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Alternative C: Partnerships

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Today's topics

- Brief overview of OECD guidance on application of treaties to partnerships
- A look at the treatment in Australia, Hong Kong, and Singapore
- Application for a US Multinational

Overview of OECD guidance

OECD Model – some key provisions (1/2)

- Article 1: Convention applies to “persons” who are “residents” of one or both of the Contracting States
- Article 3(1)(a): the term “person” includes an individual, a company and “any other body of persons”
- Article 4(1): the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature

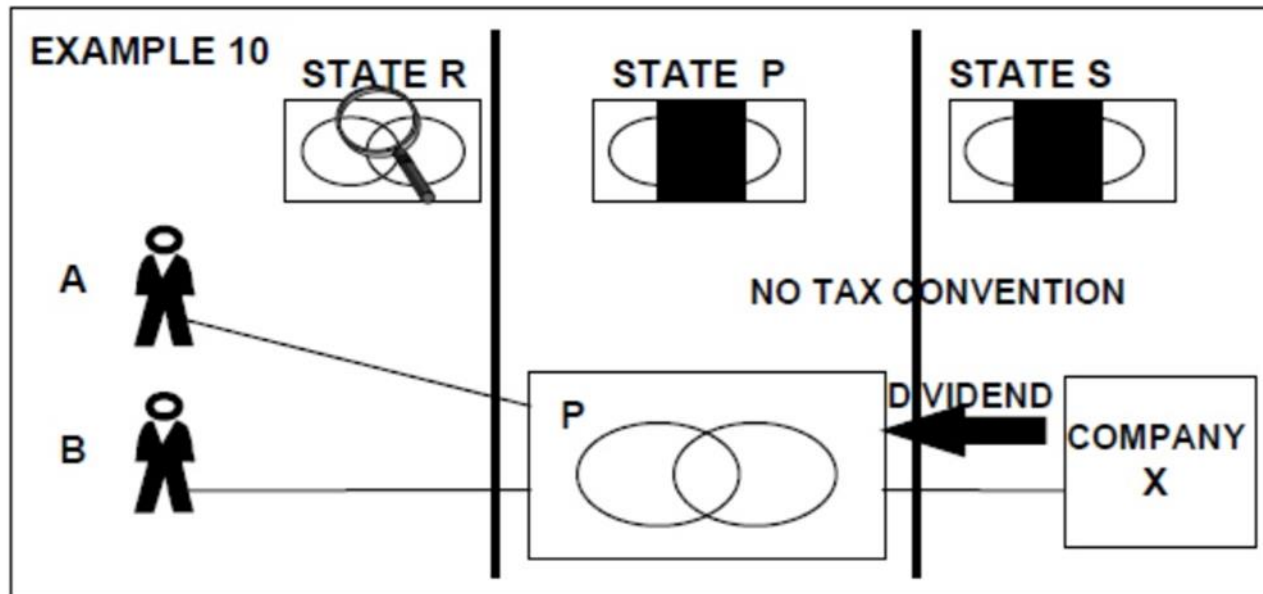
OECD Model – some key provisions (2/2)

- Article 3(1)(d): the term “enterprise of a Contracting State” means “an enterprise carried on by a resident of a Contracting State”
- Article 7(1): “Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.”
- Articles 10, 11, and 12: limit the source State tax on dividends, interest, and royalties where the “beneficial owner” is a “resident” of the other Contracting State

OECD Commentary on partnerships

- Principle based on 1999 Partnership Report (paragraph 6.3 of Commentary on Article 1):
 - “the State of source should take into account, as part of the factual context in which the Convention is to be applied, the way in which an item of income, arising in its jurisdiction, is treated in the jurisdiction of the person claiming the benefits of the Convention as a resident.”

