regard to DTA clauses that allow taxation in the Netherlands combined with relatively high Dutch tax rates. In addition, updates to other Articles – such as implementing Article 5, which deals with permanent establishments, including a separate regulation for offshore activities – will challenge taxpayers as well as their advisors.

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

Minimum net wealth tax supersedes minimum corporate income tax

In order to avoid an infringement procedure regarding the non-compatibility of the minimum corporate income tax with EU laws and especially with the Parent–Subsidiary Directive (2011/96/EU), the minimum corporate income tax shall be replaced by a minimum net wealth tax with effect from 1 January 2016. Further, the net wealth tax rate will be amended itself and henceforth follow a two-track approach comparable to the current corporate income tax:

- If the financial fixed assets, receivables towards affiliates, securities and cash (accounts 23, 41, 50 and 51 of the Luxembourg Standard Chart of Accounts) represent >90% of the total balance sheet, and if such total adds up to more than €350,000, the minimum wealth tax will amount to €3,210
- If such financial assets represent <90% of the total balance (or >90% but less than €350,000), a net wealth tax of €535 to €32,100 will apply.

However, it will be possible to deduct the amount of corporate income tax due for the prior year (exceptionally for the year 2016 by the tax due in the same year) from the minimum net wealth tax down to the net wealth tax hypothetically due based on the taxable net asset value.

If companies have entered into a fiscal unity for tax purposes, the added minimum wealth tax due by the members of the unit is limited to €32,100. Affected entities will be able to reduce their minimum wealth tax liability to the hypothetically owed tax as mentioned above.

As hitherto, corporate securitisation vehicles and SICARs as well as ASSEPs and SEPCAVs have been exempted from the wealth tax. Within the scope of said legislative changes, such entities will now become liable to the minimum wealth tax.

Although the net wealth tax credit will remain, such credit may from now on only reduce the net wealth tax to the amount of the minimum net wealth tax. Further, the new legislation clarified that a reduction of the share capital within 5 years after an increase of capital out of the net wealth tax reserve shall be deemed as premature cancellation of such reserve.

Concerning the net wealth tax rate, a two-scale rate will be introduced. As hitherto, the rate will amount to 0.5% for the first €500 million of net asset values. The assets exceeding this threshold will be taxed at a rate of 0.05%.

ROMANIA *(Contributed by Ionut Bohalteanu, BSMP, MI InterAct)*

Tax penalties

A new Tax Procedure Code has come into effect in 2016, together with the new Tax Code. One of the most relevant amendments introduced by the new tax procedure norms clarifies a situation that had previously been settled only through case law.

The provisions under the new tax procedure deal with penalties triggered when a taxpayer who initially benefited from a court injunction/order finds themselves obliged to pay, in addition to their debt (principal tax obligations), a certain amount of interest and, in certain cases, penalties at a later date.

Provided that the administrative appeal procedure with the superior tax authority was fulfilled, in order to have any enforcement proceedings closed down, the taxpayer must first address a request to court to be granted an injunction in this respect, grounded on the applicable contentious law (i.e., Romanian Law 554/2004 on administrative procedure), and either later, or simultaneously with this request, must also refer to court regarding annulment of the notice of assessment.

The problem in this case, as stated above, occurs when the injunction of the enforcement procedure is granted, but only for a limited period of time, which expires when the court vested with the settlement on the merits renders its final decision.

According to tax procedure provisions, as soon as an injunction regarding tax enforcement is granted, all effects of the administrative act are suspended until such injunction ceases and, furthermore, the tax duties are not registered in the tax ascertaining certificate of the taxpayer. Consequently, any actions or deeds undertaken by the tax authority in order to recover the amount of money to be imposed on the taxpayer are legally suspended. Hence, until a final decision is issued on the merits of the case, the notice of assessment by which the payment of main and ancillary obligations was imposed on the taxpayer should not trigger any supplementary penalties, such as delay penalties.

It is important to note here that the delay penalties are not governed by the same legal regime as the interest when it comes to suspension of all effects of a notice of assessment by means of a court decision. Therefore, the taxpayer cannot be held liable to pay an amount exceeding their initial tax debt (principal debt together with interest computed thereto), substantiated in delay penalties. Consequently, when the final decision on merits is issued and the injunction enforcement procedure is annulled, the taxpayer must pay their tax debts only within the limits initially established by the notice of assessment.

BEPS Action Plan 1: Addressing the Tax Challenges of the Digital Economy *(Contributed by Jeanne P. Goulet, Marks Paneth LLP)*

The OECD has recently expressed growing concern about tax planning by multinational enterprises (MNEs) that makes use of gaps in the interaction of different tax systems to artificially reduce taxable income or shift profits to low-tax jurisdictions in which little or no economic activity is performed.[1]

Due to the rapid development of the digital economy, many countries are worried that they are losing tax revenue. And this is by no means an unfounded fear: technology has rapidly outpaced tax legislation, and governments worldwide are trying to catch up.

Shifting taxing rights to source/market countries

With this in mind, the OECD issued its Addressing the Tax Challenges of to the Digital Economy, Action 1 – Final Report in 2015. Its aim was to minimise aggressive tax planning and to encourage governments to diminish gaps and tax arbitrage opportunities in their domestic laws. However, while the aim was simple, accomplishing it adds extra layers of complexity.

