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Global Tax Insights

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EDITORIAL

It has been a year since we started our quarterly MI tax newsletter, *Global Tax Insights*. When this project was conceived, we were not sure how many issues would be produced; but now I firmly believe that *Global Tax Insights* will be a regular feature, thanks to encouraging support from member firms.

Besides the regular sections, such as 'Country Focus' and 'International Tax Cases', this edition includes a special section on taxation of cross-border M&A transactions. Tax can be significant in a cross-border transaction, and the articles covered in this issue provide useful insights into the relevant tax laws of various countries.

Two case laws are reported: the first deals with eligibility for double taxation relief between the USA and the UK, where profits are derived by a person who is a member of a LLC that is transparent for tax purposes. The other case law deals with the concept of 'make available' between India and the UK, as per the treaty between the two countries.

I express my gratitude for all the contributions to this edition, and urge other member firms to contribute to subsequent editions. I sincerely hope that the contents of this newsletter are useful to members and their clients. Feedback and suggestions on the contents are always welcome; please email your suggestions to me at sachin@scvasudeva.com.

Happy reading!

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

ARGENTINA *Contributed by Fernando Schettini, S&A*

Changes in the rules of international tax transparency

Executive Order No. 589/2013 recently replaced Article 7 and was incorporated following Article 21 in the income tax regulation. Article 21 would provide a restrictive list of 88 countries, domains, jurisdictions, territories, associated states or special tax regimes named 'low or zero taxation countries'.

The Order provides that for all purposes covered under the law and its regulation, any reference made to low or zero taxation countries should be understood to refer to jurisdictions not deemed 'cooperative countries on tax transparency'.

The new provision replaces the list of countries, domains, jurisdictions, territories, associated states or special tax regimes of low or zero taxation, with a new list (not yet published), of non-cooperative jurisdictions on matters of tax transparency. It delegates to the Federal Administration of Public Revenues (AFIP) the power to draft and update such lists periodically.

The Executive Order defines as 'countries, domains, jurisdictions, territories, associated states or special tax regimes cooperatives on tax transparency' those countries that sign an agreement with the Argentinean government for the exchange of tax information or an international agreement to avoid double taxation (CDI) *with broad clauses on information exchange – provided that the exchange of information is actually complied with*.

That is, a double condition is required, in order to consider a country or territory as cooperative on tax transparency matters.

The Executive Order further delegates to the AFIP significant powers to implement the provision, since such body shall:

- Set forth the assumptions to be considered, to determine whether there is effective exchange of information
- Define the necessary conditions to start negotiations in order to sign the above-mentioned agreements and conventions
- Analyse and evaluate compliance with the Tax Information Exchange Agreement regarding effective exchange of tax information and the CDI with broad clauses on information exchange, signed by the Argentinean Republic
- Prepare a list of jurisdictions considered cooperative on tax transparency, and publish such list on its web page, with the commitment to keep it updated.

In other words, the new provision should allow more flexibility to withdraw and reinstate countries and jurisdictions deemed as low or zero taxation countries, since the fact of being cooperative on international transparency implies that the restrictive list might be modified.

Finally, it is worth noting that, from a tax perspective, transactions made by people with fiscal residence in Argentina, with counterparties in countries specifically defined by the provision, have the following treatment:

- Transactions are not considered adjusted to standard market practices or prices agreed between independent parties (arm's-length principle), even if there is no economic, legal or functional relation between the parties to the transaction. This means that operations are subject to transfer pricing rules
- The allocation of expenses paid to individuals domiciled, established or located in such jurisdictions is subject to the existence of the payment
- In the case of interest payments, a 100% net income is assumed. Therefore, a withholding of 35% income tax should be applied, as a foreign beneficiary
- Local shareholders who hold stock companies incorporated or located in such countries and who obtain interest, dividends, royalties, rents or other passive income will be taxed on accrual, when they have obtained at least 50% of the proceeds from such passive income
- Presumption of unjustified increase of assets, when an individual resident in Argentina receives funds from such countries, whatever their nature, concept or type of operation. This increase in equity should be added in 10% of income on non-deductible expenses, representing entire taxable income in

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Argentina. Additionally, it can have an impact on consumer taxation

- In this case the burden of proof is shifted, since the taxpayer must demonstrate that the origin of such funds is related to actual activities or placements reported in a timely manner.

