Morison KSi

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# Global Tax Insights

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# Editorial

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It is with great pleasure that I present the first "Morison KSi" edition of *Global Tax Insights*. This edition includes numerous country focus pieces and a feature on the amendments to the India–Mauritius Treaty. Two international tax cases – both from the Indian courts; one on treaty override, and the other concerning oil exploration companies – also feature in this edition.

India finally managed to renegotiate the 33-year-old Double Tax Avoidance Agreement ('the Treaty') with Mauritius. This Treaty was a major source of heartburn for the authorities, as it was considered synonymous with tax avoidance and abusive practices such as treaty shopping and round tripping of funds. Despite the Supreme Court of India upholding the sanctity of the India–Mauritius route, the investments through Mauritius were always viewed with suspicion. With the Treaty being amended, India gets rights to levy tax on capital gains tax, which hitherto was not taxable in India as per the Treaty.

In terms of Foreign Direct Investment (FDI), Mauritius was the largest contributor and amending the Treaty would have an impact on the FDI inflows into India. In its credit outlook report, Moody's stated that this would be a credit negative for the island nation. Though losing a historical advantage, Mauritius would remain competitive, as similar changes are expected to be made in the Treaty with Singapore and Cyprus. India has also asked the Netherlands to resume negotiations to amend the Treaty.

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

Happy reading!

Sachin Vasudeva

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# Country Focus

## Australia

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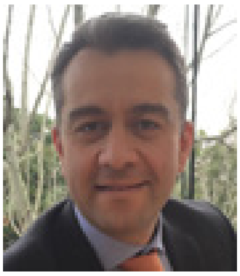
*Adrian Rosa*

**New withholding obligations on purchasers of direct and indirect interests in Australian real property**

A new withholding regime was passed into law in late February 2016. Under this regime, purchasers of Australian real property, interests in entities that predominantly hold Australian real property or options over these may have an obligation to withhold 10% of the gross sales proceeds and pay the amount to the Commissioner.

The new regime will apply to contracts entered into on or after 1 July 2016.

The purpose of these changes is to address the low levels of tax compliance by foreign residents who dispose of real property, and interests in real property.

The obligation to withhold applies to the purchase of taxable Australian property that is:

- Real property, e.g. land and buildings in Australia
- An indirect Australian real property interest, e.g. shares or units in entities whose value is predominantly derived from Australian land and buildings
- Lease premiums paid for the grant of a lease over real property
- An option or right to acquire the above property or interest.

There are a number of exemptions. The more common exemptions will be:

- Transactions involving Australian land which has a market value of less than AU$ 2 million
- Where a clearance certificate or declaration is obtained by the seller.

Importantly, in the case of shares in a company or units in a unit trust, there is no AU$ 2 million threshold and sellers will need to provide a declaration to the purchaser. Without the declaration the risk of having to pay withholding tax of 10% to the ATO is with the purchaser.

Before applying any exemption we strongly recommend that a purchaser obtain professional advice to ensure that withholding is not required and they are legally protected in that respect.

**Clearance certificates**

The ATO will allow vendors to apply for a clearance certificate online and this can be done at any time the vendor is considering a sale and is valid for 12 months. The clearance certificate must be valid at the time the certificate is given to the purchaser prior to settlement. The ATO website advises that it is implementing an automated process for issuing a clearance certificate involving:

- The vendor (or their agent) completing an online application form
- The information on the application being automatically checked against information held by the ATO to assess if the vendor should be treated as an Australian tax resident for the purposes of the transaction
- The automatic issuance of a clearance certificate which removes the obligation for the purchaser to withhold the 10% from the sale proceeds.

The ATO has indicated that straightforward cases should take 1-14 days. Non-straightforward cases may require 14-28 days and high risk and unusual cases could take longer.

**New stamp duty surcharges**

Various states around Australia have recently introduced stamp duty surcharges on the purchase of property by foreign persons. Stamp duty is a state based tax and therefore each state will have slightly different regimes. In this article we focus on the two largest state economies of New South Wales (NSW) and Victoria (VIC)

*NSW*

NSW has introduced a 4% surcharge on the purchase of residential real estate by foreign persons from 21 June 2016. The surcharge is in addition to the duty payable on the purchase of residential property.

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Foreign persons will also cease being eligible for the 12 month deferral of the payment of stamp duty for purchases of off-the-plan residential property.

Buyers should note that purchasing an indirect interest in NSW residential property may also be caught. For example if a foreign person buys a company that holds residential land, then the surcharge can also apply. The definition of foreign person does not include an Australian Citizen, irrespective of where they reside.

As an example if a foreign person, purchases a residential property in NSW for AU$ 2 million, the total duty payable is AU$ 175,490 calculated as follows:

- Duty payable on AU$ 2 million is AU$ 95,490
- Surcharge of 4% on AU$ 2 million is AU$ 80,000

*VIC*

VIC has introduced a 7% surcharge for acquisitions of residential property by foreign purchasers from 1 July 2016 (A foreign purchaser of residential property can include a foreign natural person, a foreign company and/or a foreign trust).

This surcharge means foreign purchasers who sign a contract on or after 1 July 2016 to purchase Victorian residential property will pay duty of 12.5%* of the dutiable value of the property (for property exceeding AU$ 960,000)

*Note: An existing stamp duty rate of 5.5% is currently imposed on residential property purchases in VIC.

**New land tax surcharges**

The state governments of NSW and VIC also levy an annual land tax on the owners of real property situated within the respective state.

*NSW*

Unless exempted an owner of land as at 31 December each year will be required to pay land tax to the state government. In NSW, a tax free threshold of AU$ 482,000 (2016 tax year) applies and the rate of land tax is 1.6%. The rate increases to 2% for land values over AU$ 2,947,000. It should be noted that land tax is applied on the unimproved value of land, not market value of land. From the 2017 land tax year, a 0.75% land tax surcharge applies to the taxable value of residential land owned by a foreign person. There is no threshold for the surcharge. This means that an owner of land in NSW on 31 December 2016 that is a foreign person will be required to pay the surcharge in addition to the standard rate of land tax.

*VIC*

An annual land tax surcharge of 1.5% (currently at 0.5%) will apply to Victorian land from 1 January 2017 that is owned by an absentee owner (an absentee owner can be a natural person, company or trust).

From the 2017 land tax year (based on land owned on 31 December 2016), the top rate of land tax (including this additional surcharge) for absentee owners will be up to 3.75% (this is applicable to taxable land values of AU$ 3,000,000 and above).