The report recommended a modification of 'taxing rights' among nations, shifting 'taxing rights' from resident countries to source/market countries. In this way governments in the source/market country would be allowed to unilaterally tax economic activities within their borders – but only in the case of clear-cut treaty abuse (see Action 1 Recommendations, below, for details). Of course, this may lead to double taxation if not accompanied by a foreign tax credit mechanism.

In developing their recommendations, the OECD wisely suggested that the digital economy not be 'ring-fenced', as it is quickly becoming a fundamental part of the global economy. They are taking a 'wait and see' approach in order to gather additional data and study other taxation options before taking on the broader challenges of the digital economy.

Indirect Tax

The effect of shifting taxing rights for direct tax purposes is clear enough, but what happens with regard to the source/market country when considering the effect of the indirect tax system? In this instance, the OECD recommends the implementation of Guidelines 2 and 4 of their International VAT/GST Guidelines. While the direct income tax system is shifting toward source base, the indirect tax system is also source based for both Guidelines 2 and 4. Thus, Guideline 2 would allocate taxing rights on the cross-border supply of services and intangibles to the location of the business owner's establishment. Guideline 4 indicates that taxation accrues to the location where the customer actually uses the service or the intangibles. Both look to the source/market country or place of use.

To further complicate the creation of global standards for tax collection, the US indirect (sales/use) tax system is at the subnational level and is not part of the OECD treaty process. Thus it is excluded from the international discussions on VAT/GST.

Gathering data from 10% of corporate taxpayers and assessing outcomes

Over the next few years, the OECD and various countries will be gathering data collected from the VAT/GST system, as well as from country-by-country (CbC) reporting. In this way, they will be able to assess the results generated by the BEPS report and determine if more radical measures, or alternative tax concepts, are necessary.

It's worth noting that only MNEs with annual revenues of €750 million or more are required to file the CbC report. However, many governments believe that while this reporting requirement will fall on 10% of the largest taxpayers, it will nevertheless encompass some 90% of all corporate revenues.

Although this methodology is clearly useful for some countries, it ignores the ever-growing population of micro MNEs. In fact, tax policies that target large enterprises can have unintended, often adverse, consequences for smaller players, such as additional tax

1. OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 – Final Report, page 11, OECD/G20, Base Erosion and Profit Shifting Project, http://dx.doi.org/10.1787/9789264241046-en

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complexity and the increased cost of compliance.

Action 1 Recommendations

Although Action 1 addresses the digital economy, many of the other 14 Action Plans of the BEPS report are incorporated in Action 1. The OECD hopes that these measures will address the BEPS issues exacerbated by the digital economy. The recommendations address the following issues:

Treaty abuse (Action 6)

Governments observed that taxpayers might insert a shell company within a favourable treaty network but little protection against treaty abuse. The OECD recommends limitations on treaty shopping and the use of dual-resident companies. The source/market country could thus ignore the tax treaty and assert that a permanent establishment (PE) has been established, giving rise to either local taxation or to the application of withholding taxes on the transaction.

Prevent the artificial avoidance of PE status (Action 7)

- **Anti-fragmentation:** An enterprise might engage in activities in a country that are preparatory or auxiliary in nature and still not cross the 'threshold'. The OECD recommends that the 'preparatory or auxiliary' definition be modified and that a new 'anti-fragmentation rule' be included. The activities of related companies operating in a country will need to be taken together and evaluated as to whether the totality of the activity is still preparatory or auxiliary or whether, taken together, they are creating a PE in the source/market country.
- **Warehouse:** In the past, the maintenance of a warehouse in a country did not create a PE. Targeting companies such as Amazon, the OECD recommended that a large local warehouse, where a substantial workforce is in place to quickly fulfil customer orders, would no longer qualify as an exception to a PE. Such activities would be considered a core activity and would create a PE in the source/market country.
- **Signing Contracts:** A company could avoid creating a PE in a country if the local subsidiary did not sign contracts on behalf of the principal/parent company. This very formalistic approach avoided the creation of a dependent agent in the source/ market country. The OECD has recommended that if a local subsidiary that is selling goods or services in a country plays the principal role in the conclusion of contracts, and if these contracts are routinely or automatically signed by the parent without making material modifications, then the local subsidiary would be considered to be a dependent agent of the parent company. A dependent agent would create a PE for the parent company and would draw the parent into the tax net of the market country.

These modifications serve to lower the threshold for establishing a PE in a source/market country. These provisions will add uncertainty and complexity in managing cross-border operations by removing 'bright line' tests. Now an added layer of judgment is required to analyse whether an activity is a 'core activity' or yet whether a subsidiary is playing a 'principal role' versus a 'supporting role' in the conclusions of contracts.

In some countries, such as the United States, onerous consequences may apply to a non-US company if it has an unintended PE in the US and does not file a tax return. Tax may be imposed on revenue, and deductions might not be allowed! For a micro MNE with overall losses, such a ruling could destroy the business.

In future work on the digital economy, it would therefore be useful if 'safe harbours' were developed, which would eliminate unexpected or 'pop-up' PEs. For example, if a company sets up a subsidiary in a local jurisdiction, transfer pricing mechanisms could be used to reallocate income, rather than drawing an offshore related company into the local tax net as an unexpected PE.