ISRAEL *Contributed by Ariel Zitnitski, Zitnitski Weinstein & Co.*

On 30 July 2013, the Knesset (Israel's Parliament) enacted the Law for the Change of National Priorities (Legislation Amendments for Achieving the Budget Purposes for the Years 2013 and 2014). The amendments resulted in a number of changes relating to tax law in Israel – including an increase in the corporate tax rate from 25% to 26.5% as of 1 January 2014.

There are also changes in the way that trusts are taxed in Israel: the new taxation laws effectively cancel the tax exemption available to trusts settled by foreign settlors in Israel (trusts that were settled by foreign residents were generally tax exempt in Israel, even after the settlor's death and even if there were distributions to Israeli-resident beneficiaries).
According to the changes, the tax exemption will be available only if all beneficiaries are foreign residents – although some cases will be eligible if they are new immigrants, or if the trust is for the public good.

ITALY *Contributed by Michele Nasti, Boscolo & Partners*

A recent Italian law has extended, for the period 2013–14, the incentive allowing a tax reduction on the remuneration paid to employees in the private sector for increases in work productivity, by introducing a flat tax rate of 10% on such amounts for the calendar year 2013.

In order to apply the incentive, the amounts must be paid in accordance with the collective labour agreements, which should be undersigned – at a local or national level, and under the provisions of the legislation in force and of interconfederal agreements – by the most representative trade unions, or by their representatives working within the company.

The reduced tax rate may be applied to employees in the private sector whose gross remuneration in 2012 has not exceeded €40,000.

The 'productivity remuneration' that may benefit from the reduced tax rate refers to:

- The amounts that have been paid, according to collective labour agreements, in direct correlation with the quantitative parameters of productivity/profitability/efficiency/innovation; or
- Alternatively, the amounts that have been paid under the collective labour agreements providing at least one measure in three of the following areas, aiming to reward:
  - Flexible working hours (as a measure designed to increase efficiency in the use of implants and, more generically, to increase production flexibility)
  - Flexible distribution of holiday periods
  - Widespread use and diffusion of computer technologies, with the protection of employees' rights
  - Task fungibility, to improve productivity.

In order for the tax authorities to monitor the correct application of the above tax incentive, the employer must submit a copy of the labour contract to the competent Labour Office, within 30 days from the signature of the contract, along with a declaration of conformity with the labour agreement submitted.

PERU *Contributed by Marysol León, Quantum Consultores*

Definition of 'technical assistance' for tax purposes

While Peruvian residents are subject to tax on their worldwide income, non-residents are subject to tax only on their Peruvian-source taxable income. As a general principle, an income qualifies as a Peruvian-source income when the credit is received in Peru, the tangible or intangible assets from where the income arises are situated in Peru, or the activities are carried out in Peruvian territory.

However, despite the principle of 'territorial source', there may be cases where the activity is carried out outside of Peru or partially within Peruvian territory; the income from performing these activities can be considered as a Peruvian-source income, and therefore subject to income tax. This is the case of technical assistance, which is subject to a 15% withholding tax, regardless of whether the service was rendered entirely abroad.

The tax regulations define 'technical assistance' as any service (wherever performed) through which the provider undertakes to provide specialised technical knowledge, applied through the exercise of an art or technique, intended for the manufacturing of goods; or rendering of services, or the performance of other operations, the purpose of which is to generate income. According to this, technical assistance may include, *inter alia*, engineering services such as the execution and supervision of assembly, installation and start-up of machinery, equipment, and production plants; calibration, inspection, repair and maintenance of machinery and equipment; performance of tests and trials, quality control, and project research and development; and execution of pilot programmes, laboratory research and experiments.

