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Global Tax Insights

CONTENTS

COUNTRY FOCUS

Argentina 2

Nicaragua....................................3

Malta 4

Romania 5

UK ....6 & 7

TECHNICAL UPDATES

Proposed changes to Article 5 of the OECD Model Commentary........8

INTERNATIONAL TAX CASES

James G. Mullen v Her Majesty the Queen 10

Moody's Analytics Inc 12

EDITORIAL

The OECD has recently (12 February 2013) issued a report on base erosion and profit shifting. The report deals with the application of the treaty concepts to profits derived from the delivery of digital goods and services, the tax treatment of hybrid arrangements, intra-group financial transactions, improvement to transfer pricing rules, more effective anti-avoidance measures and tackling harmful regimes with limited substance and transparency. The OECD is also proposing to change its commentary on Article 5 of the Model Tax Convention, which deals with the definition of 'permanent establishment'.

The changes being proposed by the OECD are as a result of the complex structures being formed by multinational corporations to minimise or avoid taxation in various jurisdictions. It has been argued by the corporations that the tax planning that has been resorted to is legal, legitimate and within the framework of existing law and that it is for the authorities to design better legislation. Governments across the globe are therefore introducing various anti-abuse provisions in their respective domestic laws to counter tax planning.

The 'Country Focus' section of the newsletter details the steps that have been taken by authorities in some countries to tackle tax avoidance. The 'Technical' section of the newsletter explains the OECD's proposed changes to the Model Tax Convention. Two case laws have been included in this edition. The first deals with the issue of taxability of stock options in case of an employee who is a resident of the country when the options vested but was residing in another country when the options were exercised. The second case law deals with the taxability of capital gains under the Indo-Mauritius tax treaty.

I express my gratitude to all member firms that have contributed in this edition and would encourage other member firms to contribute to subsequent editions. I sincerely hope that the contents of this newsletter are useful to the members and their clients. Feedback and suggestions on the contents of this newsletter are always welcome; please email your suggestions to sachin@scvasudeva.com.

Happy reading!

Sachin Vasudeva

Senior Partner, S.C. Vasudeva, India

ARGENTINA *Contributed by Fernando Schettini, Schipani & Asociados*

Actions against currency flight and tax detection in Argentina

For 20 years, Argentina has had tax rules on taxing profits earned and assets situated abroad; but due to poor enforcement, these rules failed to improve tax equity and collection efficiency. As a result, currency flight has been one of the most obvious macroeconomic problems affecting Argentina over the last two decades.

Argentina has adopted legislative measures to combat international tax avoidance and evasion. These include the implementation of standards related to the analysis of 'transfer pricing' for transactions by companies within the same economic group, avoidance manoeuvres in foreign trade, the transposition of assumptions and interpretive guidelines applicable to foreign trade transactions involving tax havens.

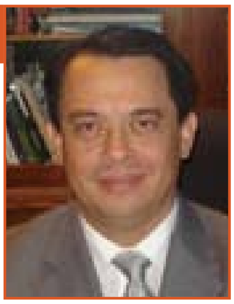
Additionally, in recent years numerous tax cooperation and information exchange agreements have been signed. In 2010 the Cooperation in Tax Matters Agreement came into force, signed with the Principality of Monaco, which includes both the exchange of information and the possibility to carry out fiscal inspections.

Since 2010, Argentina has entered into various agreements to exchange tax information with several countries (Andorra, Bahamas, Costa Rica, San Marino, Uruguay, China, Bermuda, Jersey and Cayman Islands). Furthermore, the instrument of ratification of the accession of Argentina to the OECD's *Convention on Mutual Administrative Assistance in Tax Matters* was recently published.

For the purposes of the effectiveness or degree of conflict that may involve the operation of the agreement, it is important to note that the text of the law referred to approve the subscription has not yet been published in the Official Bulletin. Official sources said that it would not require approval by law. As seen in the text of accession to the convention, published in the Official Bulletin, its provisions for Argentina would take effect from 1 January 2013.