Measures that will address BEPS issues in both market and ultimate parent jurisdictions (Actions 2, 4, 5, 8-10)

MNEs reduce taxation by moving income-producing functions to low tax jurisdictions. Governments allege that intangibles with artificially low valuation can be transferred to a country with a lower tax rate. After the transfer, a large return on investment is claimed in order to pay tax at a substantially lower rate of tax.

The OECD recommends the following Actions to minimise these abuses:

Action 2 – neutralising the effects of hybrid structures by recommending that countries modify their domestic rules and change the OECD model treaty

Action 4 – limiting base erosion via excessive interest deductions and other financial payments by recommending best practices for countries to

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incorporate into their domestic legislation

Action 5 – countering harmful tax practices employed by some countries that have set up preferential IP regimes, which allow payment for R&D but no core activities are actually taking place in the country

Action 8-10— assuring that transfer pricing outcomes are in line with value creation, i.e., income should be allocated to the location that gives rise to that income. The areas of focus include:

- Transfer and use of intangibles, including hard-to-value intangibles and cost contribution arrangements
- Delineating the actual transaction and business risks
- Global value chains and transactional profit split methods.

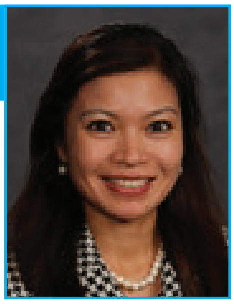
In the past, an enterprise could develop intangibles in one country but have them legally owned and funded by another company in a low tax jurisdiction. The largest return on investment would go to the legal owner/investor who funded the activity and assumed risks, even if no R&D occurred in that jurisdiction.

The OECD recommended that in order to be entitled to a higher return, the enterprise can no longer be merely a legal owner or an investor. Premium returns would only be available if the enterprise also participated in the DEMPE (development, enhancement, maintenance, protection and exploitation) functions in addition to the legal ownership and funding aspects. Legal ownership alone does not entitle the owner to premium profits.

Future Work

Time will tell how technology will develop in future, but it seems clear that the lack of consensus among governments and the absence of guidelines for revenue characterisation from the digital economy will have a detrimental effect on global business. The current state of affairs may well result in increased compliance costs, to say nothing of the debates and disputes that will invariably arise because of double taxation issues. Taken together, all of these factors could have unintended – and unwelcome – consequences for governments worldwide, as well as for taxpayers.

BEPS Action Plan 8: Intangible Assets *(Contributed by Angela Sadang, Marks Paneth LLP)*



In recent years the OECD has been trying to tighten controls and ensure that member countries don't assign low values to intangible assets for the purpose of transferring them from one tax jurisdiction to another with more favourable tax rules. The OECD has become particularly concerned over procedures that artificially segregate taxable income from the activities that actually generate and create value.

The OECD's main objective is to 'assure that transfer pricing outcomes are in line with value creation'. Its goals, as detailed in the Action Plan, are:

- Adopting a broad and clearly delineated definition of intangibles
- Ensuring that profits associated with the transfer and use of intangibles are allocated in accordance with (rather than divorced from) value creation
- Developing transfer pricing rules or special measures for transfers of hard-to-value intangibles
- Updating the guidance on cost contribution arrangements and adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it contractually assumed risks or provided capital.

With that in mind, in October 2015 the OECD issued its final report on all the 15 Action Plans. Its aim was to restore confidence in the international tax framework by addressing weaknesses that create opportunities for base erosion and profit shifting (BEPS). The focal point of the report's Chapter VI is ensuring that the profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation.

Identifying intangibles

The OECD defines 'intangible' as something that is not a physical/financial asset, can be owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties. The OECD recognises the following as intangibles:

- Patents
- Know-how and trade secrets
- Trademarks, trade names and brands
- Rights under contracts and government licenses
- Licenses and similar limited rights in intangibles
- Goodwill and ongoing concern value.

It is worth noting that group synergies and market-specific characteristics are not recognised as intangibles, since they cannot be controlled by any party or group. The OECD also emphasises that an intangible for accounting or tax purposes may not necessarily be considered as an intangible for transfer pricing purposes.

Ownership of intangibles and the DEMPE of intangibles

Determining (a) the owner of an intangible and (b) the contributors – that is the parties responsible for the development, enhancement, maintenance, protection and exploitation (DEMPE) of that intangible – is important in identifying the proper allocation of profits and costs for transactions that comply with the 'arm's length' principle.

Although legal rights and contractual arrangements form the starting-point for any transfer pricing analysis of transactions involving intangibles, as far as the OECD is concerned the pure legal owner of an intangible is not necessarily entitled to a substantial share of the returns if their role is merely that of owner. Those who assume the risks regarding the DEMPE of the intangible should be compensated for those contributions – even if they don't actually own the intangible, expect to earn a significant portion of the returns commensurate with the function and risks they have undertaken. The functions performed, assets used and risks borne by the different parties associated with intangibles should always be taken into consideration. Consequently, if the pure legal owner doesn't perform any key functions related to the intangible, then they aren't entitled to any return derived from the exploitation of that intangible – other than 'arm's length' compensation, if any.

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The following are regarded as important functions that contribute to the value of the intangibles:

- Design and control of research and marketing programmes
- Direction of and establishing priorities for creative undertakings, including determining the course of 'blue sky' research
- Control over strategic decisions regarding intangible development programmes
- Management and control of budgets
- Defence and protection of intangibles
- Ongoing quality control over functions performed by independent or associated enterprises.