Although it seems that technical assistance is linked to technical aspects and technical knowledge transfer, the Peruvian Tax Court has recently issued resolution No. 18368-8-2012, stating the following criteria:

"Tax regulation must be interpreted as meaning that, thanks to technical assistance, the user of such services will be able to provide services, produce goods and sell them. For example, if a law firm resident in Peru needs to provide legal services to a local client which does businesses in Spain and this Peruvian legal firm requires legal advice from a Spain law firm, the service performed by the Spain law firm would have to be qualified as technical assistance, because without such prior opinion, Peruvian legal firm could not provide the service for which it was hired. In the other hand, there are other services which are considered as accessories to the processes of production goods and rendering services, such as advertising and marketing services. This kind of service is not qualified as technical assistance".

Accordingly, whether the service is technical or not, the important thing is to determine whether the service provided by the supplier will be a fundamental and substantial part (an input) of the production process of the user of the service. In that sense, even legal advice rendered by a foreign law firm could qualify as technical assistance if, as the Tax Court stated, these services will be used by a Peruvian legal firm to help resolve its clients' legal consultations.

The above interpretation of the phrase 'technical assistance' is subject to double taxation avoidance agreements (DTAA). For example, according to the DTAAs between Peru–Chile and Peru–Canada, technical assistance will not be subject to a withholding tax in Peru if these services are performed without having a permanent establishment in Peru, despite the fact that these kinds of service are subject to tax according to Peruvian law.

SOUTH AFRICA *Contributed by Zweli Mabhoza, SizweNtsalubaGobodo*

Service fees and interest

South African tax legislation currently allows South African companies to deduct the expenditure incurred in the earning of income, provided that such expenditure is not of a capital nature. Therefore, if a South African company pays service fees to its foreign holding company for marketing, centralised purchasing and other management support activities, then it can deduct these expenses, thereby reducing its tax bill.

The foreign holding company will derive income on service fees. However, at present it is possible that the payment of service fees could be structured in such a way that it is not subject to tax in South Africa.

The South African company would also be entitled to claim the deduction of interest if its foreign holding company provided funding used in the earning of income. The foreign holding company will be exempt from tax in South Africa on the basis that the interest is received by a non-resident.

The National Treasury seems to have viewed service fees and interest charges as another way of eroding the South African tax base, and has proposed a withholding tax on service fees and interest with effect from 1 January 2015. The proposed legislation requires South African taxpayers to withhold tax at 15% on payments made to non-residents in respect of service fees and interest. This 15% rate could be reduced where the reduction is imposed by a DTAA between South Africa and the country in which the holding company is a resident for tax purposes.

INDIA *Contributed by Parul Jolly, S.C. Vasudeva & Co.*

Taxability of indirect transfers

Apart from taxing the direct transfer of shares as capital gains in mergers and acquisitions (M&A) transactions, India now also taxes indirect transfers as a result of the retrospective amendments made by the Finance Act, 2012 to Section 9 of the Indian Income Tax Act, 1961.