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# Country Focus

## Denmark

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**Tax-related preferential treatment concerning the rules of individual employee shares**

On 12 May 2016, the national parliament of Denmark passed the rules concerning assessment of employee shares (Tax Assessment Act § 7 P), which will be effective from 1 July 2016.

The rules allow employees to receive shares and similar bonuses (free shares, purchase of shares at discount, option to purchase/ options, authorities to sign rights/ warrants and various forms of share programs) instead of salary, to a value of maximum 10% of the annual salary. This allocation of shares can be made on individual basis; there is no requirement that it must be part of a collective arrangement for all employees.

The rules allow conversion of wage taxation (up to 56%) to a taxation of shares at 27–42%. Further, taxation does not take place at the time of shares allocation, but when they are sold on. Any dividend received on the allocated shares is also taxable at a rate of 27–42%.

According to the Tax Assessment Act § 7 P, the allocation of shares etc. requires a specific agreement between employer and employee, and the shares must originate from the employing company or from a company that is consolidated with it. The allocation can only be given in connection with conditions of employment; board members or independent consultants are not included. If the allocation is given as an option to purchase or authorities to sign rights, these cannot be handed over to a third party – not even to a company owned by the employee or a group of employees jointly. The allocated shares must not belong to a specific class of shares.

In the previous employee share agreement rules, auditors or lawyers had to make attestation, whereas the new agreement states that the company itself is obliged to make the extended reporting to the Danish tax authorities. Thus, administration of Tax Assessment Act § 7 P is simpler than in the previous rules (Act § 7 H). The report must include details such as the share identity, number of shares, date of acquisition and acquisition cost.

**The company's tax-related consequences**

Neither the employer company nor the consolidated company will have tax-related deductions for the allocation.

**Who will use the new rules?**

The new rules are likely to become popular as part of an attractive salary package for companies seeking to retain key employees whose salaries are taxed at higher rate.

# Country Focus

## Germany

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**German treaty override regulation for income from employment found to be constitutional by German Federal Constitutional Court**

The international taxation of employees is a complex area. Tax advisors have to consider the domestic law of all countries involved as well as the relevant double tax agreements (DTA) and the interaction of all these regulations.

In the past, some international employees achieved double non-taxation by benefiting from tax exemption/reduction on their employment income based on DTA regulations, regardless of actual taxation in the other state. The issue of whether countries should be allowed to enact (unilateral) domestic laws to prevent such a double non-taxation has therefore gained importance in recent years. Such 'treaty overrides' are not just a German phenomenon, but a subject discussed in many countries nowadays.

The German Federal Constitutional Court had to deal with this question at the end of 2015. The details of the case were as follows: A German tax resident worked in Germany and Turkey. According to the relevant DTA, the income relating to Turkish working days had to be taxed in Turkey. Germany as resident state avoided double taxation by exemption with progression. Since the taxpayer provided neither an evidence of an actual taxation in Turkey nor an explicit waiver of taxation, the foreign income was taxed in Germany in accordance with para. 50d (8) EStG (German Income Tax Act), suspending DTA-based tax exemption.

Finally, the German Federal Fiscal Court had to decide and referred the decision about the domestic subject-to-tax clause in para. 50d (8) EStG to the German Federal Constitutional Court. With the resolution of 15 December 2015 (2 BvL 1/12), it was stated that the German treaty override is constitutional. According to the German Federal Constitutional Court, the regulation is neither contrary to international agreements nor does it violate the principle of equal treatment in Art. 3 (1) Grundgesetz (German constitution).

The major observations by the court in this regard are:

- International agreements (such as DTAs) generally have the status of a federal law adopted by simple majority
- The lex posterior principle also applies for DTAs. This means the regulations of a DTA can be replaced by a later-enacted federal law, even if this contradicts the regulations of the DTA
- Para. 50d (8) EStG differentiates treatment of employment income versus income from other sources: only for employment income must taxpayers present a proof of taxation (i.e. an explicit waiver of taxation) to secure tax exemption. But this difference in treatment is of low intensity of intervention, and based on reasonable causes.

Therefore, the regulation is a lawful subject-to-tax clause.

Even after this resolution, the topic is still debated. On the one hand the regulation is seen as a probate instrument against treaty abuse and double non-taxation, as well as to prevent treaty shopping. On the other hand, such treaty overrides have been criticised as devaluing bilateral agreements. Other countries can no longer rely on DTAs. Even within the senate of the German Federal Constitutional Court, the resolution has been hotly debated, with one judge publishing a strong objection.

This resolution is also relevant for questioning the unconstitutionality of other rules within German tax law. It is to be hoped that the German legislator will only use treaty overrides as ultima ratio in the future.

One should also bear in mind the ongoing discussion around base erosion and profit shifting (BEPS). It is intended to avoid any treaty shopping within the bilateral treaties, and will also establish a principal purpose test. If actually implemented worldwide, this will reduce the relevance of national treaty overrides.

The above decision deals with para. 50d (8) EStG. This rule has to be considered by employees who have working days in a foreign country. Further conditions are a DTA between Germany and the foreign country and that according to this DTA the foreign country as source country has the taxation right. In the home country, Germany, the double taxation is avoided by tax exemption with progression. In this case the foreign income is only tax exempted if the taxpayer can present a proof of actual taxation i.e. waiver of taxation.

This regulation applies to income tax declarations only, and not to wage tax withholding. The employer can receive a certificate of exemption, so that German wage tax is paid only on the salary that is basically taxable in Germany.

Furthermore, para. 50d (8) EStG only refers to those periods where taxpayers are German tax residents. The taxation of foreign income received before moving to Germany or after moving abroad does not have to be proven. Nevertheless, this income has to be considered within the progression clause and therefore increases the tax rate.

If a German resident receives foreign income that is tax exempted with progression of more than €410, the filing of an income tax return is compulsory. According to the German regulations, the foreign income will only be tax exempted if the taxpayer presents a proof of actual taxation in the foreign country or can demonstrate that there exists an explicit waiver of taxation by the foreign country. This requires coordinated handling by all the countries involved. For administrative purposes, proof does not have to be presented if the foreign income does not exceed €10,000 per country.

If the income is not taxed because the foreign country explicitly waives taxation, the German tax authorities will exempt such income only if some kind of official document (such as a letter from the fiscal authorities) can be submitted. In practice, this is often difficult to obtain.

If an income tax declaration has to be filed in the foreign country, it is advisable to agree the allocation of the overall income upfront. The filed income tax declaration must be sent to the German tax authorities, along with any income tax assessment notice issued by the foreign fiscal authority.