Identifying transactions involving intangibles

Besides identifying the intangibles that make up a particular transaction and identifying the owner of and contributors to those intangibles, it is also important at the onset of any transfer pricing analysis to identify and accurately describe the controlled transactions that involve those intangibles. The OECD's guidelines identify two general types of transaction:

- Those involving the transfer of intangibles or the transfer of all, or limited rights, relating to the intangibles
- Those involving the use of intangibles in connection with sales of goods or the performance of services where said intangibles are used, but no transfer of the intangibles themselves or rights to the intangibles takes place.

The OECD guidelines also discuss features of an intangible that should be taken into consideration while conducting a comparability analysis, such as the exclusivity and duration of legal protection, geographic scope, useful life, stage of development and rights to enhancements; revisions and updates; and expectations of future benefits.

Functional and risk analysis provides the factual basis for establishing a transfer pricing methodology consistent with the arm's-length standard set forth in section 482 of the US Treasury Regulations and the OECD Guidelines. It's a means of organising facts about the companies involved in specific transactions with regard to the functions performed, risks assumed, and the intangible assets used in order to identify how these responsibilities are divided among the companies involved. Functional and risk analysis is crucial to the development of transfer pricing policy because:

- The economic return generated by the functions undertaken by each related party typically correlates with the risks borne and the intangible assets owned or developed
- The functions, risks, and intangible assets associated with a related party's operations usually have a significant effect on its profitability
- The functional analysis provides the information and insight necessary to (a) determine which transaction (or entity) to evaluate, (b) establish the best (or most appropriate) method of evaluating the transaction (or entity), and (c) develop comparability characteristics to help identify comparable, independent transactions (or companies) so as to determine the appropriate arm's-length pricing level of the controlled transactions.

By providing a description of the functions, risks and assets (both tangible and intangible), and their location within a corporate group, functional analysis provides the first step in evaluating the particular profit-related contributions of the various related companies, and the appropriate pricing of intercompany transactions.

Transfer pricing methods

Depending on the circumstances, at least one of the five OECD transfer pricing methods would be appropriate when transferring intangibles, or rights in intangibles. However, according to the guidelines, the comparable uncontrolled price (CUP) and transactional profit split methods are likely to prove especially useful in case of transfer of intangibles or rights in intangibles. Valuation techniques can also be useful.

The OECD recognises that database comparables involving intangibles may be difficult or in some case impossible to assess. In such cases, they suggest that the profit split method and/or valuation techniques might be the best method to set the arm's-length prices for the transactions involving intangibles. The application of the transactional profit split method should be in line with a comprehensive analysis that considers the functions performed, risks assumed and assets used by each of the parties in the MNE.

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The use of other approaches – such as valuation techniques based on the calculation of the discounted value of projected future income streams or cash flows derived from the exploitation of the intangible – should consider such things as the accuracy of financial projections, assumptions regarding growth rates, discount rates, the useful life of intangibles and terminal values, assumptions regarding taxes and the form of payment.

Some of MI members

HTVI are those intangibles for which no comparables exist and profit projections are highly uncertain at the time of the transfer. However, the updated report does allow tax authorities to consider ex post evidence about ex ante arm's-length pricing arrangements. This also includes any contingent pricing arrangements made when a taxpayer is unable to show that ambiguous items were factored into the pricing methodology.

Selection of the best (or most appropriate) method

The selection of the best (or most appropriate) method depends on a number of factors, such as (a) the availability of complete and reliable data; (b) the degree of comparability between controlled and uncontrolled transactions (or companies); and (c) the number, magnitude and accuracy of the adjustments necessary to apply the method.

Identifying comparable transactions (or companies) requires an evaluation of the functions performed and the risks assumed, as well as contractual terms, economic conditions and the types of intangible property exchanged between the affiliated entities engaged in the intercompany transaction. Each factor should be evaluated in order to determine its potential impact on the pricing method and, depending on the approach chosen, one factor may be more important than another in establishing comparability. The documentation of these analyses (i.e., functional analysis, risk analysis and an assessment of contractual agreements) is required to support the best (or most appropriate) pricing method.

The CUP method compares the price charged in a controlled transaction with that charged in an uncontrolled transaction. Under this method, the arm's-length nature of an intercompany price is determined by reference to either (a) the price charged by a member of the group for the provision of the same or highly comparable intangible property to an unrelated party (i.e., an internal CUP), or (b) the price charged by an independent company for the provision of comparable intangible property to a third party (i.e., an external CUP).

Conclusion

The initial step of the intangible property analysis must apply section 482 of the Treasury Regulations and the OECD Guidelines to the intercompany licensing in order to determine the 'best' (or 'most appropriate') method for assessing the royalty rates.

The importance of intellectual property management for tax planning purposes is clear. When an MNE is looking at its intellectual property portfolio, the interplay of many factors must be considered, along with guidance from the OECD and the local country tax jurisdictions where affiliates are located.

MNEs should also ensure that their transfer pricing policies reflect the guidance provided by the OECD, namely that DEMPE functions should be clearly defined and the contributions of each party evaluated in order to determine which entity within the group controls the economically significant risks. What's more, when it comes to the valuation and pricing of transactions, MNEs should carefully consider which valuation techniques they employ and whether or not the substitute methodology they are using is being applied correctly. As we said earlier, the OECD's objective is to ensure that profits arising from the transfer and use of intangibles are distributed so that they are aligned with value-creating functions and the control of risks.

