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Global Tax Insights

Q1 2021

Building Better
Business Globally

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Editorial

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Losing your head in a crisis is a good way to become a crisis!

For the past two decades in India, the taxation of transfer of all or any right in software in cross-border transactions has been a matter for litigation. The revenue authorities have insisted that the consideration for sale/license of software is actually a royalty payment, and is therefore subject to withholding tax obligations in India. Any Indian entity paying to any non-resident for purchase/use of software was therefore required to withhold tax. The foreign entity usually did not pay the withholding tax, so the Indian purchaser would have to bear that cost. The Indian Income-tax Act was also amended in 2012 with retrospective effect from 1976 to provide that any payment towards the transfer of all or any rights (including the granting of a licence) would be treated as royalty.

Since the 2012 amendment, the Indian domestic tax law provides a very broad definition of royalties (covering payments for the transfer of all or any rights for the use of, or right to use, computer software), whereas various tax treaties limit the definition of royalties to payments for the use of, or the right to use, any copyright of a literary, artistic or scientific work.

In a landmark judgement that pooled over 100 appeals (*Engineering Analysis Centre of Excellence Pvt. Ltd* being the lead case), the Supreme Court of India held that:

- An end user who obtains a non-exclusive, non-transferable and restricted right to use the software makes a payment for the copyrighted software, not for use of the owner's 'copyright'. Similarly, where the end user does not obtain any rights in the copyright under the licence agreement, making a copy of the software for internal use (as permitted by the licence) does not involve the grant of a right in the copyright.
- As the licences granted to the distributors and the end users did not involve the grant of any rights in the copyright, the payments made for such licenses cannot be considered as royalties, under both the domestic tax law (prior to 2012) and the tax treaties.
- India's position on the OECD MC Commentary would not be considered as a decisive factor for the interpretation of tax treaties, particularly when such positions are not stated in explicit language nor reflected in subsequent tax treaties concluded by India. The OECD Commentary supports the position that a payment to make a copy or adaptation of a computer program to enable use of the software for which it was supplied does not constitute a royalty. This also endorses that the payment made by distributors and end users should not constitute a royalty.
- The deductor is only required to withhold tax if the amount is chargeable to tax under both the domestic tax law and the tax treaty. The Supreme Court confirmed that the determination of a non-resident's income chargeable to tax in India is subject to the provisions of the relevant tax treaty. If an item of income is not chargeable to tax under the treaty, then such income could not be chargeable to tax under the domestic tax law.

This decision of the Supreme Court is expected to settle the controversy; but in the last two decades business models have changed, and software is no longer sold merely as a product. Software is bundled on a digital platform, which altogether changes the character of the payment. As mentioned in my previous editorial, the next round of litigation will be around taxation of the digital economy.

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After the gloom of 2020, the vaccine has brought some cheer in 2021. This pandemic has taught each one of us some important life lessons. As the vaccination drive gathers momentum across the globe, let us hope that by September 2021 we can begin our return to normalcy. I end this with a beautiful quote from the science fiction author, C.J. Redwine: 'Losing your head in a crisis is a good way to become a crisis!'

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How the new Coronavirus Relief Bill affects business taxes

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The federal Consolidated Appropriations Act, 2021 (CAA), signed into law in late December of 2020, modifies and clarifies the tax provisions of last year's Coronavirus Aid, Relief and Economic Security (CARES) Act and provides other forms of tax relief for businesses.

This article summarises key provisions of the Act and the likely implications for employers.

Deductibility of expenses paid with forgiven PPP loans

Perhaps the most significant change for small businesses comes in Title III of the Act, which resolves questions (and overrides previous IRS guidance) about the deductibility of business expenses funded through forgiven Paycheck Protection Program (PPP) loans.

Under the Act, deductions are affirmatively allowed for expenses that would ordinarily be deductible and are paid for with the proceeds from a PPP loan that is (or was later) forgiven. This business-friendly provision supersedes IRS guidance issued in April of 2020 under the CARES Act that expenses paid with PPP proceeds would not be deductible (based on the idea that allowing the deductibility of PPP-funded expenses would provide a double benefit for the recipients of forgiven loans because those loan funds are not considered gross income).

Instead, Title III of the CAA specifies that Congress did not intend to disallow the deduction of ordinarily deductible expenses, and those deductions remain available to businesses.

Allowing these deductions helps businesses in several ways:

- Offering clarity for financial statement income tax provisions
- Simplifying tax planning for companies and individual owners of pass-through entities
- Resolving questions about coordinating deductions with provisions such as research and development tax credits, payroll-based credits, and other rules.

The Act also specifies that the proceeds of forgiven loans under the first PPP loan programme and the Second Draw programme (created under the CAA) do not count as gross income (as forgiven debts would ordinarily). A forgiven PPP loan is now completely tax exempt, not taxable income.

Similarly, the CAA provides that the proceeds of an Economic Injury Disaster Loan (EIDL) are not considered gross income, and a company that receives an EIDL is entitled to deduct business expenses paid with the proceeds of that loan.

Expanded employee retention credit

The Act significantly expands the employee retention credit, which was designed to help employers that retained staff members during 2020 despite being affected by COVID-19.

The Act amends the employee retention credit to be equal of 70% of qualified wages, up to $10,000 in qualified wages that are paid to each employee per quarter for the first two quarters of 2021. This creates a maximum potential credit of $7,000 per employee per quarter, or $14,000 for 2021, compared with a $5,000 maximum annual credit per employee under the 2020 CARES Act.

An employer qualifies for the retention credit if the employer's operations were fully or partially suspended under a

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COVID-19-related government order, or if the employer's gross receipts declined by 20% in the year-ago quarter.

The CAA also expands eligibility from an average of fewer than 100 employees to fewer than 500. This provision is retroactive to an average of 500 employees in 2019, which means a significant group of employers with 100 to 499 employees who were ineligible to apply the credit under the CARES Act provisions are eligible (for the first two quarters of 2020) under the CAA.

In addition, the CAA clarifies that 'qualified wages' go beyond cash wages to include amounts paid to maintain a group health plan.

Retention credit and PPP coordination

The CAA also expands the pool of employers that are eligible for the retention credit by stating that employers who received (or receive) PPP loans can also apply the employee retention credit for 2020 and 2021, provided that the PPP proceeds and ERC don't cover the same payroll expenses.

Any wages that qualify under both programmes can be applied to either, but not both. This gives employers the opportunity to maximise their PPP loan forgiveness and retention credit by comparing the effects of both programmes and choosing the best scenario for them.

Flexible spending account flexibility

The CAA allows individual taxpayers to roll over unused amounts in their health or dependent care flexible spending accounts from 2020 to 2021, and from 2021 to 2022. This provision also means employers can allow employees to make a 2021 midyear change to their contribution amounts.

Expanded meal deductions

The Act temporarily allows a 100% business-expense deduction (compared with the previous 50%) for food or beverages provided by a restaurant that are paid or incurred after 31 December 2020 and before 1 January 2023.

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Mandatory disclosure rules in Mexico

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Mexico has been an active player in the adoption of OECD taxation principles in the Latin American landscape. Being an OECD member country, Mexico has complied with its tax commitments resulting from the approval of OECD's BEPS plan, including participations in special taskforce efforts and working groups. This participation in BEPS-related work facilitated early access to important taxation principles that were incorporated in a series of relevant tax reforms approved by the Mexican Congress affecting fiscal years 2014, 2016, 2020 and 2021, which inserted key BEPS principles into the Mexican tax legislation.

Specifically, in the tax reform affecting fiscal year 2020, the essential aspects of BEPS Action 12 (mandatory disclosure rules) were incorporated into the Mexican Fiscal Federal Code in a new chapter, adapted to the specific circumstances of the Mexican taxation environment. The new rules require all 'tax advisors' to notify the Mexican Tax Authorities (SAT) on the implementation by taxpayers of personalised or generic 'taxation schemes' affecting fiscal year 2020 (including taxation schemes implemented in previous fiscal years but generating tax effects in year 2020 and onwards).

For such purposes, the new definition of 'tax advisor' includes all individuals or corporations that, in their ordinary course of their business, provide taxation advice to taxpayers, in any of the design, commercial promotion, management, or implementation stages of a taxation scheme. Tax advisors must report to the SAT the implementation of each generic or personalised taxation scheme (using the designated coding system) in the 30-day period after the initial implementation. Annual informative tax returns should also be submitted in connection to the professional activity of the tax advisor during the fiscal year, with the first submission deadline in late February 2021.

There are 14 types of personalised or generic taxation schemes to be reported to SAT:

- Schemes limiting or impeding tax (or financial) information exchange (e.g., CRS, FATCA)
- Avoidance in the application of Mexican controlled foreign corporation rules
- Carry-forward losses amortised by taxpayers other than those entities who originally generated such losses
- Employment schemes with crossed payments between service providers and the beneficiaries of such services, returning 'benefits' to these latter entities or to any of their related parties
- Incorrect use of income tax conventions (treaty shopping)
- Transfer pricing-related issues (use of hard-to-value intangibles; corporate restructurings generating excessive reductions in operating profitability; free-of-charge operations; use of foreign safe harbours in Mexico)
- Artificial avoidance of permanent establishment consequences
- Step-up of fully or partially depreciated assets, transferred in related-party transactions
- Use of hybrid tax operations
- Schemes promoting the lack of identification of beneficial owners of assets or income
- Tax planning and transformation of carry-forward loses into tax deductions for the obliged taxpayer or its related parties
- Avoidance in the application of the additional 10% tax on dividends

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Should the obliged tax advisor fail to notify SAT on the implementation of any tax scheme, then the taxpayer who implemented the respective scheme legally assumes the obligation to file the respective notification

- Taxation effects associated to usufruct and subleasing activities
- Operations reporting differences for accounting and tax purposes that exceed 20% of value.

Tax advisors are obliged to provide all clients with evidence of their timely and complete notification to the tax authorities on the taxation schemes implemented or advised by them. Should the obliged tax advisor fail to notify SAT on the implementation of any tax scheme, then the taxpayer who implemented the respective scheme legally assumes the obligation to file the respective notification. At all times, the taxpayer must indicate (in the respective tax return) the code assigned by SAT to the taxation scheme used in the fiscal year, which has generated any form of tax benefit to the taxpayer (e.g., reductions in taxable income, specific deductions, tax exemptions, tax credits, change in taxation regimes, adjustments to the taxable base or lack thereof).

These tax reforms included the introduction of severe penalties, mostly directed to the tax advisor, but also considering the taxpayers as the main beneficiaries of the implementation of such schemes. Assuming an exchange rate of 20 Mexican pesos per US dollar ($), the following penalties could be applicable in non-tax-compliance situations:

For the tax advisor:

- Lack of submission of the annual informative tax return: cancellation of all assigned advisory contracts formalised with any government area in Mexico, at the federal, state or county level, including political parties, trusts or any person or entity operating with public funding.

For the client (taxpayer):

- Lack of disclosure of a reportable tax scheme: penalty ranging from 50% to 75% of the total amount of the 'tax benefit' obtained, as well as the cancellation (in all tax assessments) of the correlative effects associated to the tax scheme of reference.

In late November 2020, implementation tax rules were released by SAT to facilitate submission of the first annual informative tax return (described above). In late January 2021, predefined templates for this became available on the SAT website.

Finally, on 2 February 2021, the Ministry of Finance and Public Credit of Mexico (SHCP) enacted a Decree which provides that all schemes generating an aggregate effect of

	Penalty range
Omission in notifying a client with the specific scheme code assigned by the tax authority	$1,000 to $1,250
Lack of issuance of individual notifications of tax schemes	$1,250 to $1,500
Lack of submission of the annual informative tax return	$2,500 to $3,500
Omission in reporting a tax scheme, or reporting it incompletely or including incorrect information	$2,500 to $1,000,000
Lack of response to specific information requests made by SAT	$5,000 to $15,000
Lack of follow-up notifications to SAT on future performance of implemented tax schemes	$5,000 to $25,000

unpaid tax not exceeding 100 million pesos ($5 million) can be excluded from the annual return of reference (other than those related to limitations in information exchange, as listed above). This has helped reduce the accumulated pressure and uncertainty generated in FY 2020, when affected taxpayers and tax advisors had to disclose multiple, detailed and burdensome schemes; now, they can just focus on schemes mostly implemented by large taxpayers. However, many lawyers and tax practitioners in Mexico have pointed out various overlaps, lack of specific guidance, and confusing references in the Decree. These should be revised and modified by SAT or the SHCP in the near future.