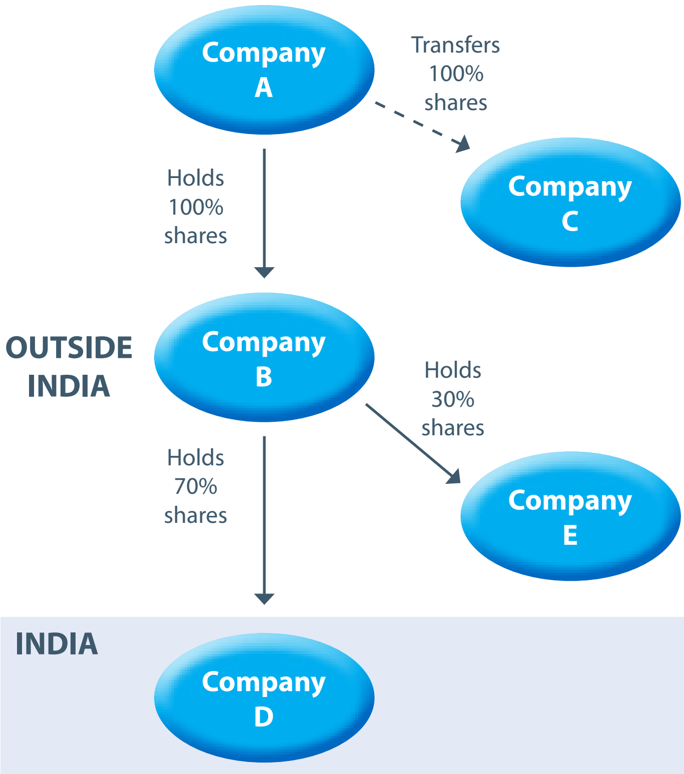


Figure 1. Taxability of indirect transfers.

As illustrated in **Figure 1**, given the amendments made by the Finance Act, 2012, on the transfer of 100% shares from Company A to Company C, the gain arising on indirect transfer of shares of Company A, held in India in Company D, would be subject to tax in India. Treaty protection is still available, and if under a tax treaty such transfers are not taxable then the taxpayer can invoke the treaty being more beneficial.

Recently, the Hon'ble Andhra Pradesh High Court in the case of *Sanofi Pasteur Holding SA* ruled in favour of the taxpayer and held that gains arising on sale of shares of a foreign company by a non-resident to another non-resident is not taxable in India under the India–France DTAA, even if the foreign company held only Indian assets. The Court factually examined various aspects such as commercial substance in a foreign investing entity, the share purchase agreements, articles of association, the need to lift the corporate veil, and also the impact of retrospective amendments in tax laws with regard to applicability of provisions of the DTAA.

The amendment in Section 9 reflects an international move by governments to expand their taxing jurisdiction to include indirect transfers of local shares by non-resident entities. Several countries (such as China, Peru and Indonesia) have introduced provisions to enable taxation of such indirect transfers of investments made in these countries. It seems that India also has followed the global trend in taxing indirect transfer of assets in India.

ISRAEL *Contributed by Ariel Zitnitski, Zitnitski Weinstein & Co.*

Israeli tax law allows certain structural changes in the context of M&A, with tax exemption under certain conditions. The important points that need to be considered for M&A transactions from a tax perspective are:

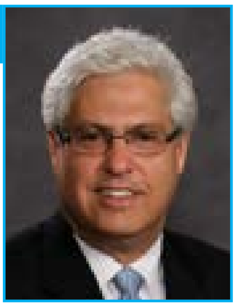
- *Economic purpose* – To be eligible for tax benefits, the transaction should have an economic substance and should not be merely for the purpose of tax avoidance or tax reduction
- *Delay of the tax event* – In certain circumstances, such as transactions where the consideration is discharged by the issuance of shares, there are several options to get tax deferral under the conditions prescribed by law
- *Withholding tax* – In certain transactions, the buyer has an obligation to withhold tax from the consideration to be paid
- *Filing consolidated report and offsetting losses* – In some cases, the accumulated losses of the acquirer company or the acquired company can be used to offset taxable income and losses between the merging companies (with certain restrictions).

Another important aspect regarding M&A is that Israeli tax law allows the participation exemption for an 'Israeli holding company'. This exemption, which is practised in many countries, is an incentive to establish base companies that are international holding companies in which most of the investments are in foreign business companies. Under certain conditions, the tax benefits due to an Israeli holding company, according to the law, are, *inter alia*:

- Exemption from capital gains tax on the sale of shares of foreign companies
- Exemption on dividend income
- Exemption on interest, dividends and capital gains from securities traded in Israel
- Exemption on interest and linkage differences (from Consumer Price Index) received from a financial institution.