Contributed by Saurabh Jain, S.C. Vasudeva & Co.

Anti-Tax Avoidance Package in the European Union

On 28 January, the European Commission has published an anti-tax avoidance package containing new measures against corporate tax avoidance in the EU that follow the global standards developed by the OECD in its BEPS Action Plan. The most important of the proposals include an Anti-Tax Avoidance Directive and a Country-by-Country Reporting Directive implementing the automatic exchange of CbC reports. The package also includes a communication proposing a framework for a new EU external strategy for effective taxation and a recommendation on the implementation of measures against tax treaty abuse.

FIRPTA reforms under the PATH Act for non-US investors

The newly enacted Protecting Americans from Tax Hikes (PATH) Act of 2015 has brought several important changes to the Foreign Investment in Real Property Tax Act of 1980 (commonly referred to as FIRPTA) that are applicable to the disposition of US real estate (or interests in companies that, directly or indirect, hold US real estate) by non-US investors. The Act provides for significant liberalisation (and interpretive clarifications) of the application of FIRPTA to certain non-US investors. Such investors particularly include publicly traded non-US investors with characteristics similar to US public REITs, minority investors in US public REITs, and investments by non-US retirement and pension funds.

France and India announce joint tax evasion crackdown

On 25 January, France and India signed an agreement to strengthen cooperation between the two countries for preventing tax evasion. During the recent official visit of French President François Hollande to India, a total of 19 agreements were signed by the French President and Indian Prime Minister Narendra Modi. These included an agreement to target offshore tax evasion and strengthen information exchange between France and India. The two leaders have agreed to explore further avenues for joint tax cooperation, especially in capacity building and sharing of best practices, in line with both countries' G20 commitments.

Hong Kong ranked as Freest Economy of the world

For the 22nd consecutive year, Hong Kong has maintained its position as the world's freest economy in the Heritage Foundation's Index of Economic Freedom. The 2016 Index ranks the degree of economic freedom in 178 economies around the world, based on 10 criteria: business freedom, trade freedom, fiscal freedom, government spending, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption, and labour freedom. On a scale of 0–100, Hong Kong has achieved an overall score of 88.6, retaining top position for business, trade and financial freedoms. The Heritage Foundation has highlighted that Hong Kong's zero tariff rates and its reputation as one of the most open economies in the world for trade and investment are key to its lead ranking.

India resolves more than 100 transfer pricing disputes with United States

The Government of India has resolved over 100 transfer pricing disputes with the US under a Framework Agreement that was signed back in January 2015, India's Central Board of Direct Taxes (CBDT) announced on 28 January. The Agreement was signed under the mutual agreement procedure (MAP) provision of the India–US tax treaty, seeking to resolve about 200 transfer pricing disputes involving US companies with operations in India. The CBDT added that the MAP programmes with countries such as Japan and the UK are also progressing very well, with regular meetings being held to resolve past disputes.

India and Armenia sign protocol amending the India–Armenia DTA Convention

A Protocol to amend the existing Double Taxation Avoidance (DTA) Convention was signed by the Government of India and the Government of Armenia on 27 January. The Protocol amends the DTA Convention between India and Armenia that has been

Continued over

in existence since 9 September 2004. The Protocol amends the Article on exchange of information for tax purposes, bringing it in line with the updated provisions in the OECD model. The Protocol will enable the two countries to exchange information related to financial and banking transactions under the DTA Convention, helping them to address tax evasion. It is also expected to further strengthen the Government of India's efforts in curbing generation of black money.

India notifies DTAA with Thailand to be effective from 1 April 2016

On 1 December 2015, India's CBDT notified the Double Taxation Avoidance Agreement (DTAA) between the Government of India and Government of the Kingdom of Thailand. Signed on 29 June 2015 and effective from 1 April 2016, the DTAA includes clauses on exchange of information and limitation of benefit.

India and Japan sign a protocol to amend DTAA

On 11 December 2015, India and Japan have signed a Protocol for amending the existing convention for avoidance of double taxation and prevention of fiscal evasion with respect to income taxes. The existing Convention for avoidance of double taxation and tax evasion was signed between both countries back in 1989. The Protocol provides for internationally accepted standards for effective exchange of information on tax matters. Under this both countries shall assist each other in the collection of revenue claims.

Phinisar Israel Ltd. v. Income Tax Assessor [Income Tax Appeal no. 1300-09 (14 January 2016)

(Contributed by Ariel Zitnitski, CPA & Adv., Zitnitski Weinstein & Co., Israel)

Facts of the case

Finisar Israel Ltd ('the company' or 'the appellant') was providing research and development (R&D) services to its parent company, Kailight Photonics Inc ('the parent company'), which was incorporated in Delaware (and was later acquired by Optium Corp.).

On 1 January 2004 an agreement was signed between the company and the parent company, according to which the appellant was to be remunerated for the R&D services rendered by the appellant to the parent company at 'actual cost' of the expenses plus a profit margin of 2%.

In 2007, they revised the terms of the agreement to cost + 8%.

From 2005 to 2007, the parent company granted to employees of the appellant options exercisable for shares, at the capital gains track prescribed in section 102 of the Ordinance (means payment of capital gains tax rate by the employee, yet without recognising expenses for the issuer).