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Interest deduction disallowance rules: Impact on controlled foreign corporations and their US shareholders

On 5 January 2021, the Internal Revenue Service and the US Department of the Treasury issued final regulations under section 163(j) of the Internal Revenue Code. These regulations finalised many of the rules for controlled foreign corporations (CFCs) and their US shareholders that were first addressed in earlier proposed regulations.

The final regulations were published in the Federal Register on 19 January 2021 and will generally apply to taxable years beginning on or after 20 March 2021.

Generally, section 163(j) limits the deduction for business interest expense (BIE) to the sum of the taxpayer's business interest income (BII), 30% of its adjusted taxable income (ATI) for a given taxable year, and floor plan financing interest. ATI is the taxable income of a taxpayer computed without regard to certain items – most importantly for this context, business interest or BII; and in the case of taxable years beginning before 1 January 2022, any deduction allowable for depreciation, amortisation or depletion.

This article explains computation of the section 163(j) interest deduction limitation with respect to CFCs of US shareholders, and identifies opportunities and challenges provided by the final regulations.

CFC group identification and election

Rather than applying the section 163(j) interest deduction limitation individually at the level of each CFC, a CFC group election allows for the application of a single limitation (similar to a US consolidated group calculation) to determine the amount of BIE each CFC group member can deduct. In many instances, making the election enables group CFCs to deduct a larger amount of their BIE.

Generally, a CFC group means one or more applicable CFCs or chains of applicable CFCs connected through a group parent, and the group parent directly or indirectly owns 80% of the value of an includible CFC. A CFC group election is made no later than the due date (including extensions) of the original federal income tax return. Once made, it cannot be revoked for 60 months following the end of the first period for which it is made. The same time period applies to making a new group election after one is revoked.

When making a CFC group election, consideration should be given to a separate-return-limitation-year (SRLY) limitation on a CFC group member's pre-group disallowed BIE carryforwards, if any. The impact is such that a CFC's BIE carryforwards can only be utilised to the extent that the CFC could have used the attribute had it not joined the group (i.e., sufficient section 163(j) limitation on a stand-alone basis).

Computation of the section 163(j) limitation for a CFC group

Under the election, a CFC group computes a single IRC section 163(j) limitation for the entire group. The computation and application of the section 163(j) limitation for a CFC group is based on the sum of each CFC group member's BIE, disallowed BIE carryforward, BII and ATI (each determined generally on a separate-company basis) for the member's tax year ending with or within the CFC group period.

Generally, a taxpayer's ATI cannot be less than zero (the 'no negative ATI' rule). However, the final regulations provide that negative ATI of a CFC group member is taken into account for purposes of determining the ATI of a CFC group.

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The ATI of a CFC group, however, cannot be less than zero. This was intended to prevent a CFC group from overstating its ATI in the event that only positive CFC ATI was included.

Further, because domestic corporations do not deduct foreign income taxes to determine ATI, the final regulations clarify that a deduction for foreign income taxes is not taken into account when computing CFC ATI. The decision to change the computation of CFC-level ATI from an amount net of foreign taxes to gross of foreign taxes is a significant revision in favour of the taxpayer. For taxpayers with CFCs that operate in high-tax jurisdictions, this new rule could enhance CFC-level interest expense deduction capacity under section 163(j).

While the US consolidated group rules would generally ignore intercompany obligations, obligations between CFC group members are considered when calculating a CFC group member's BIE, BII, ATI, and the CFC group's section 163(j) limitation.

Once a CFC group's section 163(j) limitation is calculated, it can be allocated to a CFC group member's current year BIE and disallowed BIE carryforwards. If the CFC group's current year BIE is less than the CFC group's limitation, all current-year BIE can be deducted. Carryforward BIE can also be deducted up to the group limitation amount in order of the tax year in which they arose (i.e., first-in, first-out). If the current-year and disallowed BIE carryforwards exceed the CFC group limitation, current-year BIE is deducted first. When current-year BIE exceeds the group's limitation, each CFC group member first deducts its current-year BIE to the extent of its BII. Thereafter, if group limitation remains, each CFC with remaining current-year BIE deducts a *pro rata* portion thereof.

CFC inclusions and their impact on ATI of US shareholders

Generally, a US shareholder excludes from ATI its subpart F inclusions, Global Intangible Low Taxed Income (GILTI) inclusion (reduced by any section 250(a) deduction allowed for the GILTI inclusion), and section 78 gross-up on deemed paid taxes. However, prior proposed regulations allowed a US shareholder of certain stand-alone CFCs or CFCs for which a CFC group election was made to include in its ATI a portion of its foreign income inclusions. The final regulations reserved on how to calculate a US shareholder's ATI with respect to such CFCs while Treasury and the IRS continue to study the issue. Consequently, for tax years beginning on or after 13 November 2020, a US shareholder can apply the provisions of the prior proposed regulations for purposes of increasing its ATI and section 163(j) limitation on account of foreign income inclusions.

Annual safe harbour election

The final regulations expand the scope of a safe harbour election provided by the proposed regulations. This is intended to reduce the compliance burden with respect to CFCs that would not have disallowed BIE if they applied section 163(j) by allowing taxpayers in general to use subpart F income and GILTI items in lieu of ATI. The election may be made with respect to a stand-alone applicable CFC (i.e., not a member of a CFC group) or CFC group, but not if a CFC group member has a pre-group disallowed BIE carryforward.

To be eligible for the safe harbour, a CFC group's BIE must not exceed either its BII or 30% of the lesser of the sum of either the 'qualified tentative taxable income' or the 'eligible amounts' of each CFC group member.

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'Qualified tentative taxable income' is tentative taxable income (i.e., taxable income without regard to a 163(j) limitation and disallowed BIE carryforwards). 'Eligible amounts' are generally CFC subpart F income and GILTI inclusions. An eligible amount of a CFC group member is computed without regard to section 163(j).

When the requirements are met and the safe harbour election is made, there is no disallowance of a CFC group BIE. However, if the safe harbour election is made, no CFC inclusion can be included in US shareholder ATI. Therefore, its benefits should be appropriately weighed.

CARES Act coordination

The final regulations coordinate with the Coronavirus Aid, Relief and Economic Security (CARES) Act, which temporarily increases the CFC section 163(j) limitation for years 2019 and 2020 to 50% of ATI. In addition, the regulations also coordinate with the election to use 2019 ATI instead of 2020 ATI for purposes of calculating a 2020 section 163(j) limitation. This assumes that 2019 ATI is likely to be higher than 2020 in many cases, given the economic impact of the coronavirus pandemic.

Conclusion

The final regulations are helpful in clarifying certain items, including whether a CFC group member can have negative ATI and if foreign taxes are included in a CFC's TTI computation. A taxpayer has the flexibility to model out the implications of making a CFC group election, if this has not been done before, to check whether it could result in a greater amount of interest deductibility.

Importantly, a loss of interest deductibility can increase net subpart F and GILTI inclusion amounts. As part of that modelling exercise, taxpayers should pay attention to the SRLY rules as applicable to pre-group disallowed BIE carryforwards.

Further thoughtful guidance is likely to be issued by the IRS and Treasury on a relatively timely basis as it pertains to CFC inclusions and their impact on US shareholder ATI. Until then, fortunately, taxpayers can rely on earlier proposed regulations.

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German VAT: Significant changes from 1 July 2021

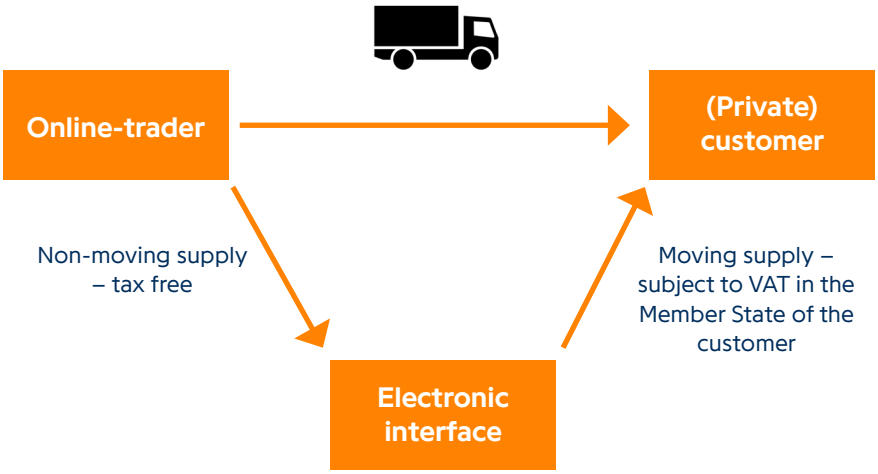
Originally planned for 1 January 2020 but postponed by the COVID-19 pandemic, the second stage of Germany's VAT digital package will be implemented with effect from 1 July 2021, bringing into force significant changes to the VAT Act. This article highlights key features of the new digital package.

Deliveries carried out using an electronic interface

For sales of goods by online traders to private individuals via an electronic interface, section 3(3a) of the VAT Act creates the illusion of a chain transaction between the online trader, the electronic interface and the end customer. This applies whether the trader is established in an EU Member State or in a third country. For shipment of goods from the EU territory, this applies without further restriction; but for shipment of goods from third countries, this fiction applies only if the material value of the goods does not exceed €150.

Section 3(6b) of the VAT Act provides that delivery of the online trader to the interface is always treated as a non-moving delivery, for which the new tax exemption of §4(4c) of the VAT Act applies. The operator's supply of the electronic interface to the end customer then constitutes a moving supply that is subject to taxation in the Member State of the end customer.

Electronic interface



Intra-community distance sales

The previous distance selling regulation of §3c of the VAT Act is maintained in principle – that is, for deliveries to private individuals in another EU Member State, taxability is established in the country where the transportation of goods ends if the delivery threshold is exceeded. What is new, however, is that instead of delivery thresholds varying by Member State, an overall delivery threshold of €10,000 applies. This applies to all intra-community distance sales and deliveries via an electronic interface. The following aspects are unchanged from the previous regulations:

- Application of the delivery threshold can be waived and taxability 'chosen' from the outset in the country where the transport will end
- The regulation does not apply to new vehicles, goods subject to differential taxation, or goods subject to excise duty.

Extension of the Mini One-Stop Shop to the One-Stop Shop

Until now, only electronically supplied services, telecommunications, radio and television services ('electronic services') to non-entrepreneurs could be reported via the MOSS procedure. Because these services are taxable in the customer's country of residence, registration in the respective Member State would, in principle, be necessary. The MOSS

procedure made it possible to report these sales, which are taxable in different Member States, centrally to the German Federal Tax Office (BZSt), thus avoiding registrations abroad. Now, the scope of the MOSS procedure is being significantly expanded.

In future, traders established in the EU will be able to report – in addition to electronic services – the following supplies via the new OSS procedure (§18j VAT Act):

- (Fictitious) supplies by interface operators to final consumers
- Intra-community distance sales
- Other services to non-entrepreneurs, if the place of supply differs from the supplying trader's country of residence.

Participation in the OSS procedure is still optional. The taxable person is free to maintain existing VAT registrations in the individual Member States while fulfilling their VAT obligations separately in each state. However, a taxable person choosing the OSS procedure can only do so uniformly for all Member States and all transactions covered by the OSS procedure. This only applies to a limited extent in the case of other supplies: if a trader has a registered office or a permanent establishment in the Member State of taxation, the application of the OSS procedure is ruled out in this respect.