In some cases, taxes are only paid via the employer's wage tax withholdings, and no income tax return is filed. In such cases, an employer statement must be prepared as 'proof of taxation'. This is also necessary in case of net salary agreements or flat-rate taxation by the employer. It might even be that the German tax authorities ask for a payment document.

In many cases, the foreign documents are not yet available when filing the German income tax return. In the past, the German tax authorities usually issued an income tax assessment based on the filed income return and subject to verification by a later tax audit when the foreign documents were supplied. But in recent years, the German tax authorities have tended to overlook the exemption and tax the foreign income. The income tax assessments are amended after proof of taxation is received; but first, the taxpayers must pay taxes in both countries. This might lead to a considerable financial burden for many employees.

The resolution of the German Federal Constitutional Court has settled a long and intense discussion of the constitutionality of a treaty override in Germany. Other countries might adopt a similar decision. In practice, taxpayers and tax consultants have to deal with tough documentation requirements.

# Country Focus

## India

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**Amendment to India–Mauritius Treaty**

Mauritius has long been considered a preferred jurisdiction for structuring investments into India, thanks to its liberal business and economic opportunities and the benefits of the India–Mauritius Double Taxation Avoidance Agreement (DTAA). Mauritius tops the list of countries that account for most foreign direct investment (FDI) in India – largely because of Article 13(4) of the DTAA between the two countries, which provides that gains derived by a resident of Mauritius on alienation of property (other than immovable property, business property of a permanent establishment, and ships and aircrafts) shall be taxable only in Mauritius. As per domestic laws of Mauritius, capital gains are not taxable; therefore, if any person resident in Mauritius transfers shares of an Indian company, capital gains shall not be taxed in India (as per the DTAA) and would also not be taxable in Mauritius (in accordance with the domestic law of Mauritius). Thus, the capital gains tax benefit promoted treaty shopping and became an important consideration while structuring investments into India. The benefits given in the DTAA were always subject to litigation, however: Circular no. 780 of 13 April 2000, issued by the Central Board of Direct Taxes (CBDT), and the Supreme Court decision in Azadi Bachao Andolan, endorsed treaty shopping and permitted the assessee to use treaty benefits on production of a tax residency certificate from Mauritius.

However, the recent introduction of General Anti Avoidance Rules (GAAR) in India once again highlighted the Mauritius route for inbound investments. The governments of both countries renegotiated the terms of the DTAA, and on 10 May 2016 the CBDT issued a press release announcing that a protocol had been signed to amend the India–Mauritius DTAA. Key amendments are:

- Source-based taxation of capital gains on shares: With this protocol, India gets taxation rights on capital gains arising from alienation of shares acquired on or after 1 April 2017 in a company resident in India with effect from financial year 2017–18, while simultaneously providing protection to investments in shares acquired before 1 April 2017. Further, in respect of such capital gains arising during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfilment of the conditions in the limitation of benefits article. Taxation in India at full domestic tax rate will take place from financial year 2019–20 onwards.

- Limitation of benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1 April 2017 to 31 March 2019 shall be subject to a LOB article, whereby a resident of Mauritius (including a shell/conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bona fide business test. A resident is deemed to be a shell/conduit company if its total expenditure on operations in Mauritius is less than INR 2.7 million (1.5 million Mauritian Rupees) in the immediately preceding 12 months.

- Source-based taxation of interest income of banks: Interest arising in India to Mauritian-resident banks will be subject to withholding tax in India at the rate of 7.5% in respect of debt claims or loans made after 31 March 2017. However, interest income of Mauritian resident banks in respect of debt claims existing on or before 31 March 2017 shall be exempt from tax in India.

In order to determine whether the change in the DTAA would have an impact on FDI, it is imperative to understand the corresponding capital gains taxation benefit under DTAA applicable to other countries from where FDI flows into India (see Table 1).

Table 1 shows that of all the major FDI countries, only Singapore, Mauritius and Cyprus allow tax gains from alienation of shares to the country of residence. On 1 November 2013, India blacklisted Cyprus for not disclosing crucial information on money transferred by Indian citizens conducting business in Cyprus who are suspected of tax evasion. The DTAA with Singapore already has a LOB clause to avoid treaty shopping. All other countries tax gains on share in country of residence. Thus, the protocol brings in parity the tax impact on sale of shares under the India–Mauritius DTAA with other countries. This change would in our view not hamper the overall FDI inflows into India, but would result in reduced FDI from Mauritius. Having said that, the Indian government must be given credit for protecting the investments that have been made prior to this amendment.

Article 6 of the protocol to the India–Singapore DTAA states that the benefits in respect of capital gains arising to Singapore residents from sale of shares of an Indian company shall only remain in force so long as the analogous provisions under the India–Mauritius DTAA continue to provide the benefit.

Now that these provisions under the India–Mauritius DTAA have been amended, one concern is that while the protocol in the Mauritius DTAA contains a grandfathering provision that protects investments made before 1 April 2017, it may not be possible to extend such protection to investments made under the India–Singapore DTAA.

Another observation is that while the Cyprus route is not a preferred option, the Dutch route is still open; so we would not be surprised to see FDI from The Netherlands increasing sharply.

*Table 1*

| Country | Cumulative Inflows (Apr 2000 to Dec 2015) (Crore Rupees in Crore) | % of total inflows | Capital gains clause for sale of shares in DTAA |
|---|---|---|---|
| Cyprus | 41,952 | 2.94% | COR is given right to tax |
| France | 24,960 | 1.75% | Taxing rights given to COR subject to conditions |
| Germany | 43,549 | 3.05% | COS is given right to tax |
| Japan | 100,384 | 7.04% | COS is given right to tax |
| Mauritius | 465,163 | 32.65% | Earlier, taxability in COR and now COS |
| Singapore | 238,352 | 16.73% | Taxability in COR but with LOB clause |
| The Netherlands | 91,183 | 6.4% | Principal right is with COR, however limited taxing rights are given to COS as well. |
| UAE | 17,720 | 1.24% | COS is given right to tax |
| UK | 112,934 | 7.92% | Both COR and COS has right to tax as per their domestic laws |
| USA | 89,983 | 6.32% | Both COR and COS has right to tax as per their domestic laws |
| **TOTAL FDIs FROM ALL COUNTRIES** | **14,24,600** | | |

COR, country of residence; COS, country of source; DTAA, Double Taxation Avoidance Agreement; FDI, foreign direct investment; LOB, limitation of benefits.