With regard to the issue of information exchange, the Convention states that the parties shall exchange any information that could be considered relevant to the administration or enforcement of the domestic laws concerning taxes covered by the Convention relating to persons or specific transactions. The Convention also provides that, by signing a mutual agreement, the parties may exchange information automatically, such as where a party, without any prior request, might forward certain information to another party (for example: a person who is liable to tax obtains a reduction or exemption that would generate a tax increase in the reporting country; that the reporting country has reasons for assuming that a tax saving may result from artificial profits transfers within a group of enterprises; and other similar cases).

NICARAGUA *Contributed by Carlos Camacho, Group Camacho S.A.*



Changes in transfer pricing

Recently, the National Assembly of Nicaragua approved a new tax reform, which constitutes one of the most important reforms the country has achieved. Once again, as has been the trend so far in most Central American countries, the tax reform introduces the international taxation issue of transfer pricing.

The new valuation rules would be applicable to transactions that are undertaken with related parties. The Nicaraguan standard is based primarily on the identification and implementation of the arm's-length principle, together with the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. There are no specific rules in the new legislation regarding periodic compliance; nevertheless, there is a clearly established obligation for transactions carried out with related parties to provide all necessary documentation and information to validate of the arm's-length principle.

The tax administration has the authority to verify that transactions between related parties are made under the arm's-length principle, for which it can request any information considered relevant to this assessment. Upon request by the tax authority, this information should be made available within 10 working days.

These rules concerning the treatment of transfer pricing are incorporated into the new long-term system which spans as far ahead as 2020. The specific case of transfer pricing rules will apply in full from 1 January 2016.

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

Digital gaming in Malta: An overview of the fiscal incentives

The Government of Malta has recently introduced certain fiscal incentives to attract foreign direct investment (FDI) and thus promote, stimulate and support Malta's growing digital games industry. These initiatives were implemented through the respective budget measures applicable for the year 2013.

The incentives and available schemes include:

- A fund providing finance to digital gaming companies seeking to develop new projects in Malta. Investment aid could reach up to 50% of the eligible expenditure in respect of tangible and intangible investment costs incurred in an initial investment project
- Assistance in the co-financing of wages of employees up to a maximum of 50% of the cost incurred in the first 24 months of operation, depending on whether the qualifying enterprise is a small, medium or large entity
- Tax credit for research and development of digital gaming projects. Projects that may be entitled to such tax credits should revolve around
  - Industrial research projects
  - Experimental development projects
  - The registration of intellectual property resulting from any one of the above-mentioned projects.

These incentives complement the existing tax regime where, while the corporate tax rate stands at 35%, non-resident shareholders could claim up to six-sevenths of the Malta tax paid upon the distribution of dividends. Therefore, the effective tax charged on distributed profits may be reduced to approximately 5%.

These latest incentives on digital gaming are expected to further consolidate the Island's attractiveness as a serious and reliable business location that is set in a favourable Mediterranean climate, enjoying a skilled workforce, high quality of health care, attractive time zone and a stable economy and political environment.

ROMANIA *Contributed by Maria Pascu, Boscolo & Partners*

The extension of the fiscal neutrality principle to allow the recovery of fiscal losses in a reorganisation process

Reorganisation operations are governed by the fiscal neutrality principle. By virtue of this principle, the transfer of assets and liabilities within a merger, spin-off, acquisition of assets and liabilities belonging to the business activity of a legal entity in exchange of shares, does not constitute a taxable transfer. This means that the capital gains – determined as the difference between the market value of the assets and liabilities transferred, and their fiscal value – should not give rise to any taxation, as long as the receiving company accounts for the assets and liabilities the same fiscal value and depreciation regime that they previously had in the transferring company.

The previous provisions related to the fiscal losses incurred by the transferring companies

The principle of fiscal neutrality is not applicable when it comes to recovering the fiscal losses recorded by the company that is absorbed or merged. As a general rule, according to the provisions of the Romanian Fiscal Code, Romanian legal entities or the permanent establishment of non-resident legal entities are allowed to recover the fiscal loss incurred through the annual profit tax return from the taxable profits obtained in the following 5 or 7 years, respectively, for the fiscal losses recorded starting with 2009. When a legal entity ceases to exist as a consequence of a merger or spin-off, the fiscal losses it incurred prior to the reorganisation operation could not be set off by the receiving entity or the permanent establishment of the receiving company from their future taxable profits.