Example

An entrepreneur resident in Germany provides digital services to private individuals within the EU. The entrepreneur has a permanent establishment in Italy.

Participation in the OSS procedure is possible for all Member States except Germany and Italy; in these countries, the general taxation procedure must be carried out.

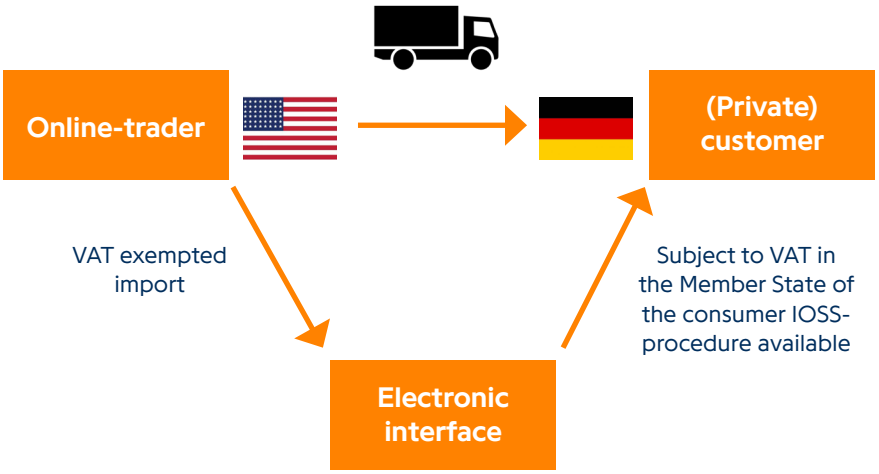
A trader established in a third country can also use the OSS procedure and freely choose the Member State in which to register for the OSS procedure. However, for traders established in the third country, application of the OSS procedure is limited to the reporting of other supplies (§18i VAT Act).

Introduction of an Import One-Stop Shop

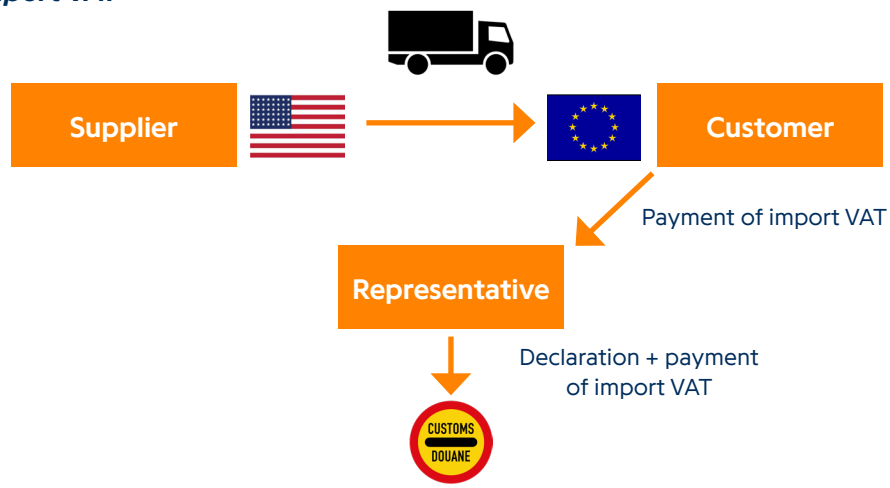
For the purposes of imports from third countries, §18k of the VAT Act introduces a new (simplified) procedure for goods with a material value of up to €150.

Irrespective of the trader's country of residence, traders who directly import goods from the third country into the EU, as well as electronic interface operators whose fictitious supplies to the final consumer were imported from the third country into the territory of the EU, can participate in the special taxation procedure IOSS. By means of this procedure, taxation is carried out with VAT in the Member State of consumption (end of transport). In return, the previous import

Import One-Stop Shop



Import VAT



is exempted from import VAT according to section 5 para. 1 no. 7 of the VAT Act by participating in the IOSS procedure.

Special procedure for import VAT

Section 21a of the VAT Act introduces a special procedure for import VAT purposes for goods with a value of up to €150. This is intended to simplify the collection of import VAT in cases where

- the special taxation procedure according to § 18k VAT Act is not used;
- an import does not take place under the normal procedure; and
- the goods are imported in the Member State of consumption.

The previous exemption from import VAT for imports with a value of up to €22 has been abolished, as this has increasingly led to tax fraud. Now, every import is subject to import VAT. However, the new procedure provides that a representative (e.g. parcel service providers and courier services) may, under certain conditions, submit the import declaration in the name and for the account of the recipient of the goods from whom the import VAT is collected. The person making the declaration is obliged to declare the consignment for free circulation under customs and tax law on behalf of the consignee and to claim the import VAT. This is then paid (together with other imports) to the competent customs authorities.

This regulation has the advantage for the parcel service providers and courier services that the transport can take place without interruption to the customer. However, this does require additional effort on the part of the parcel service providers and courier services, and they become liable for the corresponding import VAT. Given these disadvantages, the simplification might not be popular in practice.

All in all, the new regulation will lead to many changes for the companies concerned. They should check their existing supply structures in time, as the new regulations will entail significant adjustments to accounting systems, invoicing and taxation.

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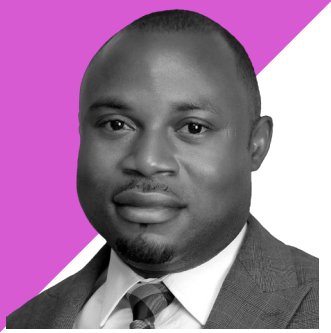
Nigeria signs the Finance Act 2020



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The President of the Federal Republic of Nigeria signed the Finance Act 2020 ('the Act') on 31 December 2020. The Act, which amends 14 existing statutes,[1] became effective from 1 January 2021 and addresses various issues, including tax.

The first Finance Act since the return of democracy over two decades ago was passed on 13 January 2020 and enacted as the Finance Act 2019, which introduced fundamental changes to the Nigerian tax regime. Similarly, the Finance Act 2020 has been passed to accompany the country's 2021 Annual Budget. The government's objectives for this Act are to:

- Support the realisation of the revenue projections in the 2021 Budget
- Integrate international tax trends to domestic laws
- Better target tax incentives
- Mitigate regressive taxation.

Major areas of amendment

Reduction of minimum tax

Minimum tax rate is reduced from 0.5% to 0.25% for 2020 and 2021 years of assessment (YA) only, after which the old rate of 0.5% is reactivated. The minimum tax is also now to be computed on the accounting gross income less franked investment income.

There appears to be a drafting error in this provision, as tax returns for 2020 YA have been filed by taxpayers at the old rate and as such the reduction should ordinarily take effect on 2021 and 2022 YAs. An amendment to this is likely, in view of the potential ambiguities it could cause.

Nonetheless, taxpayers are expected to adhere to the provisions of the Act while awaiting further amendments on the subject, if any.

Non-resident companies to obtain tax identification number

Foreign companies making taxable supplies in Nigeria are now required to obtain a tax identification number (TIN) upon registration with the Federal Inland Revenue Service (FIRS) and can appoint a representative to fulfil their tax obligations in Nigeria.

Returns by foreign companies

Foreign companies are now required to file returns on their profits from Nigeria, to include:

- Full audited financial statements of the entity
- Audited financial statement of the Nigerian operations, audited by a Nigerian auditor
- Tax computation schedules based on profits attributable to Nigerian operations
- Duly completed Companies Income Tax Self-Assessment forms.

This requirement does not apply to foreign companies whose withholding tax serves as the final tax in Nigeria in that YA.

Incentive for COVID-19 and other pandemics

Donations made in cash or in kind to the government (federal or state), or any government-designated fund in respect of a pandemic or natural disaster, is now considered an allowable deduction, subject to a maximum of 10% of assessable profits, after deduction of other allowable donations made by the company.

Supplies subject to VAT

The Act has redefined supply of goods to mean all forms of movable or immovable tangible properties, excluding land, building, money or securities.

REFERENCES
1. Capital Gains Tax Act, Companies Income Tax Act, Value Added Tax Act, Personal Income Tax Act, Tertiary Education Trust Fund (Establishment) Act, Industrial Development (Income Tax Relief) Act, Stamp Duties Act, Customs and Excise Tariff etc. (Consolidated) Act, Federal Inland Revenue Service Establishment Act, Nigeria Export Processing Zone Act, Oil and Gas Export Free Zone Act, Companies and Allied Matters Act, Fiscal Responsibility Act, and Public Procurement Act.

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Services include those consumed by a person in Nigeria, whether rendered within or outside Nigeria, excluding services provided under a contract of employment.

Taxable incorporeal supplies include the exploitation, acquisition or assignment of rights by a person in Nigeria or where the incorporeal is connected with a tangible or immovable asset located in Nigeria.

Expansion of VAT-exempt items

The following are now exempt from VAT:

- Commercial aircrafts, aircraft engines and spare parts
- commercial airline tickets
- lease of agricultural equipment for agricultural purposes
- Animal feed (now deemed as a basic food item)
- Buildings, and interest therein (i.e. rental or lease of buildings, regardless of whether the building is used for residential or commercial purposes).

Exclusion of minimum wage earners from tax

Those earning the minimum wage (currently ₦30,000, equivalent to about $79) or less are exempted from personal income tax, including minimum tax. This provision applies to the minimum wage in force at any time as contained in the Minimum Wage Act.

Employers of minimum wage earners are still required to file Nil returns for these employees.

Treatment of unclaimed dividends and dormant accounts balances

The Act establishes the Unclaimed Funds Trust Fund Act (UFTF). Unclaimed dividends in a listed company and unutilised amounts in a dormant bank account outstanding for ≥6 years are now to be transferred to the UFTF to serve as a perpetual trust. The UFTF is to be managed by the Debt Management Office and the transferred dividends and amounts are to constitute a special debt owed by the Federal Government to the shareholders and dormant account holders, respectively. This debt, including any interest accrued, is available for claim at any time.

Failure by any company or any deposit money bank to transfer unclaimed dividends or dormant account balances into the UFTF attracts a fine of not less than five times the value of the unclaimed dividends and unutilised funds, plus accumulated interest on the amount not transferred at the CBN Monetary Policy Rate.

Unclaimed dividends in a private limited company outstanding for 12 years shall be distributed to other shareholders of the company.

Excise duties on telecommunication services

Telecommunication services provided in Nigeria are now to be charged with excise duties. The applicable rates are to be as the President may by Order prescribe pursuant to Section 13 of the Customs and Excise Tariff, etc (Consolidation) Act.

Consolidated relief allowance

The Personal Income Tax Act has been amended to redefine gross income for the purpose of calculating consolidated relief allowance. Now, gross income for CRA purposes is determined after the deduction of franked investment income, allowable deductions, non-taxable income and tax-exempt income such as life assurance premiums or national housing fund contributions. The effect of this is that CRA claimable by taxpayers will be reduced compared to the relief enjoyed in prior years.

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Pioneer status for companies involved in primary agricultural production

Small or medium-sized companies engaged in primary agricultural production may now qualify for an initial tax-free period of 4 years, renewable for an additional maximum period of 2 years, subject to satisfactory performance. These companies are still required to apply to the President through the Ministry to qualify for this tax-free period.

Amendment of excise duties and levy

Vehicle type	Old rate	New rate
Tractors (HS Headings 8701)	35% duty	5% duty
Motor vehicles for the transport of >10 persons (HS Headings 8702)	35% duty	10% duty
Motor vehicles for the transport of persons [cars] (HS Headings 8703)	30% levy	5% levy
Motor vehicles for the transport of goods (HS Headings 8704)	35% duty	10% duty

Other introductions and/or amendments by the Finance Act 2020 include:

- Substitution of stamp duty on electronic transfers with Electronic Money Transfer Levy of ₦50 to be paid on every electronic money transfer of at least ₦10,000. The revenue generated from the collection of the Levy is to be distributed between the federal and state governments at 15% and 85%, respectively, and on a derivation basis to the states.
- Inclusion of the 'significant economic presence' concept into the Personal Income Tax Act.
- Introduction of rules on time of supply for determining the applicable VAT rate.
- Adoption of electronic processes: taxpayers and the tax authorities can now exchange correspondence via e-mail, and the Tax Appeal Tribunal is permitted to conduct its hearings electronically.
- Approved enterprises within free trade zones are now expected to render returns to the FIRS and comply generally with the provisions of Section 55(1) of CITA, as a condition to be tax exempt.
- Instead of audited accounts, the FIRS may specify by notice, an alternative form of accounts to be included in the tax returns filed by small and medium-sized companies.