# Country Focus

## Israel

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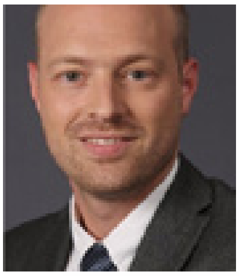

**New Israel–Germany tax treaty**

On 8 May 2016, Israel ratified the agreement between Israel and Germany for the avoidance of double taxation and prevention of evasion with respect to taxes on income and capital which was signed on 21 August 2014 (replacing the earlier treaty of 9 July 1962). The main changes in the new treaty, which comes into effect from tax year 2017, relate to a significant reduction in the withholding tax on payments transferred between countries:

- The rate of withholding tax on dividends reduces from 25% to 10% (or 5% while distribution of dividends to the holding company holding more than 10% of the shares of the company distributing the dividend)

- The rate of withholding tax on interest payments is reduced from 25% to 5%. (It should be noted that under German law, there is an exemption from withholding tax for interest payments, so this reduction is relevant only to interest payments from Israel to Germany)

- The rate of withholding tax on income from royalties will be 0% (currently 0% or 5%, depending on the nature of the royalties).

**Israel joins OECD cooperation agreement on country-by-country state reports**

On 12 May 2016, the Organisation for Economic Co-operation and Development (OECD) announced that Israel, together with other countries, has signed the multilateral competent authority agreement (MCAA) for the automatic exchange of country-by-country (CbC) state reports. This agreement supports consistent implementation and ongoing new requirements relating to forced transfer prices as defined in Action Item 13 of the ongoing BEPS project. It will also allow the tax authorities to determine how multinational corporations formulate and execute their operations, as well as protecting classified information.

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# Country Focus

## United Kingdom

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**Requirement for large businesses to publish their tax strategy**

As part of measures to drive behavioural change by large businesses, the 2016 Finance Bill sets out a mandatory requirement that they publish their tax strategy relating to UK taxation, and report to the UK tax authorities (HMRC) that they have done so.

For multinational groups, there is no requirement for a separate UK tax strategy to be published, provided that what they published covers the UK tax strategy.

The new rules will apply for financial years beginning after the date the Bill receives Royal Assent – which is usually in July, but may be delayed until October because of the EU referendum.

Whether a business is within the requirements depends on a series of tests applied at the end of the previous financial year.

- The business must be a company, a partnership, a group, or a multinational enterprise (MNE) group.
- A UK entity satisfies the conditions in its own right if its turnover was more than £200 million or its balance sheet total was more than £2 billion, the same threshold as set for the senior accounting officer (SAO) provisions
- An entity not headed by a UK company that does not meet the conditions in its own right will still be covered if the global turnover of the group of which it is part exceeds €750 million
- A MNE group is one that comprises two or more bodies that are tax resident in one jurisdiction but subject to tax on business carried on in another, where one of the two jurisdictions is the UK. This would include, for example, an overseas company operating in the UK through a branch.

The strategy must be published on the internet for the first time before the end of the first financial year commencing after Royal Assent, and thereafter annually, within 15 months of the publication of the previous version.

The contents must include:

- The approach to risk management and governance arrangements in relation to UK taxation
- Attitude towards 'tax planning' (so far as affects UK taxation)
- Level of acceptable risk in relation to UK taxation
- Approach towards dealings with HMRC.

The requirement to publish a tax strategy is a unilateral attempt by the UK government to improve transparency in relation to tax matters. The requirements are very loosely framed and open to interpretation as to what should be included. Businesses may therefore choose to use this as an opportunity to distinguish themselves from their competitors by making bold statements around their high regard for tax compliance in the current environment where the public may have a negative perception of their tax behaviour. Others may publish the bare minimum required to be compliant. What is certain is that this will add to the compliance burden, with the information provided being of questionable value to HMRC.

# Country Focus

## United Kingdom

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**Impact of Budget 2016 on real estate finance**

In the March 2016 UK fiscal budget, changes were announced to the legislation regarding the taxation of profits from trading in, and developing, UK land. The rules are designed to ensure that overseas-based developers pay the same level of tax on profits as onshore UK developers. The specific target is offshore property developers who undertake property developments in the UK through offshore structures. Historically, some offshore developers have chosen to structure their UK development activity in a way that seeks to avoid UK corporation tax and income tax on profits.

Previous planning has seen property development companies set up in jurisdictions that do not subject profits made on land developments in the UK to tax. Reliance was then placed on double tax treaties, which prevented a UK permanent establishment arising or any charge to UK income tax on profits. The net result, if the planning was successful, was a tax-free trading profit.

The most commonly used jurisdictions were Jersey, Guernsey and the Isle of Man. The new UK anti-avoidance rules and the treaties with these three jurisdictions have been simultaneously amended to prevent this planning.

Over recent months and years, increasing media and political attention has been paid to businesses and industries that, while acting within current laws, have been able to structure their operations to reduce their tax liability. We have seen the introduction in the UK of diverted profits tax and the continuing BEPS initiative by the OECD, so these new rules for offshore property developers are not totally unexpected.

Although the announcements regarding these new rules were made in March, we await more detailed legislation. This is expected some time from June onwards, when the Finance Bill reaches report stage in the UK parliamentary process.

The UK property market, particularly commercial and residential in London and the southeast of England, is globally important for property developers. It is difficult to say whether these new rules will have any significant impact. However, it should be noted that the UK rate of corporation tax on profits is forecast to fall to 17% by 2020–21; if it does, this will be one of the lowest rates in the G20. Many developers who previously sought to use offshore structures to mitigate UK tax liability may accept this low rate as an acceptable cost of doing business in the UK.

# Country Focus

## United States

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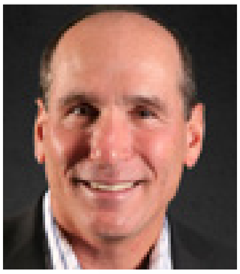

**Finding the balance**

*The FASB's new proposal on income tax disclosures*

At their annual meeting held 8 June 2016, the Financial Accounting Standards Board (FASB) made a decision to start preparation and drafting of its proposal on income tax disclosures. On the planning docket since January 2015, this long-awaited proposal is expected to see some controversy due to differing views on the amount of information necessary to divulge. While a proposal is yet to be drafted, the FASB's proposed Accounting Standard Update should be expected before the end of September.

**The opposing views:**

While the FASB makes good attempts to streamline the disclosure requirements under US Generally Accepted Accounting Principles (GAAP), this particular proposal will require businesses to release additional information about their foreign and domestic tax payments. While investors and analysts are in favor of greater transparency on income taxes to strengthen forecasting, companies are arguing that revealing too much information will give their competitors too much detail on their financials — particularly publicly traded companies. Considering the views of both sides, the FASB will be attempting a compromise aimed at identifying and strengthening the most important information provided on disclosures.