USA

Contributed by Paul Bercovici, Marks Paneth LLP



The following discussion considers the very basic US federal income tax issues associated with the taxable acquisition of a US corporation by a foreign corporation. In this context, the term 'taxable acquisition' refers to acquisitions where the foreign corporation pays for the acquisition with cash and/or a note, and the seller of stock or assets recognises gain or loss on all of the consideration received. The following analysis assumes that shareholders of the US corporation being acquired do not want to retain a continuing equity interest in the combined business enterprise of the foreign corporation and the US corporation being acquired. It should be noted that each potential acquisition presents its own particular issues, and that non-tax factors are often determinative in structuring the acquisition of a US corporation by a foreign corporation.

The basic choice for a foreign corporation acquiring a US corporation is whether to structure the acquisition of the US corporation as an acquisition of assets or as an acquisition of the capital stock of the US corporation.

Acquisition of assets of US corporation by foreign corporation

As a general rule, a foreign corporation that acquires the assets of a US corporation obtains a 'stepped-up basis' in such assets. That is, for the purpose of claiming future depreciation and amortisation on the acquired assets and for the purpose of determining the gain or loss on the eventual sale of the assets, the basis of the acquired assets is 'stepped up' to the amount of the consideration paid for the assets. It should also be noted that the acquisition of the assets of a US corporation (as opposed to the stock of the corporation) prevents the foreign corporation from gaining access to certain corporate tax attributes such as methods of accounting, net operating loss carryovers, capital loss carryovers, tax credits, and earnings and profits amounts.

Acquisition of stock of US corporation by foreign corporation

In a taxable stock acquisition, the foreign corporation that acquires the stock of a US corporation obtains basis in the stock of the US corporation, but the assets retain their historic basis. The sale of stock generally is a taxable event for the US shareholders of the US corporation. In contrast to a taxable asset acquisition, in the case of a taxable stock acquisition the purchaser generally does succeed to the relevant corporate tax attributes referred to above, subject to certain limitations. For example, the future utilisation of net operating loss carryovers may be severely limited.

Section 338 election

Under certain conditions, a foreign corporation can elect, for federal income tax purposes, to treat the acquisition of the capital stock of a US corporation as an acquisition of assets.

State and local tax issues

State and local income tax issues cannot be overlooked in making the final determination as to whether to structure the acquisition of a US corporation as an acquisition of assets or as an acquisition of stock. Each state in which the acquired US corporation does business may have different rules that impact the acquisition. In many cases, the state and local income tax issues can be a very important factor in making such a determination.

Summary

The determination of how to structure the acquisition of a US corporation by a foreign corporation is extremely complex and requires very thorough due diligence and analysis. The determination is governed by very significant tax and non-tax considerations. Preferences of buyers and sellers for one form of transaction rather than another (i.e., sale of assets versus sale of capital stock) are often resolved through comprehensive negotiation of the purchase price.

In addition, it is important that US tax considerations be evaluated in conjunction with all relevant foreign tax and non-tax considerations, to ensure that opportunities are not missed and that costly mistakes are not made. It is crucial that a foreign corporation contemplating the acquisition of a US corporation address these issues very early in the process, and that they retain experienced US tax professionals to assist them in making the most appropriate choice as to how to structure the particular acquisition.

HER MAJESTY'S REVENUE AND CUSTOMS V. GEORGE ANSON 32 taxmann.com 202 (RCJ) [2013]

Compiled by the Editorial Team

This case relates to the issue of whether a partner in a Delaware LLC is entitled, or not, to the profits of the LLC as they arise (regardless of any automatic allocation under the LLC agreement), and therefore whether the tax payable by the partner on his share of the LLC's profits in the US can be set off against the partner's liability to tax in the UK under double tax treaty relief.