OECD Partnership Report, Example 10



Conclusion: Partners A and B should get benefits of R-S Treaty

OECD Hybrids Final Report (2015)

- Cites shortcomings of 1999 Partnership Report:
 - Did not expressly address the application of tax treaties to entities other than partnerships
 - Some countries have found it difficult to apply the conclusions of the Partnership Report
- Proposed solution:
 - Include a new provision in the Model to ensure that income of transparent entities is treated, for the purposes of the Convention, in accordance with the principles of the Partnership Report

OECD Hybrids Final Report proposed solution

Proposed new Article 1(2):

For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Australia

General rules

- General partnerships are tax pass through
- Each partner of a general partnership is taxed on their proportionate share of the partnership's net income
- Limited partnerships are deemed to be companies subject to 30% corporate tax on partnership net income
- Partners in a limited partnership are deemed to be shareholders, taxed on partnership 'dividends' with a tax credit for corporate tax paid on partnership profits

Domestic law exceptions

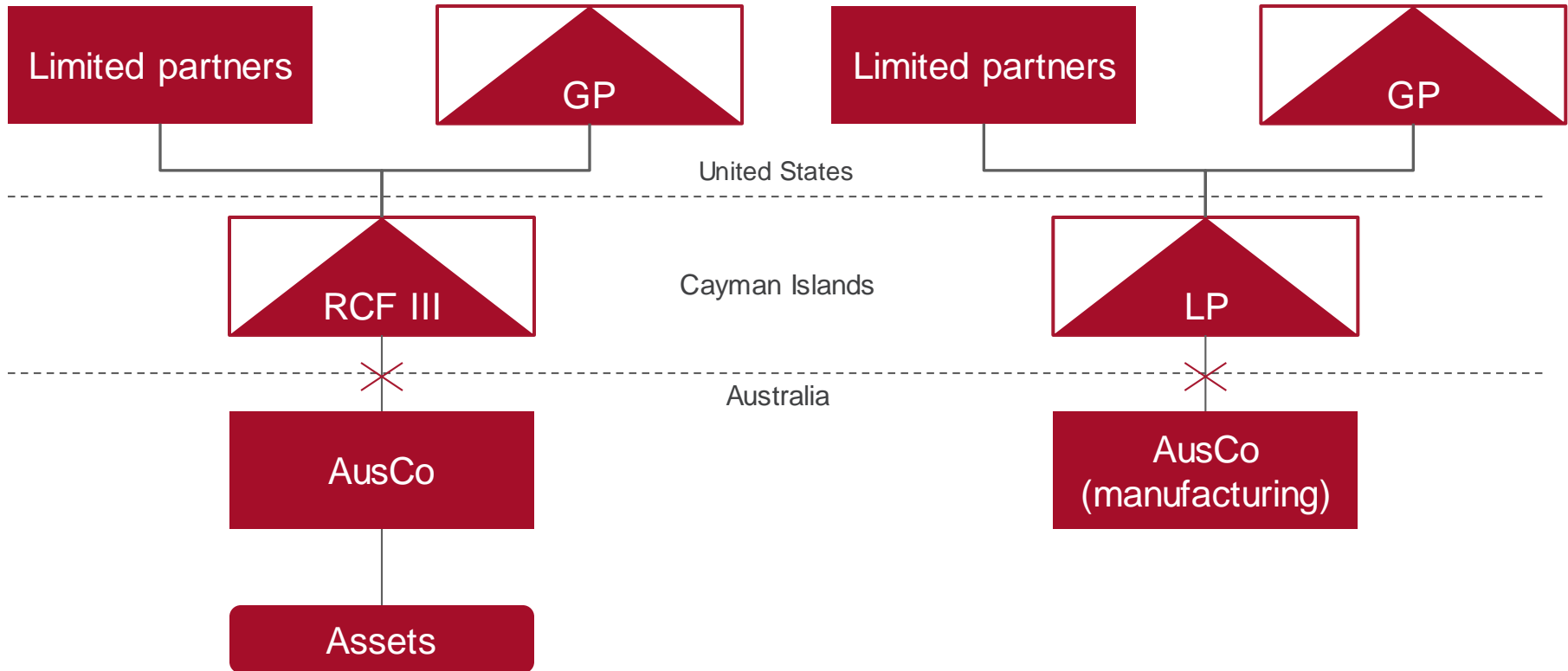
- Australian controlled foreign partnerships are taxed on a pass through basis (rather than the CFC rules)
- Australian partners in a foreign limited partnership (not controlled from Australia) can elect to be taxed on a pass through basis regarding their partnership interest
- Venture capital limited partnerships and related partnerships