New provisions offer an opportunity to recover the fiscal losses of the transferring entities

Changes were brought to these rules by Government Ordinance no. 15/2012. Thus, according to the new provisions entering into force as of 1 October 2012, the fiscal losses carried forward by the company that ceases its existence as a result of a merger or spin-off operation can now be offset by the newly established legal entities or by existing companies that take over the patrimony of the transferring company, proportional to the assets and liabilities transferred to the beneficiary entities. As for the companies that are not dissolved following the partial division of their net asset, the fiscal loss may be recovered by the transferring entity and the companies taking over the transferred assets and liabilities, proportional to the assets and liabilities transferred according to the spin-off project.

The changes introduced by Government Ordinance no. 15/2012 not only bring advantages to taxpayers who envisage implementing a restructuring plan, but can also benefit the state budget. If, under the previous rules, entities having registered large fiscal losses might have become reluctant to give away their patrimony to another legal entity, thus continuing to generate fiscal losses or even reaching bankruptcy, the new rules may encourage companies facing difficult economic conditions to carry out a reorganisation operation through which their assets and liabilities would be taken over by a more financially stable company having a more competent management, with the possibility in future of turning the activity taken over from the transferring company into a profit position. Such future profits may bring to the state budget more revenues than those companies involved in such reorganisation processes would have brought had they carried on their activity separately.

UK *Contributed by Jackie Anderson, MHA MacIntyre Hudson*

Introduction of 'statutory residence test' to determine an individual's tax residency status from April 2013

At present, an individual is a resident in the UK for tax purposes if they are present for 183 days or more in a tax year (6 April to 5 April). However, as stated in HMRC guidance, 'you can also be resident if you are present here for fewer than 183 days – depending on how often and how long you are here, the purpose and pattern of your presence and your connections to the UK'.

The pre–6 April 2013 rules covering UK tax residence are mostly based on case law; but there is a great deal of uncertainty as to how the rules apply in each case, and this uncertainty has increased in recent years as a number of cases have shown that it is considerably more difficult to relinquish UK residence than was previously thought.

Proposed new law

In an effort to bring more clarity to a person's residence for UK tax purposes, from 6 April 2013, the statutory residence test (SRT) will determine an individual's UK tax residence status.

The SRT operates by setting out the circumstances in which an individual is treated as **automatically non-resident** in the UK for a year – which is broadly (i) by spending <16 days in the UK in the year; (ii) by spending <46 days in the UK in the year after being non-resident in all of the previous 3 years; or (iii) by working full-time overseas throughout the year (while spending <91 days in the UK and working in the UK for <31 days).

An individual will be treated as **automatically resident** in the UK where broadly (i) they spend ≥183 days in the UK in the year; (ii) they have a home in the UK for >90 days and are present there for ≥30 days a year; or (iii) they work full-time in the UK (Table 1).

For those who do not fall into either the automatically resident or automatically non-resident provisions, their status is determined by a combination of how many days they spend in the UK in the year, whether they have been UK-resident for any of the 3 preceding tax years, and how many 'ties' they have with the UK (Table 2).

Table 1. Summary of UK statutory residence test (SRT) criteria.

Days spent in the UK	Resident in any of the 3 previous years	Not resident in all of the 3 previous years
Under 16	Not resident	Not resident
16–45	Resident with four ties	Not resident
46–90	Resident with three ties	Resident with four ties
91–120	Resident with two ties	Resident with three ties
121–182	Resident with one tie	Resident with two ties
183 +	Resident	

Table 2. Definitions of UK 'ties' for determining an individual's tax residence status.

Family tie	You have a UK-resident spouse or civil partner (or where you live together as such), or child (under 18 years) in the year
Accommodation tie	You have a place to live in the UK for ≥91 consecutive days, and you spend ≥1 night there, in the year
Work tie	You do >3 hours work a day in the UK for ≥40 days in the year
90-day tie	You have spent >90 days in the UK in either or both of the previous 2 tax years
Country tie	You are present in the UK for the greatest number of days (as compared to any other country) in the year. (This tie is only relevant if you were resident in the UK in any of the 3 previous years)

Will the SRT help?

The SRT should provide greater certainty for individuals in determining their residence status, and should enable them to plan their arrival in, visits to, or departure from, the UK within a clearly defined framework.