The accounting statements of the appellant recorded stock-based compensation expenses and in 2005 and 2006 included both the appellant and its parent company the value of the options expenses for the calculation of expenses at the COST+ model. However, in 2007, appellant did not ask for inclusion of such expenses for COST+ model.

In 2005 and 2006, the appellant requested to deduct the expenses for the allocation of the options for tax purposes, while in its tax report for 2007 the appellant did not ask for this deduction.

The dispute between the appellant and the Tax Assessor concerned issues relating to the provisions of section 85A of the Income Tax Ordinance regarding the transfer pricing and whether to take into account expenses for the issuance of shares by the parent company in order to ascertain the income of the appellant.

Contention of the taxpayer

- Do not include the expenditure in respect of the issue of options for determining COST+profit mechanism
- The value of options is an indirect expense and its deduction is not allowed
- Regulations market conditions of transfer pricing (85A) relate only to direct costs, not to indirect costs
- The appellant made no payment in connection with the issuance of the options
- At the very least if the position of the tax assessor will accept so need to allow the expenses of the option issuance from the net of income (like any other expenses).

Contentions of the Tax Assessor

- Allocation of options to employees of the appellant is acceptable market conditions transaction of this type and therefore should include the expenditure in the COST+ so the income is higher than the amount reported. In fact, to reflect market conditions between arm's length transaction must include the expenses of the issue of shares that are actually part of the benefit granted to employees. Therefore, the mechanism should be added to the COST also on this expenditure
- Section 102 of the Ordinance does not allow expense for allocation of shares and options at the capital gains track and therefore even when the terms of the transaction under market conditions include the share allocation expenses still can not recognize this expense for tax purposes.

Decision of District Court

- Appeal denied
- Section 85A of the Ordinance is an anti-planning section, designed to prevent the diversion of profits

Continued over

generated in Israel a deal forged between an Israeli taxpayer and the foreign side that is close to or has control, by determining the price or deal terms exceed market conditions

- The addition of the value of the expenditure was for the parent company to pay extra profit plus cost model
- Even if the appellant took no actual payment in connection with the allocation of the options, then for the purpose of computing the income of the costs should be seen in the value of the options issued by the appellant as expenses
- The company chose the capital gain track in a matter of choice, is to choose the programme that lowers the tax burden from the employee but on the other hand does not allow to recognise expenses in the company. If the appellant wanted to recognise expenses for tax purposes had to choose a marginal tax track, in which the company can recognise the issue expenses for tax purposes and the employee will pay a marginal tax which is usually higher than gain tax
- Even before the regulations were agreed (in November 2006), the appellant operating on US arm's-length principles accepted in the US and OECD guidelines, and no difference in principle between 2006 and thereafter
- The judge noted in this context the US Financial Accounting Standard No. 123R and the OECD Guidelines regarding these expenses.

EDITORIAL COMMENT

The Court has rightly held that the expenditure with regard to the options should form a part of the cost. Once the COST+ model has been adopted for transfer pricing purposes, the entire costs should be considered.

National Petroleum Construction v. Director of Income tax [2016] 66 taxmann.com 16

(Contributed by Ms. Aditi Gupta, S.C. Vasudeva & Co., India)

Recently, the Hon'ble Delhi High Court, in the case of National Petroleum Construction v. Director of Income Tax [2016] 66 taxmann.com 16, adjudicated upon the meaning of the term 'permanent establishment' (PE), as defined in the DTAA between India and the United Arab Emirates (UAE). The Court held that normally an inclusive definition expands the scope of the term defined, but in the present context the Court held otherwise. Accordingly, the Court held that the various subparas of para. 2 of Article 5 of the DTAA would be construed as a PE subject to the conditions of Article 5(1) being met. As far as subparas (h) and (i) are concerned, the Court held that the test of permanence as required under Article 5(1) is substituted by a specified minimum period of 9 months.

Background and Brief Facts of the Case

The assessee is a company incorporated under UAE laws and is a resident of UAE. It has a project office in Mumbai, India. It is engaged in the fabrication of petroleum platforms, pipelines and other equipment and also undertakes contracts for installation of petroleum platforms, submarine pipelines and pipeline coating at various sites. The fabricated material was sold to ONGC, an Indian Company outside India.

The assessee entered into contracts with ONGC for installation of petroleum platforms and submarine pipelines. The scope of work for the contract included surveys (pre-engineering, pre-construction/pre-installation and post-installation); design, engineering, procurement, fabrication, anticorrosion and weight coating in case of rigid pipeline; load-out, tie-down/sea fastening, tow-out/sail-out, transportation, installation, hook-up and installation of submarine pipelines; installation and hook-up of submarine cables; modifications of existing facilities; and testing, pre-commissioning and commissioning of entire facilities, as described in the bidding document.

The activities relating to survey, installation and commissioning were done entirely in India and the platforms were designed, engineered and fabricated overseas, at Abu Dhabi.

The assessee appointed Arcadia Shipping Ltd (ASL) as its sole and exclusive consultant for providing consultancy services in India.