**Decisions of the meeting:**

On 8 June, the FASB reviewed comments from both companies and audit firms, ultimately leading to the overturn of a previously made decision that required an entity to disaggregate the cumulative amount of indefinitely reinvested foreign earnings for any country that represents at least 10% of the total cumulative amount. The new decision will require companies to disclose the aggregate of cash, cash equivalents and marketable securities held by foreign subsidiaries.

Also discussed were the differing disclosure requirements for public entities and nonpublic entities. The current use of "public entity" will now be changed to "public business entity" so that some disclosures will be required of public business entities while other disclosures will be required of non public business entities.

Another decision made at the 8 June meeting stemmed from a discussion on disclosures about income tax carryforwards, resulting in the decision to require public business entities to disclose:

1. The amounts of federal, state and foreign carryforwards (not tax effected) by time period of expiration for each of the first five years after the reporting date and a total of the amounts for the remaining years, and
2. The deferred tax asset for carryforwards (tax effected) before valuation allowance disaggregated by federal, state and foreign amounts. Each category of carryforward asset would also be further disaggregated by time period of expiration for each of the first five years after the reporting date and a total of the amounts for the remaining years.

# Country Focus

## United States

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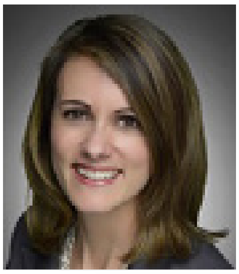

**R&D tax credit receives facelift and is made permanent**

**What is the R&D tax credit?**

The research and development (R&D) tax credit helps companies remain competitive in the marketplace by allowing a dollar-for-dollar reduction of federal and state income taxes owed for qualified expenditures incident to the development or improvement of a product, process, software, formula or invention. The federal R&D tax credit can be used to offset federal income taxes to the extent that qualified research expenditure exceeds a base period amount. Business entities that do not pay federal corporate income tax, such as S-corporations and partnerships, are allowed to 'pass-through' their federal R&D tax credits to shareholders or partners. Each state uses a slightly different approach to calculate the R&D credit.

On Friday 18 December 2015, the federal R&D tax credit was finally revamped and made permanent after being extended numerous times since its inception in 1981. Many state R&D tax credits rely on the federal R&D tax credit.

The main features of R&D credit are:

- Credit made permanent: The previous R&D tax credit expired on 31 December 2014. This new law retroactively applies from 1 January 2015, with no expiration. This means that a company will finally be able to create accurate forecasts and budgets around the R&D tax credit.

- Eliminates the AMT requirement: The new R&D tax credit law includes an alternative minimum tax (AMT) patch for tax years beginning after 31 December 2015, which will allow companies and individuals paying AMT with less than US$ 50 million in average sales over the prior 3 years to claim the credit. Currently, many companies and individuals are limited by AMT and cannot fully utilise their R&D tax credit. The AMT patch allows companies to use the R&D credit against AMT where previously the use of the R&D credit was limited by AMT.

- Start-ups can offset federal payroll tax: In tax years beginning after 31 December 2015, companies with less than US$ 5 million gross receipts and which are less than 5 years old will be able to use the credit to offset up to US$ 250,000 in payroll taxes annually. Essentially, this will allow start-up companies to get cash back for their R&D efforts on a federal level, and is designed to encourage innovation across the country. This new benefit of the federal R&D tax credit is similar to the Georgia payroll tax withholding benefit that has been in place since 2009.

# Country Focus

## United States

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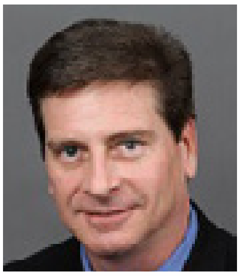

**Tax Inversion**

**Corporate desertion or savvy business move?**

At this point we've all heard about tax inversions: The process by which a company that's taxed heavily in its home country buys a smaller company headquartered in a country where the business taxes are considerable lower, then maintains that the newly amalgamated business is now officially headquartered in the low-tax country. Now domiciled in, say, Dublin, Ireland, with a corporate income tax rate of 12.5% or less, rather than Chicago, Illinois, with an effective US corporate income tax rate around 40%, the new entity enjoys greatly reduced income tax levels.

For example, US medical device manufacturer Medtronic, purchased Irish company Covidien, and promptly declared Ireland to be Medtronic's domicile. Then there was US-based drug maker AbbVie, which acquired Ireland-based Shire and moved its tax base to the island of Jersey. And, in another high-profile deal, American icon Burger King bought Canadian coffee and doughnuts chain Tim Horton so that Burger King could take advantage of Canada's lower tax rates. Even the failed attempts at tax inversion – Pfizer's bid to buy UK rival AstraZeneca springs to mind – are nothing if not audacious in the sheer scale of their ambitions.

And this is more common than you might think. In 2014, for instance, at least 15 of the top companies in the US held cash reserves of over US$ 800 billion outside of the country. One of America's leading computer companies had well over US$ 50 billion sitting in overseas accounts, while its main US rival was presiding over a US$ 75 billion 'nest egg'. Meanwhile, another major American conglomerate had some US$ 100 billion cash residing in various overseas tax havens. And so the list goes on – and grows larger by the year.

However, before we look at the pros and cons of this practice –and there are compelling and persuasive arguments both for and against tax inversions – we need to be clear about what inversions really are and how they work.

While no one has yet to offer a formal definition of a tax inversion we can still say that tax inversions fall into one of two categories: Pure tax inversions, which is what most people think of when they hear the term; and modest tax inversions, which, as the term suggests, is less far reaching in nature. In the former, 'pure' transaction, one company purchases another just to achieve a tax inversion. That is, Company #1 acquires Company #2 simply to change its tax status. But Company #1 has no real interest in Company #2's products, its supply chain resources or its brand. Tax relief is all that Company #1 desires.

By contrast, in a modest tax inversion — "Tax Inversion Light" as one observer termed it — Company X buys Company Y for legitimate business reasons: It might be that together both companies are able to reduce costs and grow their market share. Or, one might want to eliminate the other as a competitor. Or, perhaps, together they want to expand and solidify their respective supply chains. Whatever the reason, the tax advantages that Company X might realize through its purchase of Company Y is merely an added bonus; it's not the main motivating factor behind the acquisition.

And, despite what some pundits and politicians might like to claim, there is actually no formal or legal difference between a normal cross-border merger and a tax inversion. In the case of most pure tax inversions virtually nothing changes: Company X (in Chicago, say) may be re-headquartered in Company Y's capitol city (Dublin), but the CEO, the CFO, and the rest of the main management teams remain in Chicago.