Facts of the case

1) The appellant, 'Mr A', was a member of HV, a Delaware Limited Liability Company (HV, LLC). HV is treated as 'tax transparent' in the USA, meaning that its members paid tax on their share of its profits and the LLC paid no tax. Mr A was subject to US federal and state tax on the profits of the LLC as they arose (on the basis that the LLC had not elected to be treated as a corporation, and was thus treated as transparent for US tax purposes).

2) The respondent, Her Majesty's Revenue and Customs (HMRC), seeks to levy tax on Mr A's share of HV's profit, on the contention that the remitted income was a dividend. No credit was given for taxes paid in the USA. Mr A contended that he was entitled to double taxation relief (DTR) under the terms of the UK/US Double Tax Convention. As per Article 23 of UK/US Double Taxation Convention, in order to obtain DTR, the taxpayer must establish that his share of HV's profits is the same profits as those by reference to which he was taxed in the US.

3) Mr A claimed that the same source requirement was satisfied by showing that its entitlement to profits was an automatic one, not dependent on the act of any third party. There was no necessary requirement of ownership of assets of business for claiming DTR. He also claimed that a right to profit was not required. There needs to be simply an entitlement to profits as they arose. Also, no director's resolution was required to pay dividend.

4) HMRC submitted that the source in tax terms was the assessee's immediate source. A shareholder gets his dividend from his shares. In that case, the shares are the source. Therefore, Mr A's share in HV's profits were not the same as those taxed in the USA; rather, they represented income received by him from his investment in HV.

Decision of First Tier Tribunal (FTT)

The FTT decided that the same profits were taxed in both the UK and the USA, and therefore Mr A was entitled to DTR. The FTT found that the LLC was a separate legal entity; its business was carried on by its members; it owned its assets, and was liable for its debts; the LLC had nothing akin to share capital, as its capital was more like the partnership capital of an English partnership; and finally, the members of the LLC had an entitlement to profits as they arose.

Decision of Upper Tier Tribunal

The Upper Tribunal, on the contrary, had stressed that a crucial factor was the fact that the taxpayer had no proprietary interest in the assets of the LLC. The profits of the LLC belonged to the LLC, and this position was not changed by a contractual obligation to distribute them to the members. Treaty relief was therefore not available.

Judgement of the Tax Court

The court considered the submission of the counsel and the decisions of the FTT and Upper Tribunal. The court held the order of Upper Tribunal on the basis of the following reasons:

- The relevant test for determining whether a person is taxed on the same profits in both jurisdictions is whether the source of the profits in each jurisdiction is the same
- Where the taxpayer becomes entitled to the profits of an entity because of some contractual arrangement to which he is a party, he must show that the contract is actually the source of the profit rather than a mechanism to secure a right to a profit derived from another source. This will, in general, mean that he has to show a proprietary right to the profits

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- The Upper Tribunal was right to conclude that the FTT erred in law insofar as it held that the profits of HV belonged to the members
- The Upper Tribunal was also right to conclude that, on the facts of this case, the profits of HV did not belong to its members.

The Court of Appeal upheld the decision of the Upper Tribunal concluding that Mr A was not entitled to a share of the profits of the LLC as they arose. A clear indication was the fact that deductions could be made from profits before they were allocated to the partners. Mr A merely had a contractual entitlement to receive LLC profits under the LLC agreement, which provided for automatic allocation. It followed that the source of Mr A's income must be a different source of income from that of the entity itself; and so double tax treaty relief was not available.

EDITORIAL COMMENT

In order to determine whether DTR would be available to the partners of LLC, it is necessary to ascertain whether the right to the profits was proprietary or contractual. Being a partner of LLC does not mean that there is a proprietary right in the LLC, as the LLC had its own identity, conducted its own business, owned its own assets etc.

This issue is not only between the UK and the USA: many countries struggle with classifying US LLCs' profits under their own domestic tax statutes. From a UK perspective, a UK citizen and resident who invests in a US LLC in their own personal name will be subject to double taxation, unless the investment is routed through some other entity.