Conclusion

This is the second Finance Act in consecutive years, demonstrating the federal government's ongoing commitment to ensure that the tax laws align with current business and economic realities.

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German residence in case of temporary stay abroad

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> *Anyone who has a domicile or their habitual abode in Germany is subject to unlimited tax liability according to domestic law. This applies irrespective of whether one (partially) resides in another country*

Temporary stays abroad are becoming increasingly popular, whether among students or employees. In this context, it is advisable to assess whether a previously existing German residence should be maintained or alternatively moved back to the parental home to qualify for benefits such as child benefit or the tax deductibility of certain expenses during this time. This article provides an overview of what should be considered in such cases.

Unlimited tax liability in Germany

Anyone who has a domicile or their habitual abode in Germany is subject to unlimited tax liability according to domestic law. This applies irrespective of whether one (partially) resides in another country.[1] Unlimited tax liability is a prerequisite for the consideration of personal circumstances, e.g. the deduction of special expenses and income-related expenses. Income-related expenses incurred for work-related reasons, or resulting from a study programme for a second degree, can be taken into account for tax purposes (if necessary, they can even be carried forward), and thus have a tax-reducing effect.[2]

Those who continue to be tax resident in Germany during a stay abroad are generally subject to double unlimited tax liability (in the destination country and in Germany). Depending on the country of destination, double taxation is avoided either by a double taxation agreement or by domestic rules for crediting the foreign tax against the German tax. The consequences must be examined in each individual case, and an additional tax burden may be the outcome.

Giving up one's German residence might make sense under certain circumstances, to take advantage of a lower tax rate in the destination country. If the taxpayer holds shares in corporations, however, the departure could result in the taxation of hidden reserves ('exit taxation'). If the taxpayer returns to unlimited tax liability within 5 years of departure and can credibly demonstrate the intention to return from the beginning, the tax is waived retroactively.

Entitlement to child benefit

Parents who are subject to unlimited tax liability in Germany are generally entitled to child benefit. In the case of limited tax liability, parents can be entitled to child benefit if they live in another EU or EEA state but work in Germany and are subject to German social insurance.

In general, only children whose domicile or habitual abode is in an EU or EEA state and who are younger than 18 years of age are considered. If the child is in full-time education, parents can receive child benefit until their child's 25th birthday.

In case of a child temporarily staying in an EU or EEA state (e.g. for studying abroad), the parents may be entitled to receive benefit regardless of whether their child is a German resident. However, the latter may be necessary if the child's country of destination is a non-EU/-EEA country. The Federal Fiscal Court (*Bundesfinanzhof*, BFH) has dealt with similar cases several times, and in any case it should be examined in detail whether the requirements for receiving child benefit are still fulfilled.

Example: Deduction of income-related expenses caused by a second degree study programme

Costs for a (job-related) double household are deductible as income-related expenses if the conditions of Section 9, paragraph 1, sentence 3, number 5 German Income Tax Act are fulfilled. Accordingly, a double

household exists if the employee (i) lives at the place of work and (ii) maintains their own household outside the place of work. A prerequisite for the existence of a separate household is that the taxpayer contributes financially to the 'costs of living' of this household.

In a recent dispute[3] heard by the Düsseldorf Fiscal Court, the plaintiff declared costs of a double household in his tax return. His justification was as follows: For the purpose of studying for a Master's degree, the plaintiff moved into an apartment abroad; at the same time, he had concluded a rental agreement with his parents for two rooms in their home, located in a German city. The competent tax office denied the plaintiff a tax deduction for the rent payments to his parents on the grounds that he did not maintain his own household in his parents' house and did not contribute to the costs of living in the year in dispute. Since the tax office did not alter its opinion after the plaintiff filed an objection, the taxpayer filed a lawsuit.

In its ruling, the tax court upheld the defendant tax office. With reference to recent case law on the concept of 'costs of living', it argued that the financial participation of the plaintiff, which had only included various incidental living costs on a pro rata basis (according to the rental agreement) as well as sporadic purchases, was not sufficient for the existence of a separate household. Rather, participation in the costs of living presupposed that the taxpayer systematically and appropriately participated in all expenses relating to the joint household. In the case in dispute, the plaintiff would also have had to make regular, not sporadic, contributions to ongoing expenses – such as the costs of food and consumables, purchase of household items, things for everyday use and repairs.

These explanations show that in addition to the extensive organisational effort involved in a stay abroad, tax considerations may be useful. In this context, no general statement can be made as to whether it is advisable to maintain a German residence during the time abroad. Finding the best solution requires a detailed assessment of the circumstances.

REFERENCES

1. Contrary to widespread assumption, a tax residence is not established or terminated by registering with the competent registration office. Section 8 of the German Fiscal Code states that it is sufficient that someone 'holds a home under circumstances that indicate that he or she will maintain or use the home'. The registration only has an indicative effect.
2. Costs incurred as a result of a first degree study programme are considered special expenses and can only be taken into account for tax purposes in the assessment period in which they occurred, but cannot be carried forward in time (Federal Constitutional Court, ruling of 19 November 2019 – 2 BvL 22–27/14).
3. Duesseldorf Fiscal Court, judgement of 28 May 2020 – 9 K 719/17 E.

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Recent reforms in Italian securitisation legislation open to tax efficiency profiles in real estate investment

Italian securitisation law: Background

In Italy, increasing attention has been paid in recent years to the area of credit securitisation by banks and financial intermediaries. New legislation has sought to foster securitisation schemes allowing banks and financial entities to dispose quickly of non-performing loans (NPLs) and facilitate them to respect the capital ratios established by the supervisory authorities. However, the management of NPLs becomes particularly complex when they are secured by mortgages on real estate, since their collection is hampered by the long duration of the tender processes and the inadequacy of court sales procedures. To simplify the management of real estate assets, in 2017 the concept of REOCo (Real Estate Owned Company) was introduced, with further legislation in 2019 and 2020 extending the securitisation directly to real estate assets and movable registered assets.

Securitisation vehicles may now also directly acquire real estate assets or registered movable assets (e.g. ships, aircrafts, vintage cars and motorbikes) and securitise any proceeds arising from them. Such assets will be segregated by law from those owned by the securitisation vehicle itself, and their proceeds will be dedicated to the sole fulfilment of the noteholder's rights under the securitisation scheme, as well as the rights of any licensed lender and/or bank, if involved. Securitised assets must be managed and serviced by entities having the required expertise and authorisation, although the asset managers are not statutorily required to hold any banking licence. This new investment scheme could provide several advantages to foreign investors in Italian real estate assets, combining the simpler management and the flexibility of a note with the safety provided by the real estate collateral.

Tax advantages for foreign investors

The new investment scheme provided by the amended law seems also to provide several tax advantages for foreign investors and noteholders. There are two main advantages:

Income tax on the securitisation vehicle and direct taxation on proceeds from management of the assets

With regard to the taxation aspect of the securitisation vehicle, the constraint on the separation of assets explicitly provided for in Article 7.2., paragraph 2, of the securitisation law, leads to the non-relevance for corporate income tax (CIT; both regional and state tax) of the revenues obtained in the medium term from SPV 7.2., which are intended to satisfy the holders of the notes, as provided for in the SPV (vehicle company). This means that the full income realised by the management of the securitised assets is not subject to corporate income tax and is passed on directly to the noteholders, pursuant to the securitisation scheme that has been established. On this aspect the Italian tax authorities already provided a clear opinion in a previous interpretation letter (Circolare 8/E/2003), according to which the constraint on the allocation of segregated assets excludes *a priori* a profile of 'possession' of the relevant related income for the purposes of CIT levied on the SPV.

Withholding taxes on the proceeds passed on to the noteholders

The securitisation law provides for a general application of Law 239/1996, which excludes non-resident noteholders from withholdings and from general taxation in Italy of the proceeds of the notes, provided they are residents of states and territories

that allow an adequate exchange of information ('white list').

The first notable examples of real estate securitisation schemes have applied in full the exemption from withholdings on the notes' cash flows, in line with the current generally accepted interpretation of the law granting exemption from withholdings. However, this is still to some extent open to debate, since the amendments of the securitisation law are partially incomplete. Official clarification is expected from the tax authorities.

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Implementation of DAC 6 within Maltese law

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The concept of tax sovereignty used to impose numerous practical obstacles for states wishing to assert their jurisdiction to tax. Countries took the view that tax policy formed an integral part of their national sovereignty, and so developed the doctrine of non-enforcement of other nation states' tax claims. This issue is no longer as stringent, since nation states have decided to assist each other in certain areas such as by exchanging information about taxpayers' transactions. One of the latest legislative initiatives taken by Malta in this respect, along with all other EU countries, was the enactment of DAC 6 through Legal Notice 342 of 2019.

DAC 6's main feature resides in the mandatory automatic exchange of information of cross-border arrangements, should any of the hallmark criteria listed within the respective annex of the law be present. This directive came into effect in Malta from 1 July 2020, but due to the COVID-19 pandemic, the Commissioner for Revenue deferred the first reporting deadlines of the relevant cross-border arrangements ('the Reportable Arrangements') by 6 months. The intention was to provide taxpayers and intermediaries impacted negatively by COVID-19 more time to ascertain their compliance with the reporting obligations brought about by DAC 6.

The obligation to file information on the Reportable Arrangements shall fall both upon the primary tax intermediary (the person who has designed or manages the implementation of the Reportable Arrangement), and also on secondary intermediaries (e.g. lawyers, accountants, auditors, notaries, financial advisers, banks, insurance companies and fund managers) who know or should reasonably have known that they have (directly or by means of other persons) committed to provide assistance or advice with respect to a Reportable Arrangement. However, if an intermediary cannot file this information for professional secrecy reasons, the obligation shall either fall upon another intermediary who is not bound by such professional secrecy, or (in the absence of such an alternative) on the individual taxpayer. In this respect, a non-disclosing intermediary is required to notify another intermediary or the relevant taxpayer of their reporting obligation within 7 working days, commencing on the earliest of the following:

- The day after the reportable cross-border arrangement is made available for implementation
- The day after the reportable cross-border arrangement is ready for implementation
- When the first step in the implementation of the reportable cross-border arrangement has been made.

In these cases, where an intermediary waives their reporting obligation to another intermediary or to the relevant taxpayer, the intermediary shall be required to notify the Commissioner for Revenue on an annual basis of those reportable cross-border arrangements in respect of which the reporting obligation was waived.

The law further clarifies that an intermediary shall be obliged to file information on the Reportable Arrangements in the following instances, taken in the following order:

- The intermediary is resident in Malta for tax purposes
- The intermediary is not resident for tax purposes in any EU Member State (including Malta), but has a permanent establishment (PE) in Malta through which the services with respect to the Reportable Arrangement are provided

- The intermediary is incorporated in Malta or is governed by the laws of Malta and the above-mentioned instances do not apply
- The intermediary is registered with a professional association related to legal, taxation or consultancy services that is established in Malta and the above-mentioned instances do not apply.

An intermediary shall only be exempted from the reporting obligation in either of the following two scenarios: if it proves that the information on the Reportable Arrangement has already been filed with any other competent authority of an EU Member State; or it proves that the information on the Reportable Arrangement has already been filed by another intermediary. In these instances, the Guidelines issued by Malta's Commissioner for Revenue ('the Guidelines') instruct that the intermediary is to maintain the arrangement reference number ('Arrangement ID') assigned to the arrangement by the other EU Member State, as well as a copy of the information submitted with the competent authority of the other EU Member State.