**Why so many tax inversions and why now?**

While it's true that we've been seeing larger numbers of tax inversions of late, they have actually been around for quite a while. According to Bloomberg QuickTake, "More than 50 US companies have reincorporated in low-tax countries since 1982, including more than 20 since 2012. And much of the data points to the fact that these may be 'pure' inversions, especially since most of the foreign companies being acquired are at least 75 percent smaller than the purchasing entity[1]."

The more immediate trigger for this new wave of inversions is probably the fact that the US and Europe are now enjoying low interest rates, and that almost always leads to an increase in mergers and acquisitions. Some of this

M&A activity may be occurring for reasons other than tax inversion, but easier access to credit only makes mergers more attractive and that may be incentive enough for more companies to seek out inversion possibilities.

But there are larger and more deeply embedded forces at work here. Prime among them is the US corporate income tax rate, which stands at a whopping 35% for Federal taxes plus another 5–10% for State income taxes or roughly 40-42% combined, making it the highest in the world. What's more, companies in the US also have to contend with the fact that unlike their counterparts in, say, Canada and the UK, they are required to pay that 40% rate on everything they earn, everywhere in the world. Of course, defenders of the tax status quo will point to the fact that US companies can defer the bill on monies earned abroad until they repatriate said funds. But that is poor consolation for most companies as they still will need to accrue deferred income taxes on the deferred earnings, unless those earnings are going to be permanently reinvested outside the US.

It's also worth pointing out that the tax authorities in Canada and the UK only impose taxes on domestic income – not profits made abroad by the foreign subsidiaries of companies domiciled in other countries. One irony here is that a US firm making say, guitars, or duck lures, can end up paying more taxes than an identical US company owned by a foreign enterprise.

Another force at work here is more easily identifiable: Washington, the legislative and regulatory communities in equal measure. Given the political impasse that now seems to be the norm in Washington, the reluctance of either party, in either house, to engage in meaningful dialogue or make compromises may actually be encouraging companies to seek out inversion opportunities.

That may not seem to make sense, but in fact it does: Despite the fact that legislators have been talking for some time now about enacting a complete ban on tax inversions it never comes to a floor vote. Neither party seems willing to engage in the kind of Congressional 'fire fight' that would inevitably ensue. Even ominous rumblings from the White House about possible executive orders limiting inversion deals consistently come to nothing. But it sure does make for good political fodder and press!

As a result it became abundantly clear to many in the US corporate community that in such a political climate there was little or no risk of regulatory backlash if they pursued their tax inversion agenda. Further, they have an obligation to their shareholders to maximize shareholder value — and decreasing corporate taxes can significantly enhance value. Hence the upsurge in high-profile, multi-billion dollar inversion deals.

**Is tax reform the answer?**

As we pointed out earlier, the US has the highest corporate income tax rate in the world, and that, many agree, is why so many major companies are moving their executive operations abroad. Which begs the obvious question: Is the US tax code so onerous, so burdensome, that traditionally American companies are deserting the country simply because no one — Congress, the White House, the major Federal regulatory agencies, et al — is prepared to make the necessary reforms and reduce the prevailing tax rates to reasonable levels?

Critics say that high tax rates notwithstanding, the current tax structure is so arcane, so convoluted and so riddled with loopholes that most U.S corporations never come close to paying anything like the full rate. But that certainly should not be a reason for inaction. Another irony here is that practically everyone — politicians, regulators, economists, and, of course, business people — agree that the tax code as it stands is not just flawed, but broken, and should be fixed.

But that's where agreement ends. None of the major players in this drama seem to agree upon what, exactly, should change. It's one thing to talk about 'loopholes', but it's another matter entirely to agree upon which loopholes should be closed. After all, one person's loophole may well be another's legitimate tax break!

But are US corporations really deserting the country en masse? In point of fact, no. Companies that elect to exercise their tax inversion rights do not, as we pointed out earlier, actually move all their operations, or their management teams, offshore.

So are these companies what President Obama called "corporate deserters"? "I don't care if it's legal - it's wrong" said Obama in a 2014 speech at a Los Angeles college, "You don't get to choose the tax rate you pay. These companies shouldn't either. . . . You shouldn't get to call yourself an American company only when you want a handout from American taxpayers[2]."

Nobel Prize-winning economist Paul Krugman agrees. As he wrote in one of his New York Times op-ed pieces[3]:

"It's already illegal for a company to claim that its legal domicile is someplace where it has little real business . . . . and tightening the criteria for declaring a company non-American could block many of the inversions now taking place. So is there any reason not to stop this gratuitous loss of revenue? No."

However, advocates for tax reform point to the fact that companies undergoing tax inversions don't do so lightly. In addition to the negative publicity such a move can elicit (witness the uproar when Burger King announced its purchase of the Tim Horton chain, or the reaction to the news that Perrigo had acquired Elan Ireland) the cost of the restructuring and the subsequent management complications can be daunting – and not a little inconvenient, even if management remains in the US.

But as John S. Barry, of the Tax Foundation pointed out as far back as 2002[5], rather than castigating companies as unpatriotic tax dodgers:

"Policy makers should be looking at fundamental reform of the existing US corporate income tax code, which has become overly burdensome and mind-numbingly complex, thus penalizing American firms that compete in the global market place."

Even the courts ruled — over 80 years ago — that "Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands[4]."

For those who claim that cutting the corporate tax rate would shift the tax burden to the ordinary tax payer, and that corporations would not reinvest the savings in the US, one merely has to ask: Why wouldn't they? Why make life complicated and management processes even more convoluted by becoming a 'foreign' company? It's more likely that these corporations would pass some of the savings on to the consumer in a competitive market place. This makes small businesses that don't pay a corporate level tax nervous and keeps their lobbyists busy.

Ponder the burden to the consumer! A publicly traded corporation has a targeted return to its shareholders. Let's say that return is US$ 100 net of all expenses and taxes. If a country imposes an income tax, then the company must increase its prices to meet its target return passing the cost on to the consumer. If the tax rate is 20% then profits must be increased by 25% to cover the difference and in addition sales tax or VAT tax is also inflated by 25% or i.e. the consumer is paying sales tax or VAT on income taxes. If the tax rate is 40% then profits must be increased by 66.67% to meet the target return. Welcome to the USA!

Writing in Politico Magazine[6], the dean of Columbia Business School and former chairman of the Council of Economic Advisers, R. Glenn Hubbard observed:

"Reducing the US corporate tax rate – currently the highest in the industrial world – would increase investment, employment and wages, especially if financed in large part by broadening the corporate tax base. Economists once thought the tax burden was borne entirely by owners of capital, but many now see it as generating a significant burden on workers through lower wages.
(By reducing investment, the tax reduces productivity and wages)."