UK *Contributed by David Bennett, MHA Moore and Smalley LLP*

The UK general anti-abuse rule

The UK is introducing a General Anti-Abuse Rule (GAAR). It will apply to arrangements entered into on or after the date when the 2013 Finance Bill is given Royal Assent, likely to be in July. The GAAR will cover all the main UK taxes, including corporation tax, income tax, capital gains tax, stamp duty land tax and inheritance tax, but not VAT. Disputes on the operation of GAAR will be referred to a GAAR advisory panel, chaired by a non-HMRC official.

A two-part test is followed to determine whether GAAR applies:

- Consider whether 'tax arrangements' have been entered into. This will be the case if it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements. Clearly, this first step catches a great deal of tax planning, but the GAAR is then narrowed down by the second step:
- Consider whether those 'tax arrangements' were abusive. Here, so-called 'double reasonableness' test applies. Arrangements are abusive if they cannot be reasonably regarded as a reasonable course of action in relation to the tax provisions, having regard to all the circumstances.

The 'circumstances' referred to above include whether the results of the arrangements are consistent with the policy objectives of the tax code; whether they include any 'contrived' or 'abnormal' steps; or if they simply exploit a shortcoming in the legislation. Under the double reasonableness test, the panel does not necessarily have to form the view that a course of action was 'reasonable;' if it concludes that such a view can be reasonably held (even though the panel itself does not hold it), the GAAR will not bite.

In reaching a conclusion, the GAAR panel must take account of the guidance material prepared by HMRC and approved by the panel. Draft guidance has now been published, and is currently awaiting approval by the panel. Where the benefit of double taxation agreements is relied upon, GAAR is to be applied consistently with the OECD commentary on the Model Tax Convention. In particular, the model convention provides that states do not have to grant the benefits of a double tax convention where abusive arrangements have been entered into.

It should be noted that the GAAR is an 'anti-abuse' rule, and is therefore intended to have a somewhat narrower scope than the 'anti-avoidance' rules that apply in other jurisdictions. What is more, it will not replace any of the targeted anti-avoidance rules scattered throughout the UK tax code, and neither will it supersede the body of case law on tax avoidance.

PROPOSED CHANGES TO ARTICLE 5 OF THE OECD MODEL COMMENTARY

Contributed by the Editorial Team

Article 5 of the OECD Model Tax Convention deals with the concept of a permanent establishment (PE) and lists down the situations in which an enterprise is deemed to have a PE in the other state. The Model Tax Commentary of the OECD explains in detail the concept of a PE. Paragraph 4 of the existing Commentary provides that 'a place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal'.

Paragraph 4.1 of the existing Model Commentary further provides that if the enterprise has a certain amount of space at its disposal, then no formal legal right to use that place is essential and a permanent establishment could exist where an enterprise illegally occupies a certain location where it carried on its business. However, paragraph 4.2 provides that while no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. The Commentary goes on to provide certain examples illustrating in what circumstances an enterprise would have space at its disposal so as to constitute a PE. Paragraph 4.2 of the Commentary reads as follows:

> *4.2 Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. These principles are illustrated by the following examples where representatives of one enterprise are present on the premises of another enterprise. A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).*

Paragraphs 4.3, 4.4 and 4.5 provide further examples of situations where an enterprise would deem to have space at its disposal. Though the Commentary provides different examples to explain the term 'at the disposal', it was felt by the OECD members that an approach relying too heavily on facts and circumstances would inevitably lead to situations where neither tax authorities nor taxpayers will be in a position to determine in advance whether a PE exists or not. It was therefore felt that a non-exclusive list of criteria should be provided as to what constitutes 'at the disposal'.

Given the above background, the OECD is intending to change the Model Commentary by replacing paragraph 4.2 of the Commentary on Article 5 by the following new paragraphs 4.2 to 4.4 and by inserting new paragraphs 4.8 and 4.9. The existing paragraphs 4.3 to 4.5 are proposed to be renumbered as 4.5 to 4.7. The paragraphs to be inserted are given below:

> *4.2 Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a 'place of business through which the business of [that] enterprise is wholly or partly carried on' will depend on that enterprise having the effective power to use that location as well as the extent of the presence of an enterprise at that location and the activities that it performs there. This is illustrated by the following examples. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself,*

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that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise. It is also important to remember that even if a place is a place of business through which the activities of an enterprise are partly carried on, that place will be deemed not to be a permanent establishment if the business activities carried on at that place all fall within the scope of paragraph 4.