Contention of the Assessee

- The Project Office merely acted as a communication channel between the assessee and ONGC; apart from that, it had no other role to play.
- The Project Office acted as the assessee's back office for liaison, coordination and collection of information from ONGC.
- The only activity carried out by the assessee in India was the installation and commissioning of the platforms, which was carried out by the assessee"s employees at the offshore site with the help of barges.
- The installation PE would come into existence only if the construction or assembling activity continued for a period of ≥9 months in India, commencing from the date when the barges with the fabricated platforms reached the work site; therefore, it did not have an installation PE in India.
- ASL was an independent entity and carried out substantial business activities other than those related to the assessee; therefore, it did not constitute a dependent agent permanent establishment (DAPE) of the assessee in India.

Contention of the tax authorities

- The assessee had a fixed-place PE in India in the form of a project office at Mumbai.
- ASL constituted a DAPE of the assessee in India.
- The assessee contented that as per subpara. (h) of Article 5(2) of the DTAA between India and UAE, since the site, project or activity continued for a period of <9 months, it therefore did not constitute an installation/construction PE. However, this argument was rejected.

Continued over

- Regarding the assessee's contention that the fabricated material was sold to ONGC outside India, the authorities held that the contract was a turnkey and a composite contract and was not divisible as claimed by the assessee. Accordingly, entire contractual receipts – including the activities performed outside India – were taxable in India.
- The assessee contended that the payments for engineering, procurement of material and fabrication could not be treated as fees for technical services (FTS) as being a part of the consideration for installing the platform; however, this claim was rejected by the authorities.
- The consideration received by the assessee for design and engineering was held to be FTS. Since the assessee had not maintained separate books pertaining to the contract, the authorities estimated the profit to be 25% of the consideration received from ONGC. The assessee's contention that it should be taxed by applying provisions of section 44BB of the Act – i.e., taxation on a presumptive basis at a rate of 10% of the receipts, in case of an assessee engaged in the business of providing services or facilities in connection with supplying plant and machinery on hire for the purpose of prospecting for extraction/production of mineral oils – was rejected, as the authorities held that the activities carried out by the assessee were not covered under that section.

The assessee filed its objections before the Dispute Resolution Penal (DRP).

Ruling of DRP

- The DRP held that Article 5 of the DTAA provided an inclusive definition of PE and that the assessee's project office constituted a PE of the assessee in India. It held that the assessee's office in India provided a fixed place for the employees of the assessee visiting India for execution of the project from time to time, and it was not necessary that the permanent employees at the project office be directly involved in the execution of the project.
- The DRP also agreed that ASL was a DAPE of the assessee, because ASL was actively involved in the project since pre-bid meetings, hard core marketing and business development till until finalisation of the contract.
- The DRP held that since the assessee had contended that payments for engineering, procurement of material and fabrication could not be treated as FTS as being a part of the consideration for installing the platform, the assessee could not treat those activities as separable for the purposes of limiting the duration of its PE in India and/or splitting the income between that arising overseas and that arising in India. The DRP, accordingly, held that the installation PE of the assessee came into existence at the stage of commencement of the contract.
- The DRP also observed that the pre-engineering or pre-design survey, which was claimed to be done by a subcontractor employed by the assessee, was an integral part of the contract and the time spent by the subcontractor would also constitute the time spent by the assessee under the DTAA. Thus, the DRP reasoned that the existence of a PE would commence from the date the subcontractor started their job at the ONGC site.
- The DRP rejected the contention that the contract was divisible so that the income of the assessee for the activities done outside India was not taxable under the Act. The DRP held that the title in the goods passed to ONGC in India.
- The DRP also concurred with the tax authorities that the payment in respect of drawings and design were FTS; and it was held that since the assessee did not have a PE in India, the aforesaid payment would be taxable under the Act as FTS.
- The DRP also rejected the assessee's contention that section 44BB of the Act was applicable. It held that the contract in question was a turnkey contract, in the nature of a works contract, and could not be considered as a contract for services as envisaged under section 44BB of the Act.

The assessee filed an appeal to the Income Tax Appellate Tribunal (ITAT) against the order of the DRP.

Ruling of Tribunal

- The ITAT concurred with the finding of the authorities (as reported below) and rejected the assessee's contention that it had no PE in India. The ITAT observed that the assessee had itself shown the project office in Mumbai as its PE in India, and the assessee's employees were present during the

Continued over

negotiation of the contracts in question.

- The ITAT also agreed that ASL was a DAPE of the assessee, as it was working wholly and exclusively for the assessee.
- The ITAT rejected the assessee's contention that its installation PE existed only when the barges carrying the platforms entered the territorial waters of India. It held that the assessee had a PE in India even prior to the notification of award of the contract.
- The ITAT, however, accepted the assessee's contention that the contract could be segregated into offshore and onshore activities and that the assessee's income for the activities carried out outside India could not be attributed to its PE in India. Accordingly, it held that the profits attributable to design, procurement of material and fabrication could not be taxed in India.
- The ITAT rejected the assessee's contention that the tax payable should be computed as per the formula adopted in the preceding years (i.e. 10% of the receipts attributable to activities in India less expenses in India and 1% of the receipts attributable to activities carried out overseas). The ITAT also did not accept the assessee's contention that section 44BB of the Act was applicable.

Issues for consideration before the Hon'ble Court

- Whether the project office could be considered as a PE of the assessee in India, as per Article 5(2)(c) of the DTAA between India and UAE; and whether it would fall within the exclusionary clause, i.e., Article 5(3)(e)?
- Whether the assessee had an installation PE as per subpara. (h) of Article 5(2) of the aforesaid DTAA?
- Whether ASL was a DAPE of the assessee in India?