Another and arguably better approach might be for the government to take an unbiased, non-partisan look at what, exactly, our taxes are used for. For example, US$ 223 million for the infamous Alaskan 'bridge to nowhere'. But Congressional pork barrel projects like the Gravina Island Bridge pale into insignificance when compared with the projected trillion-dollar price tag for Lockheed Martin's much maligned – and still not operational – F-35 Joint Strike Fighter.

The list is virtually endless, but it does point to the fact that there is a serious misallocation of taxpayer funds that needs to be addressed – along with the arcane and outdated corporate tax code.

**What you need to know**

This is obviously a very complicated –and controversial – subject, so providing definitive answers to all the questions it raises is difficult.

Most companies, of course, have neither the resources nor the operational scale to even consider tax inversion possibilities. But there is, in fact, no official financial threshold a company must reach before it can consider the tax inversion route. In the end it comes down to costs and the real benefits a company might realize.

It almost goes without saying that before you and your company venture into tax inversion country that you should talk with qualified tax advisors and attorneys skilled in the field. You should exercise extreme caution as you carefully consider all the tax implications, including evaluating different ownership structures and exit strategies. For the unprepared making these sorts of crucial decisions, failure to consider all the consequences could be a costly mistake.

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# International Tax Headlines

## Six more countries agree to exchange country-by-country (CbC) reports

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On 12 May 2016, six more countries signed the OECD's multilateral competent authority agreement (MCAA) for the automatic exchange of CbC reports, bringing the total number of signatories to 39. The new signatories are Canada, China, Iceland, India, Israel and New Zealand. The MCAA allows all signatories to bilaterally and automatically exchange CbC reports with each other, as contemplated by Action 13 of the BEPS Action Plan. It will help to ensure that tax administrations obtain a complete understanding of how multinational corporations structure their operations, while also safeguarding the confidentiality of such information.

**Five states agree to adopt new tax transparency standard**

Bahrain, Lebanon, Nauru, Panama and Vanuatu have agreed to the commitment of sharing financial account information automatically with other countries. With these new commitments, 101 jurisdictions around the world have committed to implement information sharing in accordance with the Common Reporting Standard developed by the OECD and G20 countries and endorsed by the Global Forum in 2014.

**Australia launches new tax avoidance taskforce**

The Australian Taxation Office (ATO) will receive AU$ 679 million (US$ 508.3 million) in government funding to launch a new Tax Avoidance Taskforce to focus on multinational companies, private companies, and high-net-worth individuals. The Taskforce will be led by the Commissioner of Taxation and external experts will be appointed to review any proposed settlement arrangements, to ensure that they are fair and appropriate. The Taskforce will also work closely with government partner agencies, including the Australian Crime Commission, the Australian Federal Police, and the Australian Transaction Reports and Analysis Centre (AUSTRAC). Legislation will be introduced to enable the ATO to improve information sharing with the Australian Securities and Investments Commission (ASIC).

**Canada to adopt latest tax transparency standard**

The Canadian Government has released draft legislative proposals for consultation in order to implement the Common Reporting Standard (CRS) from 1 July 2017. Under CRS, Canadian financial institutions would be required to have procedures in place to identify accounts held by non-residents and they would be required to report certain specified information to the Canada Revenue Agency (CRA).

**UK announces new beneficial ownership register**

While hosting an international anti-corruption summit in London on 12 May, Prime Minister David Cameron announced that foreign companies that own or wish to purchase property in the UK will be required to publicly disclose who owns them. The companies that own UK property will have to join a new public register of beneficial ownership. Any foreign company wishing to bid for central government contracts will also need to sign up to the register. The register will mean that corrupt individuals and countries will no longer be able to move, launder and hide illicit funds through the property market.

**Germany announces 10-point plan to counter tax evasion**

On 12 April, the German government outlined the key aspects of a '10-point plan' to combat international tax evasion and aggressive tax avoidance in the wake of the Panama Papers affair. Under the plan, jurisdictions refusing to sign up to the new international standard for the automatic exchange of financial account data between national tax authorities would be blacklisted. The German plan also suggests that tax offences should not be subject to legal time limitations, making it easier for law enforcement authorities to prosecute tax evaders.

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# International Tax Cases

## Delhi High Court rules that unilateral amendment in Act does not impact taxability under DTAAs

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Recently, the Hon'ble Delhi High Court in the case of DIT v. New Skies Satellite BV & Others [ITA 473/2012, ITA 474/2012, ITA 500/2012 and ITA 244/2014] has held that an amendment in the domestic law, whether retrospective or prospective, cannot be read into the tax treaties and therefore the domestic law cannot override the treaty provisions. A tax treaty is a carefully negotiated agreement between the two contracting states and therefore, no one party to the treaty can ascribe to itself the power to unilaterally change the terms of the treaty and annul this economic incentive.

**Facts of the case**

- The assessees (M/s Shin Satellite Public Co. Ltd and M/s New Skies Satellite BV) are companies incorporated in the Netherlands and Thailand, respectively
- The assessee companies were engaged in providing digital broadcasting services, by way of leasing transponders of their satellites as well as consultancy services to residents of India and non-residents
- During the years under consideration, the assessee companies filed their income tax return showing nil taxable income in India. The case of each company was selected for scrutiny
- During the course of assessment proceedings, the assessing officer (AO) held that the income earned by the assessee companies was in the nature of royalty, as covered under Section 9(1)(vi) of the Finance Act, 2012 ('the Act') and hence taxable in India
- The AO filed the draft assessment order before the Dispute Resolution Panel (DRP), which directed the AO to complete the assessment as per the draft assessment order.

**Appeal to Income Tax Appellate Tribunal (ITAT)**

- The assessee companies filed an appeal to the Hon'ble Tribunal
- The Tribunal placed reliance on the judgement of the Hon'ble Delhi High Court in the case of Asia Satellite Telecommunications Co. Ltd, wherein it was held that income from data transmission services through the provision of space segment capacity on satellites does not constitute royalty within the meaning of Section 9(1)(vi) of the Act, since the control of the satellite always remains with the satellite operator and the customers are only given access to the transponder capacity. Based on this judgement, the Tribunal held that the income earned by the assessee company did not fall under the term 'royalty' under Section 9(1)(vi) of the Act.