4.3 These principles are illustrated by the following additional examples where representatives of one enterprise are present on the premises of another enterprise.

4.4 A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

4.8 Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 4.2 above). Where, however, a home office is used on a regular and continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise.

4.9 A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of subparagraph e) of paragraph 4.

The OECD had come out with a discussion draft in 2011 which proposed to clarify whether or not a place of business can be considered to be at the disposal of the enterprise depends on the extent of that enterprise's presence at the location and the activities it performs. The 2012 draft proposes to add that this distinction also depends on that enterprise having the effective power to use that location. The proposed amendments thus seek to clarify the scope of the term 'at the disposal of'.

JAMES G. MULLEN. v. HER MAJESTY THE QUEEN *Complied by the Editorial Team*

23 taxmann.com 171 (TC - Canada) [2012]

The Tax Court in Canada in the above-mentioned case held that income from exercise of stock options, vested during the employment in Canada, is taxable in Canada even if the assessee is not a resident of Canada in the year in which option is exercised.

Facts

James Mullen, the appellant, is a Canadian citizen. He was employed by a company, subsidiary of BMS in Belleville Canada, from 1980 to 1993. He was nominated in 1987 to receive stock options from the company and received 1,683 stock options. In 1993, the company offered the appellant an assignment in China that was expected to last for approximately 3 years. The appellant accepted the assignment, selling his house and cars in Canada. He purchased a car for each of his children, who were attending university in Canada. He rented apartments for his son and daughter and leased their Belleville property from August 1994 until August 1996. In 1998, his employment with the company was terminated and as his China visa expired, so he moved back to Canada. He received a visa for China again and travelled there in 1999; he stayed in a hotel and looked for work, but failed to find a job. He therefore returned to Canada in May 1999. That same year, he purchased a condominium in Phuket, Thailand and was resident of Thailand throughout the years 2000 and 2001, opening bank accounts in Singapore and Malaysia. In June 2001 he purchased a condominium in Costa Rica and obtained a temporary residence permit there. However, he returned to Canada in 2002.

In 1997, 1999 and 2001, the appellant exercised the stock options granted by the company in 1988 when he was employed and resident in Canada.

Issue

Based on the aforesaid facts, the following issues were raised before the Tax Court:

- Issue 1: Taxability of stock options received by the appellant in Canada
- Issue 2: Whether the appellant was ordinary resident in Canada for the tax years 1999 and 2001.

Decision of the Tax Court

Issue 1: As per Section 7(1), when the appellant exercised the stock options in 1997, a deemed benefit was received in 1997 because of his employment. 'Employment' refers to his employment at the time the option was granted in 1988. Although, the appellant was not resident in Canada in 1997, for the purposes of Section 115 the benefit he received is taxable in Canada in 1997 due to the duties of employment performed by him at the time when he was resident in Canada.

Reliance was placed in the case of *Hurd v. The Queen* [1982] 1 FC 554 (FCA) at paragraph 5, and it was held that the appellant was in the same position as 'a resident of Canada who acquired the shares in similar circumstances'; hence, the amount is taxable in Canada.

Issue 2: In this regard, considering the facts of the appellant, it was concluded that the appellant had both social and emotional ties with Canada which could not be severed. Reliance was also placed on the decision of Supreme Court of Canada in the case of *Thomson v. Minister of National Revenue* (1946 CTC 51) and *The Queen v. Reeder* (1975 CTC 256 FCTD). In the case of *The Queen v. Reeder*, various factors were listed to determine the residential status, including the following: (a) past and present habits of life; (b) regularity and length of visits in the jurisdiction asserting residence; (c) ties within that jurisdiction; (d) ties elsewhere; (e) permanence or otherwise of purposes of stay abroad.