INCOME TAX OFFICER, INTERNATIONAL TAXATION-II V. VEEDA CLINICAL RESEARCH (P.) LTD 35 taxmann.com 577 (Ahmedabad – Tribunal)

The case relates to the issue where training services provided to the assessee company's employees were general in nature, not involving any transfer of technology; fees for same were not taxable as fees for technical services, as per Article 13 of the India–UK DTAA.

Facts of the case

The assessee made certain payments to Veeda Clinical Research Ltd UK, for providing in-house training to its employees, and to Steve Matheson UK, for providing market awareness and development training to its employees.

The assessee claimed that it had no obligation to deduct tax at source under Section 195 of the Act, since such training services did not 'make available' any technical knowledge, experience, skill, know-how or process, nor consist of the development and transfer of a technical plan or design as required under Article 13(4)(c) of the India–UK DTAA.

Revenue's contention

The Assessing Officer (AO) held that that connotations of the expression 'make available' also include cases in which technical services were offered or made accessible to the recipient of services, and are not necessarily confined to the cases in which the recipient should be 'trained or made expert' in such technical knowledge, etc. Accordingly, the AO concluded that the training fees paid by the assessee are taxable in India under Article 13(4)(b) of the India–UK DTAA.

Aggrieved by this order of the AO, the assessee preferred an appeal before the CIT(A) (Commissioner of Income Tax (Appeals)), which held that Article 13(4)(b) of the DTAA deals with technical and consultancy services that are 'ancillary and subsidiary to the enjoyment of the property' referred to in Article 13(3)(b) of the India–UK treaty – something that is clearly unrelated to the facts of this case; and inferred that since instant the services are not covered under Article 13(4)(b), *'the payment made by the appellant is not covered by Article 13(4) of the DTAA between India and the UK'.*

Decision of the Tribunal

The Hon'ble Tribunal stated that the law is now settled that for the applicability of the 'make available' clause in the definition of Fee for Technical Services (FTS), the condition precedent for invoking this clause is that the services should enable the person acquiring the services to apply technology contained therein. The Tribunal relied on the two High Court judgements in the case of *DIT v. Guy Carpenter & Co. Ltd* [2012] 346 ITR 504 (Delhi) and *CIT v. De Beers India (P.) Ltd* [2012] 346 ITR 467 (Karnataka) in support of this proposition. There was no contrary decision in this regard by the Hon'ble jurisdictional High Court or by the Hon'ble Supreme Court.

The Hon'ble Tribunal held that unless there is a transfer of technology involved in technical services extended by the UK-based company, the 'make available' clause is not satisfied; accordingly, the consideration for such services cannot be taxed under Article 13(4)(c) of the India–UK DTAA. There can be situations in which technical training is imparted, resulting in transfer of technology; consideration for rendering of such training services will be covered by the definition of FTS. However, what was really the decisive factor was not the fact of training services *per se* but the training services being of such a nature that this results in transfer of technology. In the present case, the training services rendered by the service provider were general in nature, as the training was described as 'in-house training of IT staff and medical staff' and of 'market awareness and development training'. Clearly, this training does not involve any transfer of technology.

Further, it was held that in order to successfully invoke the coverage of training fee by the 'make available' clause in the definition of FTS, the onus is on the revenue authorities to demonstrate that these services do involve transfer of technology. That onus was not at all discharged by the AO, nor even by the tax department.

Accordingly, the fees for training services were of a general nature, which does not seem to involve any transfer of technology; therefore, they cannot be brought to tax under section 13(4)(c) of the India–UK DTAA.

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EDITORIAL COMMENT

The question of taxability of technical services under tax treaties that include the 'make available' clause has been debated for many years. The present decision is in line with the various judicial pronouncements of Hon'ble Tribunal and High Courts interpreting the meaning of the words 'make available' in the FTS clause of the tax treaties.