As mentioned earlier, an arrangement shall be considered as reportable if it contains one of the numerous hallmarks contained in the law that present an indication of a potential risk of tax avoidance. The hallmarks may be divided in two: those that are accompanied by the main benefit test, and others that are not accompanied by this secondary test. As its name entails, the main benefit test contemplates whether the main benefit(s) of the cross-border arrangement in light of the relevant facts and circumstances is that of obtaining a tax advantage. As the Guidelines stipulate, the main benefit test is an objective one and does not contemplate subjective assessments which would take into account the purpose or intentions of the participants to the arrangement. Therefore, the fact that a person does not actively seek to obtain a tax advantage will not be a determinative factor when considering whether a cross-border arrangement meets the [main benefit test].

Harsh penalties will apply to any intermediary or taxpayer choosing not to abide by these DAC 6 reporting obligations. While the effectiveness of DAC 6 within the European Union remains to be seen, it supports cooperation in the field of tax administration and enforcement. Through a better understanding of cross-border transactions, nation states should be able to achieve a better and fairer division of tax revenue.

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Foreign-owned/-controlled US businesses and second-draw paycheck protection loans

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The Paycheck Protection Program (PPP) was first established in the Coronavirus Aid, Relief and Economic Security (CARES) Act, the United States' major COVID-19 relief bill. It was designed to provide a cash infusion to small businesses, keeping them afloat during the pandemic-driven recession. Given its success, it has been incorporated into section 311 of the Economic Aid Act, a 2021 follow-up to the CARES Act.

The PPP authorised the Small Business Administration (SBA) to issue fully forgivable loans of up to $10 million to qualifying small businesses. In the first round, foreign-owned or -controlled US businesses were able to receive PPP loans, subject to certain qualifying criteria.

Any business that wants a second-draw PPP loan (available until 31 May 2021) must fulfil the requirements outlined in the SBA's Interim Final Rule (IFR). To qualify for a second-draw loan (of up to $2 million), an entity must:[1]

- Have experienced a gross revenue reduction of at least 25% in one quarter in 2020 relative to 2019
- Have 300 or fewer employees (there are possible waivers for this limit, including franchises operating in multiple locations)
- Have used or will use the full amount of the first-draw PPP loan on or before the expected date on which the second-draw PPP loan is disbursed to the borrower. The IFR clarifies that the borrower must have spent the full amount of the first-draw PPP loan on eligible expenses under PPP rules.

Notwithstanding any other eligibility requirements, a US entity is not eligible to receive a second-draw PPP loan if that entity is primarily engaged in political or lobbying activities. Additionally, entities that have been created in certain countries or are at least 20% owned by citizens of those countries face additional restrictions. Similar restrictions apply to retaining a board member who is a resident of an excluded country. For foreign-owned businesses located in the US, a key limitation is that the total number of foreign and domestic employees cannot exceed 300, including employees of affiliates.

The SBA uses four tests to determine affiliation:[2]

- **Affiliation based on ownership** Affiliation arises when one entity controls another, or a third party has the power to control both. Negative control also qualifies; for example, when a minority shareholder has the ability to prevent a quorum or otherwise block action by the shareholders or board of directors. It does not matter whether control is exercised, so long as the power to control exists.
- **Affiliation arising under stock options, convertible securities, and agreements to merge** The SBA considers all of these factors to have a present effect on the power to control an entity.
- **Affiliation based on management** Affiliation arises when two or more entities have the same CEO, President, or are otherwise managed by the same individual, concern, or entity.
- **Affiliation based on identity of interest** Affiliation arises when there is an identity of interest between close relatives who have identical or essentially identical business or economic interests.

Key takeaways

Foreign-owned or -controlled businesses located in the United States might qualify

REFERENCES
1. US Small Business Administration (2021). Business Loan Program Temporary Changes; Paycheck Protection Program Second Draw Loans. Washington DC.
2. US Office of Capital Access (2020). Affiliation Rules Applicable TO US Small Business Administration Paycheck Protection Program. Washington DC.

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for PPP loans. The crucial factors in determining whether such a business is eligible for a PPP loan is the number of people employed by a company and its affiliates, and qualifying under the gross revenue reduction requirements.

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Finance Bill 2021: Significant amendments proposed that will impact international tax

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> *The proposals for direct tax will fundamentally change various tax procedures in the light of advancement of technology*

India's Budget for the year 2021/22 provides a strong focus on infrastructure, health and well-being, inclusive development, human capital, innovation and R&D and maximum governance. The Indian government has always been quite prompt in aligning the provisions of its domestic law with the technological advancements and strengthening the international tax principles. The proposals for direct tax will fundamentally change various tax procedures in the light of advancement of technology. Here, we summarise budget proposals that will impact foreign companies and other non-residents.

Ambit of the equalisation levy enlarged – Global consensus on taxing digital transactions has still not been achieved, but India has already taken an aggressive stand on taxing all ecommerce transactions. The equalisation levy was introduced in Chapter VIII of the Finance Act, 2016 levying 6% charge on online advertisement; thereafter, the ambit of the equalisation levy was widened by the Finance Act, 2020, which enlarged its scope to cover non-residents engaged in online sale of goods or online provision of services. It is now proposed to amend/clarify the provisions of the equalisation levy as follows:

- Consideration received or receivable for specified services and consideration received or receivable for e-commerce supply or services shall not include consideration which are taxable as royalty or fees for technical services in India under the Income-tax Act read with the agreement notified by the Central Government under section 90 or section 90A of the Income-tax Act.

  Thus, transactions that were hitherto taxable as 'royalty or fees for technical services', either under the Act or treaty, shall continue to be taxable under the Income-tax Act and not under the equalisation levy.

- For the purposes of defining e-commerce supply or service, 'online sale of goods' and 'online provision of services' shall include one or more of the following activities taking place online:
  - Acceptance of offer for sale
  - Placing the purchase order
  - Acceptance of the purchase order
  - Payment of consideration
  - Supply of goods or provision of services, partly or wholly.

  The proposed amendment as to the definition of online sale of goods and provision of service will enlarge the scope of the equalisation levy. Whether placing of an order through email and subsequently making payment through a payment gateway will attract the equalisation levy is still a matter for debate and will lead to litigation. If this interpretation holds good, then it is likely that all import transactions would be covered if any of the limb of the transaction is done online through any digital or electronic facility/platform.

- Consideration received or receivable from e-commerce supply or services shall include:
  - consideration for sale of goods irrespective of whether the e-commerce operator owns the goods; and
  - consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator.

  This proposed amendment will also enlarge the scope of the equalisation levy to cover ecommerce operators that are not actually selling the goods or providing the services.

Withholding on payment made to FIIs at DTAA rate – The existing provisions dealing with withholding of payments made to FIIs provides for deduction of tax on income of FII from securities at the rate of 20%. Since the said section provides for TDS at a specific rate indicated therein, the deduction is to be made at that rate and the benefit of double taxation avoidance agreements (DTAA) cannot be given at the time of tax deduction. This is because the benefit of DTAA rate can be given for withholding taxes wherever the relevant provisions provide for withholding at 'rates in force'. This position has also been affirmed by the Supreme Court in the case of PILCOM v. CIT West Bengal [2020] 425 ITR 312. In order to provide benefit of DTAA to FIIs, the Finance Bill 2021 has proposed that for FII residents of countries to whom a DTAA applies, if the payee has supplied a tax residency certificate (TRC), then the tax shall be deducted either at the rate of 20% or at the income tax rate specified in the DTAA for such income, whichever is lower. Thus, FIIs are relieved of hardship that might result from tax deduction at a higher rate, where the treaty either exempts or specifies a lower tax rate for such income.

Introduction of definition of 'liable to tax' – The term 'liable to tax' has been used in the recently introduced section 6(1A) of the Income-tax Act, as well as in DTAAs (for determination of residency), but has not been defined in either. The Finance Bill 2021 proposes to define the term as meaning that 'there is a liability of tax on that person under any law for the time being in force in any country and will include a case where subsequent to the imposition of tax liability, an exemption has been provided'. Going forward, the tax authorities will also extend this definition for the purpose of determining residency under DTAAs.

Changes to the advance ruling system – The Finance Act 1993 introduced the provisions of advance ruling, whereby any non-resident by way of an application can approach the Advance Ruling Authority (AAR) to obtain a ruling on tax implication on any proposed transaction to be undertaken by such non-resident. Later, these provisions were made applicable to residents also. Such rulings are binding on both the applicant and the department, and thus provide certainty of taxes to the applicant. Earlier the Chairman and Vice Chairman of AAR used to be retired judges of the Supreme Court, High Court, etc. The Finance Act 2021 has proposed to reorganise the AAR by providing that the existing AAR will cease to exist and new Advance Ruling Board will be constituted, which shall consist of two members not below the rank of Chief Commissioner. The intent behind the amendment is to address the issue of slow disposal of applications because of vacancy for the seat of chairman/vice chairman due to non-availability of eligible persons. However, to increase confidence among non-residents for unbiased ruling, it is desirable that at least one member of the Board should be a person from outside the Income Tax Department and should be a judicial person.

The Finance Bill also proposes to notify rules for removing the hardship of non-resident Indians returning to India on the issue of their accrued incomes in their overseas retirement account. It was expected that there would be some relaxation to residency rules for non-residents stuck in India due to the pandemic, but no such relief has been announced in the budget proposals. The proposed changes to the scope of the equalisation levy have not been well received by some countries, and until the OECD develops a unified approach to tax such transactions we will see great deal of litigation on this aspect.

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Q2 2021

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Editorial

Sachin Vasudeva

> *During these times, hope will be the very thing that carries you through*

Profit shifting by multi-national corporations (MNCs) to tax havens and other low-tax jurisdictions has been in vogue for many years. Under its Base erosion and profit shifting (BEPS) initiative the OECD has tried to address this issue (through various action plans) but there is still no global consensus on various issues being covered by BEPS, especially the taxation of the digital economy. In the absence of a global consensus many countries have adopted a unilateral levy to tax such companies, which is outside the scope of their double tax avoidance agreements. In the Commentary on its Model Double Taxation Convention the United Nations has proposed a revision by inserting a section on taxation of automated digital services. While the world waits for a consensus on taxing digital payments the recently concluded meeting of the finance ministers of the G7 countries has mooted another proposal: that a global minimum corporate tax rate of 15% be adopted to tax MNCs.

Implementation of the global minimum tax proposal would entail countries changing their tax laws for companies that are resident in such countries, so that if the companies' profits go untaxed, or are taxed at a lower rate in an offshore jurisdiction, the company would face an additional top-up tax back home to bring the overall rate it pays up to the minimum global level. This would act to deter companies from shifting profits to low-tax countries, because if those companies escape taxes abroad, they will only have to pay more in the home country. While this sounds good, 'there is many a slip between the cup and the lip' and to achieve consensus even on this would be a herculean task. India for a start has expressed reservations on this proposal.

As vaccination gathers steam across the world there is hope of life returning to normalcy. There is no better way to explain 'hope' than in the words of Nikki Banas and I quote:

> *If you carry only one thing throughout your life, let it be hope. Let it be hope that better things are always ahead. Let it be hope that you can get through even the toughest of times. Let it be hope that you are stronger than any challenge that comes your way. Let it be hope that you are exactly where you are meant to be right now, and that you are on the path that you are meant to be … because during these times, hope will be the very thing that carries you through.*

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Ze'ev Lederman v. Tax assessor Tel-Aviv No. 5 – Civil Appeal Number 41182-01-19 (24/03/2021)

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Facts of the case

Ze'ev was born in the United States and immigrated to Israel with his family when he was a child. He returned to the United States in 1990, when he was aged about 30, to study for a master's degree in business administration, and later (in 1993) married an Israeli citizen living in the United States.

At the same time, he was employed at a senior position in American companies and used to visit his family in Israel from time to time until he decided to return to Israel in September 2009.

In 2011 and 2014, Ze'ev sold shares of WIX (an Israeli company) which he had purchased in 2006. These generated him a total capital gain of over NIS 10.5 million.