Based on these considerations, it was held that all the factors are not necessarily material in every case. They must be considered in the light of the basic premise that everyone must have a fiscal residence somewhere, and that it is quite possible for an individual to be simultaneously resident in more than one place for tax purposes. Nevertheless, one key factor to take into account is the regularity and length of time the appellant spent in Canada. In *Johnson v. The Queen* (2007 TCC 288), Paris J faced a similar situation, where the taxpayer had returned to Canada only three or four times each year for a period of 2 years. The decision found that the taxpayer had not severed his ties with Canada when he went to work in the UAE because he maintained his houses (which he rented), his RRSPs, (Registered Retirement Savings Plan) his driver's licence, his credit cards and his

Continued over

investments; he was therefore found to be ordinarily resident in Canada.

In the light of the above facts and judicial decisions, the tax court has held that the appellant was resident in Canada in 1999 and 2001.

EDITORIAL COMMENT

The court has rightly held that the benefit of employee stock options flows from the employment, and therefore the country in which the services are rendered gets the right to tax the stock options which were granted while exercising the employment in that country – even though the option is exercised later. The court has also rightly observed that for tax purposes, social and emotional relations play a vital role in determining a person's residential status, especially when they are simultaneously resident in more than one country.

MOODY'S ANALYTICS INC., USA, 24 taxmann.com 41

AAR No. 1186–1189/2011 dated 31 July 2012; India

In this case, the Authority for Advance Ruling (AAR) held that the capital gains arising from direct and indirect transfer of the Indian company's shares by the Mauritian company are not taxable under the India–Mauritius tax treaty.

Facts

Copal Research Ltd Mauritius (CRL, Mauritius) is a company governed by the laws of Mauritius. It acquired 100% shares of an Indian company, Copal Research India Private Ltd (CRIL). Another company, Copal Mauritius Ltd, Jersey (CPL, Jersey) acquired 100% shares in CRL Mauritius. CRL Mauritius acquired 100% shares in Copal Market Research Ltd, Mauritius (CMRL Mauritius). CMRL Mauritius in turn acquired 100% shares in Exevo Inc. US, a company governed by the laws of the United States. Exevo Inc. US had acquired 100% shares in Exevo India Pvt. Ltd.

CRL sold its entire holding in CRIL to Moody's Analytics Inc (Moody Cyprus). Further, CMRL sold its entire holding in Exevo to another US company, Moody's USA (M USA). Figure 1 illustrates the entities and their shareholdings.