Decision of the Hon'ble Delhi High Court

First issue – PE under subpara. (c) of Article 5(2) and exclusionary clause (e) of Article 5(3):

- The Hon'ble High Court held that the project office of the assessee was used only as a communication channel, and not for any other purpose (e.g. execution of contracts). The same was even permitted by RBI that the assessee could open a project office in India. Accordingly, since the project office in India merely acted as a liaison office, the Hon'ble Court held that the project office did not fall within clause (c) of Article 5(2) of the DTAA.
- Regarding the exclusion clause (e) of Article 5(3) of the DTAA, the Hon'ble Court held that where the main business of the assessee is fabrication and installation of platforms, merely acting as a communication channel would qualify as an activity of auxiliary character, i.e., an activity that aids and supports the assessee in carrying on its main business. Accordingly, the Hon'ble Court held that the activities of the project office clearly fall within the exclusionary clause (e) of Article 5(3) of the DTAA and, therefore, cannot be construed as the assessee's PE in India.

Second issue – installation PE under subpara. (h) of Article 5(2):

- The Court further held that the exclusionary clause of Article 5(3)(e) would apply equally to a place of business falling within the Article 5(2)(h), as it would be an office falling within the scope of Article 5(2)(c) of the DTAA. Thus, the assessee also cannot be stated to have a PE under Article 5(2)(h) of the DTAA.
- The Court has, however, dealt with clause (h) of Article 5(2) of the DTAA and held that the duration of a PE would commence with the performance of business activities in connection with the building site or assembly project. In the case of the assessee, it had commenced its activities at site when the barges entered into the Indian Territory in November 2006 and such activities relating to the installation, testing and commissioning of the platforms continued until April 2007. The assessee did not have access to the site before November 2007. The Court therefore, held that there should be some degree of permanency of the fixed place of business before it can be construed as a PE of the assessee. Thus, although a building site or a construction has been recognised as a PE, the same is conditional on the site/project representing an enterprise's fixed place of business, through which the business of the enterprise is carried on, for a minimum period of 9 months. Therefore, where an enterprise is not granted access to the site for a long duration and carries out no activity at site during that period, the site could hardly be construed as the fixed place of business of an assessee during that period.
- The Court also rejected the Revenue's contention

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that since the duration of the project exceeded 9 months, the same should be covered under the aforesaid clause (h). This is because Article 5(2)(h) of the DTAA indicates that it is necessary that the 'site, project or activity continues for a period of more than 9 months'. It is an implicit condition that the enterprise should be involved at the site or involved in the assembly project in the source country, which is so in the present case for a period of <9 months.

Third issue – whether ASL should be treated as a DAPE of the assessee:

- The Hon'ble Court, on the basis of the agreement between ASL and the assessee, observed that ASL's activities were not limited to providing services to the assessee only but extended to various other activities. The agreement entered into between the assessee and ASL is on a principal-to-principal basis.
- ASL also provided logistics and consultancy support to various companies other than the assessee. The Director's Report of the ASL also clearly indicates that the activity of providing offshore marketing/ technical consultancy and offshore fabrication and installation work were among the regular activities carried on by ASL.
- The consultancy agreement did not restrain ASL from carrying on its regular activities, including providing consultancy services to persons other than the assessee's competitors. ASL's financial accounts also indicated that it had earned substantial income other than that received/ receivable from the assessee.
- The presence of ASL at pre-bid meeting with ONGC was in pursuance of the services agreed to be rendered by them to the assessee. However, this by itself cannot lead to an inference that ASL constituted a DAPE of the assessee in India.
- A plain reading of para. 4 of Article 5 indicates that for a person to constitute a DAPE, the agent (a) must not be an agent of independent status to whom para. 5 applies; (b) acts on behalf of the enterprise; and (c) habitually exercises authority to conclude contracts on behalf of the enterprise.
- In order to consider whether an agent of an enterprise falls within the ambit of para. 5 of Article 5 of the DTAA, it is necessary to consider whether the agent (a) is one of an independent status and (b) is acting on behalf of the enterprise in the ordinary course of its business.
- Applying the aforesaid tests in the facts of the present case, the Court held that it is at once clear that ASL has acted on behalf of the assessee in its normal course of business; this is also evident from the ASL Director's Report, according to which ASL's regular activities include offshore marketing/ technical consultancy and ASL in its regular course of business provides logistics and consultancy support to various entities, including the assessee.
- Further, the assessee would bid and execute contracts in its own name. The consultancy agreement does not authorise ASL to conclude contracts on behalf of the assessee.
- Accordingly, the Court held that ASL would not constitute a DAPE of the assessee in India.

In view of the above, since there is no PE of the assessee in India, there is no question of attribution of total receipts.

EDITORIAL COMMENT

The Hon'ble Delhi High Court has, by way of the above decision, explained in detail the meaning of the term 'permanent establishment' and laid down clear principles as to when a fixed place may be considered as a PE in India. The Court has also explained the scope of the term 'PE' inasmuch as the said term, though inclusive, would still be restricted to the conditions laid down in para. 1 of Article 5 of the DTAA and the intent of drafting para. 2, per se, is not to give it an inclusive meaning.

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Global Tax Insights: Issue 15 - Q1, 2016