The issue in concern was the possibility of taxing the capital gain from the sale of WIX shares in Israel.

The Tax Authority claimed that Ze'ev had been a resident of Israel since 2002, while Ze'ev claimed that he returned to Israel only in 2009.

The contention of the taxpayer

The appellant argued that, the year of his return to Israel being 2009, therefore he should enjoy the benefits of a long-term returning resident (similar to a new immigrant) who is exempt from capital gains tax on the sale of securities of an Israeli company purchased while he was a foreign resident.

Contentions of the tax assessor

The Assessing Tax Officer claimed that Ze'ev had been a resident of Israel since 2002, as the centre of his life, i.e. centre of vital interest, was in Israel even then and therefore he should not be entitled to an exemption since the law only applies from 2007 onwards.

The court decision

The following is a summary of the analysis of the indications that led the court to decide that Ze'ev had returned to Israel only in 2009 (and therefore entitled to tax exemption in Israel on the sale of the shares):

1. **The test of days** – For Ze'ev, the first test for defining residence in Israel under the tax law (whether he had stayed in Israel for 183 days or more) was met for the years 2004 and 2002 (before Amendment 132, which applied from 1.1.2003). The second test (whether he had resided in Israel for 30 days or more during a tax year, and whether his stay in Israel in the tax year and the two preceding years totalled 425 days or more) was met for the years 2003 to and including 2006.

   Neither test was met in the years 2007 and 2008 and it was not disputed that Ze'ev has been a resident of Israel since 2009. Ze'ev was present in Israel for an average of 154 days per year during the years 2002–2008 and, except for 2002 and 2004, he was outside Israel for most of the year. Ze'ev explained that his relatively long stays in Israel in 2002 and 2004 had been for reasons that did not depend on him, such as the birth of his second son. His presence in Israel was not continuous and he visited it many times (over 12 visits on average per year, in the years 2002 to and including 2008).

   In addition, there was no change in the pattern of stay or in the number of days, even compared to 2001 (his last year as a foreign resident, according to the income tax). Since 2009, Ze'ev has spent

significantly more days in Israel each year.

2. **Family conduct** – The court did not give much weight to the fact that Ze'ev's wife and children had returned to live in Israel. "Splitting the family cell" did not formally occur: Ze'ev and his wife did not divorce and did not split the share of their property.

   Although complete disconnection may support an argument that the family cell has been split, the opposite is not necessarily true. A good relationship may be managed so that despite the centre of family life being separate personal closeness is maintained.

3. **Permanent home** – A number of permanent homes were available to Ze'ev in those years, and so this factor in itself did not help to decide the question of the date residency in Israel was resumed.

4. **Place of residence** – This test applies to family members and not just to the taxpayer. The court distinguishes between affiliations created as a result of Ze'ev's choice and those that do not depend solely on him. His wife's choice to live in Israel with their children and in particular the fact that the children were very young did not justify giving high weight to this element in the totality of the circumstances.

5. **The usual place of occupation** – Ze'ev's professional occupation did not commit him to work permanently and continuously in a particular place. He worked outside Israel by choice and put his career first in his priorities. Managing his life around professional pursuits outside Israel was given significant weight in the overall assessment.

6. **The place of active and material economic interests** –The court examined where the bulk of Ze'ev's property was located. This is not necessarily where the taxpayer's sources of income are located but where it carries out its material economic activities. The court also distinguished between private/family property (in Israel) and business property (in the USA) and noted that in 2009 Ze'ev had reduced his economic activity in the USA in parallel with strengthening his economic ties to Israel.

7. **National Insurance and Health Services** – Only as of September 2009 did Ze'ev formally register for Israeli National Insurance.

8. **Ongoing reporting to the tax authorities** – Ze'ev is an American taxpayer. As an American citizen, he submitted reports to the US tax authorities (up to and including 2008, he even mentioned a residential address in the USA in his reports) and presented residency confirmation letters for the years 2006 to 2008 issued for him and his wife by the US Treasury Department.

In its judgment, the court referred to Ze'ev's reports to the tax authorities in Israel and the United States and to the implications of these reports for the issue in dispute. In his original 2011 tax report in Israel, Ze'ev reported taxable capital gains in Israel and demanded the Israeli tax as a foreign tax credit in his US report (so that double taxation would not occur).

In November 2015 (three years later), Ze'ev submitted a request to amend his Israeli tax report. After receiving the amendment, the tax assessor refunded the capital gains tax, noting that the issue of residency had not yet been resolved.

Ze'ev also confirmed that on professional advice he had not yet submitted an update to the US tax authorities so that in the test of

the result for the income tax claim, he did not pay tax in both countries. He did, however, state that at the end of the legal proceedings he will report as required to the US Internal Revenue Service, and the court agreed that this removed the fear of double non-taxation (both in Israel and in the USA).

In conclusion, the place of residence of the family is important in determining the centre of an individual's life, but it is not a single or decisive indicator. The court stated that residency is determined according to the totality of the circumstances and emphasised that finding the mark of a permanent home and place of residence, and meeting the test of days is insufficient to show an affiliation with Israel.

This is an aggregate test and the assessor must look at the whole picture.

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Engineering Analysis Centre of Excellence Pvt Ltd v. The Commissioner of Income Tax & Anr

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On 2 March 2021, the Hon'ble Supreme Court of India (SC) delivered a landmark judgment putting rest to the 20-year-old controversy revolving around the characterisation of payments made by Indian residents to non-residents for use or resale of shrink-wrapped computer software ('software' hereafter) in India. The controversy was whether the payments for purchase of software would amount to royalty in the hands of the non-resident (NR) and thus taxable in India (basis: the source rule), or be classified as sale of a copyrighted product and thus business income for the NR. The SC collected under the judgment 103 appeals where the core issue was the same; grouped those appeals into four categories; and held that the payments at issue did not constitute royalty.

The four categories of transaction dealt by the SC are:

- **Category 1:** Sale of computer software by NR to an end user in India.
- **Category 2:** Sale of computer software by NR to Indian distributors for resale to end users in India.
- **Category 3:** Sale of computer software by NR to foreign distributor for resale to end users in India.
- **Category 4:** Sale of computer software bundled with hardware by NR to Indian distributors/end users.

The contentions of the revenue and the assessees were as follows:

Assessees' contentions

Software providers and end users have always contended that the software is sold as a copyrighted product and, hence, the payments are for "goods"; this was also held in the decision in *Tata Consultancy Services*.[1] The assessees relied on the following arguments:

- By virtue of section 90(2) of the IT Act, double tax avoidance agreements (DTAA) prevail over domestic law to the extent that this is more beneficial to the deductor of tax under section 195 of the IT Act.
- A retrospective, 2012 amendment to section 9(1)(vi) of the IT Act, which added explanation 4 to the provision and expanded its ambit with effect from 1 June 1976, could not be applied to the DTAA.
- There is a difference between copyright in an original work and a copyrighted article, and that this is recognised in section 14(b) of the Copyright Act, which refers to a "computer program" per se and a "copy of a computer program" as two distinct subjects.
- They also relied strongly upon the OECD Commentaries, which distinguish between the sale of a copyrighted article and the sale of copyright itself.
- They further argued that the doctrine of first sale/principle of exhaustion are cemented in section 14(b)(ii) of the Copyright Act, thereby making it clear that the foreign supplier's distribution right would not extend to the sale of copies of the work to other persons beyond the first sale.

Revenue contentions

The Indian Income Tax Department has characterised payments made to purchase software as royalty under section 9(1)(vi) of the Income Tax Act (the IT Act hereafter) on the basis that these payments pertain to a licence granted by the software provider to use the software and hence are a payment for the use of or right to use the copyright in the software. The Revenue relied on the following arguments:

- Section 9(1)(vi) of the IT Act provides that income by way of royalty payable by an Indian resident is deemed to

accrue or arise in India if the royalty is for the purpose of earning any income from any source in India. Explanation 2 to section 9(1)(vi) defines "royalty" as a consideration for the transfer of all or any rights (including the grant of a licence) in respect of any copyright. **The Revenue relied upon the language of explanation 2(v) to section 9(1)(vi) and stressed that the words "in respect of" have to be given a wider meaning**.

- Further, in 2012 explanation 4 was inserted in section 9(1)(vi), to clarify that the "transfer of all or any rights" included and **had always included the "transfer of all or any right for use or right to use a computer software**". In view of this, the Revenue argued that explanation 4 to section 9(1)(vi) is only clarificatory in nature and outlined the position of law that had been followed since 1976.
- The Revenue further pointed out that, since India is not a member of the OECD and had expressed its reservations on the OECD Commentary on royalty, that commentary should have no bearing on determining the characterisation of payment for software.
- On the issue of copyright, the Revenue relied upon a number of judgments in order to argue that, under section 14(b)(ii) of the Indian Copyright Act, 1957 (the Copyright Act hereafter), the doctrine of first sale cannot be said to apply insofar as distributors are concerned.

We now summarise the analysis of the SC decision.

Copyright v. copyrighted article

The SC opined that a non-exclusive, non-transferable licence, merely enabling the use of a copyrighted product, is in the nature of restrictive condition which is ancillary to such use and cannot be construed as a licence to enjoy all or any of the rights mentioned in the Copyright Act.

The transfer of copyright would occur only when the owner of the copyright parts with the right to do any of the acts mentioned in section 14 of the Copyright Act. In the case of a computer program, section 14(b) of the Copyright Act speaks explicitly of two sets of acts:

- the seven acts enumerated in sub-clause (a)[2] and
- an eighth act, selling, or giving commercial rental, or offering for sale or commercial rental any copy of the computer program.

The right to reproduce a computer program and exploit the reproduction by sale, transfer or licence is the exclusive right of the computer program's owner. The SC further held that **ownership of copyright in a work is different from ownership of the physical material in which the copyrighted work is embodied**. Transfer of the ownership of the physical substance, in which copyright subsists, gives the purchaser the right to do with it whatever they please, except the right to reproduce it and issue it to the public. A licence from a copyright owner, conferring no proprietary interest on the licensee, does not entail parting with any copyright, and is different from a licence issued under section 30 of the Copyright Act, which grants the licensee an interest in the rights mentioned in section 14(a) and 14(b) of the Copyright Act. Therefore, the payment for the software is a payment for a copyrighted article and not for any right in the copyright of the software.

Characterisation of nature of payment as goods

In respect of payments made by Indian distributors to NR manufacturers/owners, and payments made by end users in India

to foreign distributors, the Court held that in neither case is there a transfer of any copyright in the software, either to the Indian distributor or to the Indian end user, that would entail the payment of royalty. The Court relied upon its earlier judgment in Tata Consultancy: since sale of shrink-wrapped software is **in the nature of sale of goods**, the Court opined that there is no transfer of any right in the copyright when shrink-wrapped software is sold. In arriving at this conclusion, the Court went through agreements signed between the distributors in India, non-resident manufacturers and end users and noticed that they gave no right in the copyright to either the Indian distributors or the Indian end users.

Definition of royalty in the DTAAs vis-à-vis the IT Act

The definition of royalty under the DTAAs is exhaustive. The term "royalties" under the DTAAs "means" **payments of any kind that are received as a consideration for the use of or the right to use any copyright in a literary work**, while the definition of "royalty" in explanation 2 to section 9(1)(vi) of the IT Act is wider in three aspects:

1. It speaks of "consideration" but includes lump-sum consideration that would not amount to income of the recipient chargeable under the head "capital gains".
2. When it speaks of the transfer of "**all or any rights**", it expressly includes the granting of a licence in respect of such rights.
3. It states that such transfer must be "in respect of" any copyright in any literary work.

In 2012, an explanation 4 was inserted in section 9(1)(vi) to clarify that the "transfer of all or any rights" (in respect of any right, property or information) included and had always included the "**transfer of all or any right for use or right to use a computer software**". The SC opined that although explanation 4 to section 9(1)(vi) expanded the scope of royalty, the explanation's position of law relating to computer software could not possibly have existed since 1976 since the term "computer software" was first introduced to section 9(1)(vi) in 1991. Therefore, it would be ludicrous to expect that the amendment to insert explanation 4 should apply retrospectively since 1976. Before this amendment, a payment could be treated as royalty only if it involved a transfer of all or any rights in copyright by licence or similar arrangements under the Copyright Act.