**Appeal to High Court**

- Against the order of the Tribunal, the tax authorities filed an appeal before the High Court. The tax department raised two questions before the Hon'ble High Court:
  - Was the income earned by the assessee from providing data transmission services taxable as royalty under the Act?
  - If so, then is the assessee eligible to claim the benefit of DTAA?
- During the pendency of the appeal, explanations 4, 5 and 6 were inserted with retrospective effect into the definition of 'royalty' under Section 9(1)(vi) of the Finance Act, 2012. Explanations 5 and 6 are relevant to this case.

Explanation 5. – For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—the possession or control of such right, property or information is with the payer; such right, property or information is used directly by the payer; the location of such right, property or information is in India.

This explanation nullified the judgement of the Hon'ble Delhi High Court in the case of Asia Satellite Telecommunications Co. Ltd, since this explanation states that the royalty income of non-residents will be taxable India even if the possession of the property (in this case, is the satellite) is not with the payer of royalty.

Explanation 6. – For the removal of doubts, it is hereby clarified that the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

This amendment resolved all controversy regarding the taxability of income earned by non-residents via satellite transmission. The Hon'ble Delhi High Court held that the digital broadcasting service provided by the assessee was specifically covered in Explanation 6 of Section 9(1)(vi) of the Act and would therefore be in the nature of royalty. Hence, the said amount would be taxable as per the Income Tax Act.

- With regard to the second question raised by the department, the Hon'ble High Court held that :
  - Amendments to the domestic law, in an attempt to contour, restrict or expand the definition under its statute, cannot extend to the definition under the DTAA. In other words, the domestic law remains static for the purposes of the DTAA
  - No one party to the treaty can ascribe to itself the power to unilaterally change the terms of the treaty and annul this economic agreement. It may decide to not follow the treaty; it may choose to renege from its obligations under it, or exit it; but it cannot amend the treaty, especially by employing domestic law
  - It is fallacious to assume that any change made to domestic law to rectify a situation of mistaken interpretation can spontaneously further their case in an international treaty. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change in treaty.
- In view of the above, it is held that the amendment in the definition of royalty in the Finance Act, 2012 will not apply mutandis mutatis to the definition of royalty as per the relevant Article of the DTAA. Therefore, it would follow that the first determinative interpretation given to the word 'royalty', when the definitions were in fact pari materia.
- Therefore, the services provided by the assessee will be taxable as royalty under the Income Tax Act but the assessee company can benefit from the relevant Article of the DTAA and accordingly claim that the said income is not taxable.

## *Editorial Comments:*

*This decision of the Delhi High Court should help to settle the controversy on whether transponder hire charges and leased line charges qualify as royalty under the tax treaties, following the retrospective amendments in the Act. It also lays to rest the debate around treaty override by changes in the domestic law.*

# International Tax Cases

## IPGS Exploration (Norway) AS v. Additional Director of Income Tax [2016] 68 taxmann.com 143 (Delhi)

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### Facts of the case

- The assessee (M/s PGS Exploration [Norway] AS) is a company incorporated under the laws of Norway and is principally engaged in the business of providing geophysical services worldwide.
- M/s BG Exploration and Production India Ltd (BG) and M/s Reliance Industries Ltd (RIL) (being oil exploration companies) engaged the services of the assessee company for acquiring and processing three-dimensional marine seismic data with respect to an offshore block awarded to the said companies.
- During the relevant assessment year, the assessee company opted to be taxed on a presumptive basis under Section 44BB 9(1)(vi) of the Income-tax Act, 1961 ('the Act'), since it was providing services for production or exploration and accordingly offered to tax an amount equal to 10% of the gross receipts. Accordingly, the assessee company filed its return of income for the relevant assessment year on a presumptive basis under Section 44BB of the Act.

### Contention of the assessing officer

- The AO contended that the services provided by the assessee were technical in nature, and accordingly the consideration received by the assessee was in the nature of 'fees for technical services' covered under Explanation 2 to Section 9(1)(vii) of the Act. Therefore, the said amount is taxable under Section 115A of the Act and not under Section 44BB of the Act, since Section 44BB specifically states that the provisions of that Section will not be applicable in a case where provisions of Section 115A of the Act are applicable.
- The AO filed the draft assessment order before the DRP, which directed the AO to complete the assessment as per the draft assessment order.

### Contention of Hon'ble ITAT

- The assessee filed an appeal before the ITAT stating that the said services were not in the nature of 'technical services' as defined in Explanation 2 of Section 9(1)(vii) of the Act, since they fall in the exclusion clause of the definition of 'fees for technical services'. The exclusion clause includes construction, assembly, mining or like projects.
- The Hon'ble ITAT held that the services were in the nature of 'technical services' as defined in Explanation 2 of Section 9(1)(vii) of the Act, and do not fall into the exclusion clause of the definition of 'fees for technical services'.

### Issues for consideration before High Court

- Were the services provided by the assessee in the nature of 'technical services' as defined in Explanation 2 to Section 9(1)(vii) of the Act?
- Had ITAT had erred in stating that the income of the appellant can be assessed under Section 44BB of the Act only when the assessee has a permanent establishment (PE) in India?

### Decision of Hon'ble High Court

- With regard to the first issue, the Hon'ble Delhi High Court relied on the Hon'ble Supreme Court judgement in the case of Oil and Natural Gas Corporation Ltd. v. CIT (Civil Appeal No. 731 of 2007, dated 1 July 2008) and accordingly held that the service provided by the assessee was not in the nature of technical services as defined in Explanation 2 of Section 9(1)(vii) of the Act.
- The issue involved in the said judgement was similar: the contention of the assessee was that its services falls within the expression 'mining projects or like projects' and thus, the consideration received by them for such services stood excluded from the scope of 'fees for technical services'.
- In the said judgement, the assessee classified its business activities into eight parts, of which one part related to 'carrying our seismic survey and drilling for oil and natural gas'.

The Supreme Court in the said judgement relied on Circular No. 1862 of 22 October 1990, and after examining various contracts involved in the appeals held that the contracts were inextricably connected with prospecting, extraction or production of mineral oil and will accordingly fall into the expression 'mining projects or like projects' and thus exclude from the definition of fees from technical services. The Supreme Court further held that although there may be certain ancillary works contemplated under the contracts in question, since the dominant purpose of each of such contract is for prospecting, extraction or production of mineral oils, the income from such services should be computed under Section 44BB of the Act.

- The Court held that since the first issue has been decided in the favour of the assessee, the second question relating to PE does not require adjudication.

## *Editorial Comments:*

*This decision of the Hon'ble Delhi High Court is in line with the decision of the Hon'ble Supreme Court that payment received for carrying out a two-/three-dimensional seismic survey in connection with exploration of oil would not be in the nature of 'fees for technical services' in terms of Explanation 2 to Section 9(1)(vii).*

# The Next Step

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