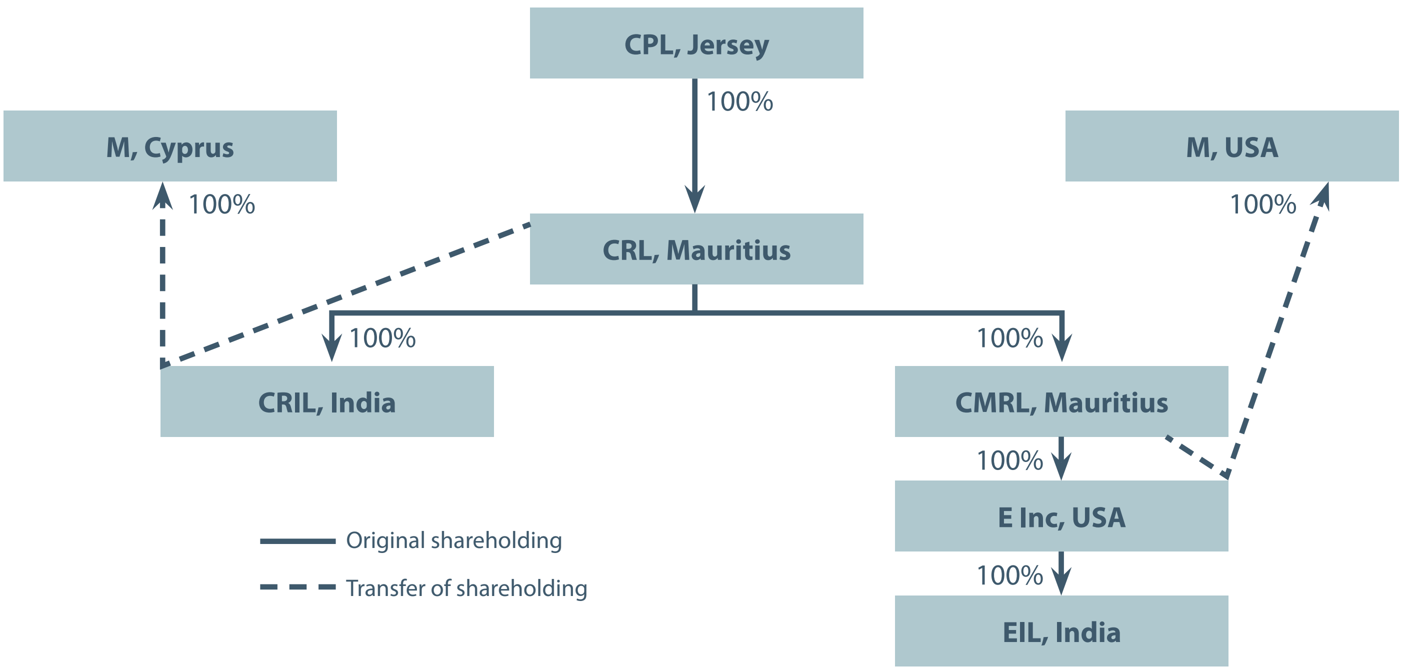
Issues

Whether capital gains arising on sale of shares in CRIL by CRL to Moody Cyprus would be chargeable to tax in India and whether capital gains arising on the sale of shares held in Exevo by CMRL to Moody's, USA would be chargeable to tax in India in the hands of CMRL?

Applicant's contention

The two sellers, being Mauritian companies, are entitled to claim the benefit of the tax treaty; and relying on Section 90(2) of the Act, the right to claim relief on the basis of the tax treaty cannot be disputed. Accordingly, even if by virtue of the Finance Act, 2012, the applicant's transactions are held to be taxable in India; but following para. 4 of Article 13 of DTAA (Double Taxation Avoidance Agreement) between India and Mauritius, the power to tax this income lies with Mauritius, since the seller is a resident of Mauritius (as demonstrated by the tax residency certificates [TRCs] submitted by the company) and not of India.

Figure 1. Graphic illustrating the shareholding relationships among the various business entities.



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Revenue's contention

This was a clear case of the devising of a scheme for avoidance of tax. The beneficial owner of the shares is CPL, Jersey; and since there existed no tax treaty between India and Jersey, the taxability of the transactions shall be under the Act. Secondly the whole transaction has been left to the discretion and management of Mr RK, who is a resident of UK and also the Director of Exevo, Director and CEO of group companies. Therefore, the management and control of the companies is not in Mauritius but is with Mr RK; hence, the applicant cannot claim advantage of the tax treaty between India and Mauritius. The position adopted by the Supreme Court in *Union of India v. Azadi Bachao Andolan* has been modified to that extent by the decision in the case of *Vodafone International Holdings B.V. v. Union of India*. Hence, the transaction is taxable in India.

Ruling of AAR

AAR held that on the basis of documents submitted, it is clear that Mr RK has played an important role in the sale transaction, but there is insufficient evidence to show that he controls the management of the company. Therefore, by applying the place of management test, the seller companies cannot be held as non-Mauritian companies.

AAR observed the provisions of Section 9 of the Act and the judgment of the Supreme Court in the case of *Union of India v. Azadi Bachao Andolan* and *Vodafone International Holdings B.V. v. Union of India* and held that the capital gains from indirect sale of shares are taxable in India but, following the DTAA between India and Mauritius, the power to tax such capital gains earned by a resident of Mauritius lies with Mauritius; India cannot tax such capital gains, even if this is non-taxable in Mauritius.

The benefit of tax treaty to the taxpayer cannot be denied. Accordingly, the capital gains on sale of shares by Mauritian companies cannot be taxed in India.

EDITORIAL COMMENT

The Finance Act, 2012 amended Sections 9 and 195 to tax the indirect transfer of capital assets in India, and even non-residents are now liable to deduct tax on payments of income chargeable under the Income Tax Act, 1961. The taxation of cross-border transactions involving transfer of shares of an Indian company and the applicability of the India–Mauritius tax treaty has been the focus of debate for several years. The Supreme Court ruling in the case of Union of India v. Azadi Bachao Andolan upheld the applicability of the India–Mauritius tax treaty. Further, the Supreme Court also upheld the validity of TRC which confirms the residential status of the taxpayer. The AAR, in the said ruling, upheld that even after the amendments, the benefit of treaty cannot be denied.