The SC further held that once a DTAA is applicable, the provisions of the IT Act can only apply to the extent they are more beneficial to the taxpayer.

Since the end user receives the right to use computer software only under a non-exclusive licence, **and the owner continues to retain all the rights under section 14(b) read with sub-section 14(a)(i)–(vii) of the Copyright Act**, payments for computer software cannot be classed as a royalty.

Characterisation of payments for software under IT Act

The machinery provision in section 195 of the Act (under which tax is to be deducted at source)[3] is inextricably linked with the charging provisions contained in section 9 read with section 4 of the Act. The SC relied on the judgment in GE India on the interpretation of the language of section 195 of the IT Act,[4] where it was held that **the payer is obligated to withhold tax only if the sum payable is chargeable to tax** under the provisions of the IT Act. Since payment for software is not royalty but business income, it is not subject to tax in India unless the recipient has a permanent establishment in India.

Interpretation of tax treaties

The SC made some very interesting observations about the interpretation of tax treaties. It held that tax treaties entered by India should be interpreted liberally with a view to implementing the true intention of the parties. It opined that in all the DTAAs with which the present cases were concerned the definition of "royalties" is either identical or similar to the definition contained in Article 12 of the OECD Model Tax Convention and held that the OECD Commentary will continue to have persuasive value as to the interpretation of the term "royalties" contained in agreements based on the Convention. The SC further noted that India had taken positions about the OECD Commentary, but it and the other contracting states had made no bilateral amendment to change the definition of royalties in any of the DTAAs reviewed in the appeals; mere positions taken with respect to the OECD Commentary do not alter a DTAA's provisions, unless it is actually amended by way of a bilateral re-negotiation. Further, taxpayers in the nations governed by a DTAA have a right to know exactly where they stand under the treaty provisions. Such persons can thus place reliance upon OECD Commentary on provisions which are used without any substantial change in bilateral DTAAs. The SC noted that India had entered or amended tax treaties with several countries after expressing its reservation, yet the definition of royalty remained unchanged from the OECD Model definition. Hence, India's reservation would not apply.

Conclusion

Since the DTAA is more beneficial and would apply, there is no obligation on an Indian entity to deduct at source tax on payment to NR, as the distribution agreements/End User License Agreements in the case papers **do not convey to such distributors/end users any interest or right that would amount to the use of or right to use any copyright**. The software products sold were held to be copyrighted articles and hence goods, as a result of which the persons referred to in section 195 of the IT Act were not liable to deduct tax at source.

Editorial comments

The detailed analysis in this landmark judgment certainly gives clarity to the characterisation of payment for digital transactions, which have similar characteristics to software and which sales involve grant of a licence. However, many questions still remain unanswered after this judgment. Will the assessee be eligible to reclaim wrongly withheld tax? If no return was filed, what constitutional remedies are available to them? Taxpayers will have to look for the procedures for getting their refunds based on the facts and circumstances in each case. While the judgment settles the issue on characterisation as royalty and taxability under the Income Tax Act, taxpayers will now be posed with another question regarding the applicability of the Equalization Levy on such transactions.

REFERENCES

1. Tata Consultancy Services v. State of Andhra Pradesh, 2005(1) SCC 308.
2. The seven acts enumerated in section 14(a) in respect of literary works are:
   (i) to reproduce the work in any material form, including storing it in any medium electronically
   (ii) to issue copies of the work to the public, provided they are not copies already in circulation
   (iii) to perform the work in public, or communicate it to the public
   (iv) to make any cinematographic film or sound recording of the work
   (v) to make any translation of the work
   (vi) to make any adaptation of the work and
   (vii) in relation to a translation or an adaptation of the work, to do any of the acts in sub-clauses (i) to (vi).
3. s. 195(1) reads: "Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or **any other sum chargeable under the provisions of this Act** (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force".
4. GE India Technology Centre (P) Ltd v. CIT, (2010) 10 SCC 29.

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UN model for taxing the digitalised economy

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Background

The advent of modern Information & Communication Technologies (ICT) has significantly changed the way businesses are conducted. ICTs are the soul and backbone of modern business models (which are born digital) and for businesses going digital. While they have simplified day-to-day life in more ways than one, they have also brought complexity in determining the nexus and characterisation of income for source-based taxation, as digital businesses are mostly conducted in nebulous cyberspace. The initial debates over the taxation of the digital economy were mostly founded on economic principles; which later metamorphosed into political debate after reaching a consensus on allocation of taxing rights with a special focus on market jurisdiction. While the Pillar One and Pillar Two deliberations under the aegis of the Organisation for Economic Co-operation and Development (OECD) are still in progress, on 20 April 2021 the United Nations (UN) approved a new Article 12B of its Model Double Taxation Convention (and associated commentaries) dealing with the taxing rights of contracting states in respect of automated digital services (ADS), with particular emphasis on additional taxing rights for developing countries in which ADS providers' customers are generally located.

Meaning and scope of automated digital services

Unlike the expansive reach of the services covered in the report prepared by the OECD, *Pillar One Blueprint*, the UN has focused on a smaller subset of services defined in Article 12B as 'automated digital services'. Paragraphs (5) and (6) of Article 12B explain that two preconditions need to be satisfied for a service to be classified as ADS. Firstly, the service should be capable of being provided to the user through the internet or another electronic network and, secondly, it should involve minimum human involvement.

Further, Article 12B(6) specifically includes the following examples of ADS: online advertising services; supply of user data; online search engines; online intermediation platform services; social media platforms; digital content services; online gaming; cloud computing services; and standardised online teaching services. The commentary to this paragraph further clarifies that online sale of goods/services will not fall in the category of ADS unless the service itself is delivered online through the internet or a digital network. Although the definition of ADS and its scope under Article 12B is broadly in line with OECD's Pillar One definition of ADS, Pillar One additionally includes consumer-facing businesses (CFB) in its scope, allowing the market jurisdiction to exercise taxing rights on CFBs along with ADSs.

Taxing rights of states and tax rates

The schemes of taxation prescribed for ADS under Article 12B are broadly in line with those for dividends, interest, royalties and fees for technical services prescribed under Articles 10, 11, 12 and 12A respectively of the UN Model Double Taxation Convention.

Article 12B grants rights to tax income from ADS arising in a contracting state, both to the contracting state which receives the ADS income and to the contracting state where the ADS income arises. However, it also proposes to put a cap on the rate of tax that may be levied by the contracting state where ADS income arises, provided the resident of the state receiving ADS income is the beneficial owner of the goods or services. Although the maximum tax rate is left open for the two contracting

states to negotiate, the commentary recommends a cap of 3% or 4% of the gross ADS payment. Where the recipient is not a beneficial owner, the source country is free to impose tax as per its own domestic tax laws.

Location of the state in which ADS income arises

Income from ADS arises in a state where the person paying for ADS is resident, or in the state where that person's Permanent Establishment (PE) is situated, provided the obligation to make payment for the ADS is incurred in connection with the PE and the cost of the ADS is borne by the PE. Therefore, where payment for ADS is economically linked with the PE of the person paying for the ADS then the state where that payer is resident would not matter and in such cases location of the PE would determine the state in which the income from ADS arises. Consequently, the state in which the PE is situated would have the right to tax the income of a non-resident arising from ADS. It is important to note that the source rule under Article 12B operates on the basis of the payment for the service and not on the basis of location of the user of the services although, more often than not, the user and the payer will be based in the same location (market jurisdiction).

Formulaic net taxation

A unique feature of the scheme for taxing ADS under Article 12B is that it grants the beneficial owner of the income from the ADS an option to request the contracting state in which that income arises to tax the 'qualified profit' embedded in the ADS revenue under its domestic tax laws, i.e. at the rate provided in the contracting state's domestic law. 'Qualified profits' for this purpose, expressed as an equation, will be worked out as follows:

Qualified profit = 30% × (beneficial owner's profitability ratio[1] on revenue from ADS segment[2] × gross annual ADS revenue from the contracting state where ADS income arises)

Other provisions

To avoid double taxation, the Article provides that if a specific ADS is also characterised as a 'royalty' or a 'fee for technical services' under Article 12 or Article 12A of the Model Tax Convention then Article 12B will not apply and in such cases Article 12 and 12A will prevail. Further, in cases where the beneficial owner of the ADS revenue has a PE or fixed base in the state where the ADS income arises then the beneficial owner in the state where the income arises will be taxable under Article 7/Article 14 on a net basis.

Our comments

Simplicity and ease in administering digital taxation are the two hallmarks of the UN's approach for addressing the tax challenges of the digital economy, as compared to the complexity in establishing the new nexus and calculations prescribed under Pillar One of OECD's approach. As there is no exclusion from applicability of Article 12B of the UN Model for individual payer for ADS for personal use, as is the case with payment of fees for technical services under Article 12A of the UN Model, there would be a significant compliance burden on individual purchasers of ADS services who otherwise might not be taking action to comply. There are significant differences between the new Article 12B and OECD's Pillar One, in the scope as well as in the architecture of taxation of e-commerce/automated digital services. It would be interesting to note whether countries specially developing tax models will be inclined to adopt this new Article, or settle for the Pillar One approach, or continue to follow the unilateral approach taken under domestic tax legislation.

REFERENCES

1. Where segmental accounts are not maintained by the beneficial owner, the overall profitability ratio of the beneficial owner will be applied to determine qualified profits.
2. Where the beneficial owner of the ADS revenue is part of a multi-national group then the group's consolidated profitability ratio from the ADS segment, or the consolidated profitability ratio of the group as a whole (where segmental accounts are not prepared by the group), will be considered. However, group profitability will be considered only when the group's profitability ratio is higher than the profitability ratio of the beneficial owner of the ADS revenue.
   Where a profitability ratio is not available for the multi-national group then this option will not be available and the beneficial owner will be taxed on the gross basis explained in the text and note 1.

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Spanish tax residency in COVID times

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> *FY2020 was an unusual year, in which many individuals who are not tax-resident in Spain have faced complications in their mobility and had to stay on Spanish territory, creating issues of potential double tax residency*

The Spanish personal income tax return FY2020 campaign started in April and will end on 30 June. FY2020 was an unusual year, in which many individuals who are not tax-resident in Spain have faced complications in their mobility and had to stay on Spanish territory, creating issues of potential double tax residency.

The Spanish tax regulation provides that an individual becomes tax-resident in Spain if one of the following requirements is met:

- staying more than 183 days on Spanish territory during the calendar year. To determine total length of stay on Spanish territory, sporadic absences are included, unless the taxpayer proves tax residence in another country; in the case of countries or territories considered as tax havens, the tax authorities may require proof of residence for 183 days during the calendar year.
- that the main base of activities or economic interests is, directly or indirectly, located in Spain.

It will be presumed, unless proven otherwise, that taxpayers have their habitual residence on Spanish territory when, in accordance with the above criteria, their spouse (not legally separated) and any dependent minor children habitually reside in Spain.

Owing to the extraordinary situation faced in 2020, as a consequence of the pandemic affecting the mobility of individuals and employees, in April 2020 the Organisation for Economic Co-operation and Development (OECD) issued Guidance on tax treaties and the impact of the COVID-19 pandemic.

As a result of the legal uncertainty of the restrictions on mobility in determining tax residency, the OECD recommended that countries where tax residency is based on the criterion of physical presence should adopt a more flexible position, taking the COVID crisis into account. One such country is Spain.

Despite this recommendation a tax ruling, issued in June 2020, states that an individual who was in Spain and could not return to Lebanon during 2020 was regarded as tax-resident in Spain for spending more than 183 days on Spanish territory. Even though the COVID mobility restrictions prevented this individual from moving to Lebanon, as he had stayed more than 183 days in Spain, the Spanish Tax Administration applied local legislation directly.

In this particular case, as there is no tax treaty between Spain and Lebanon and the latter is considered by Spain as a tax haven, the Administration did not consider the tax treaty tie-breaker rules.

The Spanish tax authorities expressed their view on the impact of the mobility restrictions relating to COVID-19 in a report prepared by the General Directorate of Taxes for tax residency purposes. In this report, the Administration considers it unnecessary to introduce suspension measures for the duration of the state of alert, as it understands that conflicts of residence as a consequence of the restrictions on mobility would be resolved by application of the tie-breaker rules under the Double Taxation Conventions, and expressly adheres to the recommendations of the OECD, concluding that:

> ... where a Double Taxation Convention exists, no tax implications should arise as it is unlikely that such person will ever be considered as tax resident in Spain under the Spanish law despite the extension of their stay in Spain as a result of COVID-19 and that, in the event that they were indeed considered to be tax

residents, the criteria established to resolve situations of dual residence provided in Article 4 of the respective Double Taxation Agreement signed between the two States would be sufficient for the individual not to be considered as a resident in Spain but only in his or her original State of residence.

Another tax ruling issued in April 2021 related to the tax residence of an individual from Morocco, holding that "if due to the pandemic situation you could be considered Spanish tax resident in Spain, the tie breaker rules (permanent home available, personal and economic relations are close, habitual abode, nationality) of the tax treaty would be applicable".

The Spanish Tax Administration concludes that, even in the case of double taxation, application of these criteria makes it unlikely that a residence dispute will be resolved in favour of the state of temporary movement (Spain), since it is much more likely that a person who came from abroad has their centre of vital interests, lives habitually and is a national of their original state of residence (in this case, Morocco).

In the context described, and where a Double Taxation Agreement applies, it will be difficult for a non-resident who is forced to extend their stay on Spanish territory beyond 183 days in a year for a reason related to COVID-19 to be considered tax-resident in Spain, but maintain their original tax residence. These recommendations apply for 2020 and could be extended for 2021.

Another circumstance is where the individual has stayed on Spanish territory owing to mobility restrictions and after the restrictions are lifted the individual stays in Spain to work remotely. The Spanish Tax Administration could take into account these days of voluntary presence in Spain to determine tax residency and so residency would be regarded as determinable on a case-by-case basis.

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Planning of cross-border assignments: Income-related expenses and the progression proviso

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If an employee retains German residence during a posting abroad, they continue to be subject to unlimited tax liability in Germany. Double taxation agreements frequently prevent both states from taxing the taxpayer's wages

Cross-border employee assignments require careful planning. After three recent rulings by the German Federal Fiscal Court,[1] this becomes even clearer: depending on the structure of the employment relationship in the host country and the taxpayer's centre of life, deductibility of travel expenses or rental costs can be denied. Following a change in German travel expenses law, this article explains what needs to be considered in the case of international assignments.

If an employee retains German residence during a posting abroad, they continue to be subject to unlimited tax liability in Germany. Double taxation agreements frequently prevent both states from taxing the taxpayer's wages. In simplified terms, this results in many cases where the wage is taxed by the state in which the work is carried out. However, income that is thereby tax-exempt in Germany is regularly subject to the progression proviso.

This means that the foreign income is subject to a special tax rate: the income that is taxable in Germany is taxed at the rate that would have resulted if the income subject to the progression proviso had also been taxed in Germany. Due to the progressive income tax rate, this can result in significant additional burdens for the taxpayer.

In the process of calculating the special tax rate, all income must be determined according to German tax law. Consequently, income subject to the progression proviso may be reduced by income-related expenses. In the context of international employee assignments, for example, travel expenses or costs of double housekeeping may constitute such income-related expenses. However, following a change in German travel expenses law in 2014, the prerequisites for this have become more stringent.

Under the recent rulings, the remuneration of the seconded employees included quite considerable reimbursements of housing costs and flights home. In Germany, such reimbursements are tax-free to the extent to which they would be deductible as work-related (additional) expenses of the employee – if they were not reimbursed by the employer but claimed by the employee as income-related expenses. If these reimbursements are tax-free, this means that they are not taken into account when calculating the special tax rate under the progression proviso and thus do not increase the taxes on domestic income.

The German Federal Court, however, decided that the reimbursements at issue, for housing costs and flights home, could not be tax-free, because the expenses themselves are not deductible as income-related expenses. This results from a new legal definition of the "first place of employment".

In the past, the deductibility of such costs was dependent on the "regular place of work". In similar cases, courts had previously ruled that the regular place of work was not at the foreign host company. Since the change in law in 2014, work-related expenses for housing and travel costs may be deductible if the place of residence or the travel destination is not (at) the first place of employment.

The first place of employment is an operational facility of the employer to which an employee is permanently assigned. The court considered such assignment to have occurred in all cases, as the employees had each concluded an employment contract with the host company and were to work on site for the entire period of the contract.

The fact that the plaintiffs continued to have an employment contract with the German parent company during the

postings did not affect the Federal Fiscal Court's conclusions. Since these employment contracts were dormant, they were of no significance in determining the first place of employment.

In principle, travel and accommodation expenses may also be deductible if the destination or residence is (at) the first place of work, namely in the case of double household. One prerequisite here is that the taxpayer continues to maintain their main household in Germany. Because the plaintiffs had each moved the centre of their lives abroad, this was not the case, and therefore living and travel expenses for reasons of double household were not deductible.

In the end, in all these cases, the employers' reimbursements of housing and travel expenses were not considered tax-exempt income, so became subject in their full amount to the progression proviso. Thus, the reimbursements led to higher tax rates on the domestic income of the employees. Of course, this "specialty" of German tax law is only relevant where you have income that is taxable in Germany. One issue that needs to be borne in mind is that even if the employee gives up their domicile in the home country, the foreign income must be declared on the tax return in the year of departure and the rules explained above are applicable for this year.

The cases described show how important it is to plan cross-border postings carefully. If the taxpayer receives substantial income in their domestic country, it may make sense to temporarily give up the home residence when the progression proviso is applied to tax-exempt foreign income. On the other hand, it may make just as much sense to maintain the home residence as the main residence, to preserve the tax deductibility of work-related travel and housing expenses. In order to make secondments more attractive for employees, it can also make sense to use tax equalisation models. In any case, the tax consequences should be thoroughly examined to avoid unwelcome consequences.

REFERENCES

1. German Federal Fiscal Court, 17.12.2020, VI R 21/18; German Federal Fiscal Court, 17.12.2020, VI R 22/18; German Federal Fiscal Court, 17.12.2020, VI R 23/18.

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Proposed new tax residency rules in Australia

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Tax residency is very important for many reasons. Australian tax residents are generally taxed on worldwide income, eligible for capital gains tax discount and capital gains tax exemption on sale of their home, subject to different tax rates, levies, withholding and tax offsets. Similar to many jurisdictions, Australia operates a residence-based approach to determine the tax liability of a taxpayer.

The Australian Government handed down its 2021/2022 Budget on 11 May 2021 with proposed changes to our current residency rules for individuals, companies and other entities.

The following proposed tax residency rules are intended to apply from 1 July following the enactment of the amending legislation.

Individual tax residency rules

The Government announced in its Budget that it will replace the individual tax residency rules with a simplified and modern framework, adopting the recommendations of the Board of Taxation 2019 report *Reforming Individual Tax Residency Rules – a model for modernisation*.

The current tax residency rules for individuals in Australia are complex. An individual taxpayer is currently treated as a resident of Australia for income tax purposes if they satisfy one of the following tests:

1. a ***Resides Test*** – the taxpayer is a resident according to the ordinary meaning of the word (this is a common law test and it is the most difficult test to apply in practice)
2. a ***Domicile Test*** – the taxpayer is domiciled in Australia unless the Australian Taxation Office (ATO) is satisfied that their permanent place of abode is overseas
3. a ***183-Day Test*** – the taxpayer has been in Australia for 183 days or more, unless the ATO is satisfied that the usual place of abode is overseas and the individual does not intend to take up residence in Australia and
4. a ***Superannuation Test*** – the taxpayer is a member of certain Commonwealth government superannuation schemes.

Australia's tax residency rules rely upon a "facts and circumstances" approach which has been the subject of criticism for its reliance on qualitative (not quantitative) factors. Given the subjective nature of tax residency rules, even where the statutory tests deem residency, they contain undefined terms such as 'domicile' and 'permanent or usual place of abode' which have been the subject of judicial interpretations over many years. With the rising number of court cases dealing with individual tax residency, and particularly some recent cases such as *FCT v Pike (2020), Harding v FCT* (2019) and many more, it is clear that the current residency rules are inadequate to deal with today's modern global work practices and have imposed an unnecessary compliance burden upon taxpayers.

The proposed new individual tax residency model is based on a two-step approach as follows:

A. The primary test will be a simple "*bright line*" test whereby a person who is physically present in Australia for 183 days or more in any income year will be treated as an Australian resident for tax purposes.

B. The secondary tests will be a combination of other physical presence and measurable, objective criteria.

Individuals failing the primary (183-day) test will be subject to the secondary tests, which look for the following four objective

facts, of which any two are required to be established for an individual to be a resident:

iii. right to reside permanently in Australia (citizenship or permanent residency status)

iv. Australian accommodation

v. Australian family and/or

vi. Australian economic connections.

These proposed new rules are more objective and quantitative in nature, but still depend on each individual's circumstances.

It should be noted that these proposed new rules are to be considered alongside the impact of "tie-breaker" tests contained in double tax agreements and it is uncertain how these rules will interact with the current COVID restricted travel measures.

People who come to Australia for work need to be mindful of these proposed new residency tests when considering their potential exposure to Australian income tax.

Corporate tax residency rules

The Government announced in its last, 2020/2021 Budget that it will seek to consult on addressing uncertainty for foreign incorporated entities by introducing law amendments to provide a company incorporated offshore to be treated as an Australian tax-resident if it has a "significant economic connection to Australia".

This test will be satisfied by the company meeting the following two conditions:

- core commercial activities of the company are undertaken in Australia and
- the central management and control of the company are in Australia.

As of the time of writing, these measures have not yet been legislated.

In this Budget, the Government has announced that it will consult to extend the amendment of similar residency rules to trusts and corporate limited partnerships.

The Australian Government's move to make legislative changes to the tax residency rules has been welcomed by many as it should provide greater certainty and lower compliance costs when it comes to determining Australian tax residency status for both individual and non-individual taxpayers.

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DTAA between Israel and United Arab Emirates

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On 31 May 2021 the Israeli Finance Minister signed the double taxation treaty between Israel and the United Arab Emirates. The tax treaty will join Israel's tax treaty network, which includes 58 conventions, and is the first tax treaty signed after the normalisation agreements with the UAE. The treaty is in line with the Multilateral Instrument (MLI) to which both Israel and UAE are signatories.

The double taxation treaty is an agreement designed to prevent a situation in which businesses operating in two countries will have to pay double tax – in both. In this type of agreement the states reach an agreement on the division of rights to tax various types of income, and it allows greater ease of doing business between the countries, provides certainty to investors and encourages economic cooperation between countries.

The tax treaty just signed is based on the OECD Model Convention. It includes clauses relating to non-discrimination, information exchange, prevention of business abuse and it also provides reduced tax rates. For example, it has been determined that the rates of withholding tax in the country of residence of an interest payer are zero, or limited to 5% if the interest is paid to a government or certain government entities or a pension fund, and to 10% in any other case.

In the case of a dividend, the tax deduction rate in the country in which the company paying the dividend is resident is zero, or limited to 5% if the dividend is paid to a government or certain government entities or a pension fund, and to 5% or 15% for private investors. The Convention also defines that the rate of withholding tax in the country of residence of the royalty payer is limited to 12%.

The convention must go through ratification processes in the Knesset and the government, is expected to be approved in 2021, and its provisions are expected to apply in early 2022.

> *The tax treaty will join Israel's tax treaty network, which includes 58 conventions, and is the first tax treaty signed after the normalisation agreements with the UAE*

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The Next Step

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