Treaty context

- Australia has not lodged an observation or reservation indicating Australia's position differs from the Article 1 OECD Commentary
- Examples of application:
 - Tax Determination 2011/25: Article 7 applies to profits of a fiscally transparent LP
 - ATO ID 2013/58: applying Article 11 to interest income of a disregarded US LLC with a US resident shareholder
 - ATO ID 2010/188: confirming treaty benefits to the shareholder in a disregarded US LLC
 - ATO ID 2002/1088: confirming treaty benefits to a German investment fund

RCF case

TD 2011/25



RCF

- RCF is possibly inconsistent with Article 1 Commentary
- Court questioned flow-through treatment – and how paragraph 6.3 and 6.4 of the OECD Commentary applies.
- Court concluded the Aus/US treaty did not apply
- Arguably, the case can be distinguished on the basis that the assets of the partnership were principally real property
 - TD 2011/25 now amended to confirm this: Article 7 applies to profits of a fiscally transparent LP if profits are not dealt with under another Article (such as Article 13)

What then, going forward?

- High Court refused taxpayer’s special leave to appeal:
 - “[the treaty] provides **relief** to persons who are residents of the United States and... that can **operate at both the partnership level and the partner level**”
 - “treaties are **not designed to tell the contracting state who they should tax ...**”
(Richmond SC, for the Commissioner)
 - “**a problem between the relationship between the Assessment Act and the treaty ...** fixing the Assessment Act to make it accommodate and accord with the treaty, rather than saying that it is a bonus which the taxpayers in this case are seeking to obtain”
(Slate SC, for the taxpayer)
- The new Australia/Germany treaty gives effect to the OECD/G20 BEPS recommendations

Hong Kong

Domestic Law

- Assessable profits of a partnership (general / limited partnership) are computed in one sum
- Tax is charged in the partnership name as though the partnership is a separate legal person or assessable entity
- Profits tax liability is calculated by applying the standard tax rate (i.e., 15%) (partnership of individuals) / corporate tax rate (i.e., 16.5%) (partnerships comprised of corporations) to the total assessable profits of the partnership

Domestic Law

- If a partnership is comprised of both individuals and corporations / some partners have tax losses b/f / an individual partner elects for personal assessment;
- partnership's tax liability is calculated by determining the tax liability of each partner individually
 - Step 1: apportioning the partnership's assessable profits in profit sharing ratio
 - Step 2: deduct any applicable losses b/f
 - Step 3: apply the applicable tax rate (individual or corporation taxpayer)

Domestic Law

- Partners to decide how the tax liability of their partnership is to be divided and allocated between them
- No special incentive / exemption for partnership in Hong Kong

Tax Treaty Context

- 35 comprehensive double tax treaties (33 are currently in effect)
- Hong Kong has not lodged an observation or reservation indicating Hong Kong’s position differs from the Article 1 OECD Commentary
- Inland Revenue Department generally applied treaties in accordance with principles in Article 1 OECD Commentary
 - taxable unit vs fiscal transparency
 - treaty entitled if “liable to tax”

Tax Treaty Context – Example (HK & China DTA)

Article 1

- This Arrangement shall apply to **persons** who are residents of One Side or both Sides

Article 3

- 1(3) - The term “**person**” includes an individual, a company, a trust, a **partnership** and any other body of persons.

Article 4

- the term “resident of One Side” means..in the case of [HK]..
(iv) any other person constituted under the laws of [HK], or if constituted outside [HK], being normally managed or controlled in [HK].

DIPN 44

- In Hong Kong, **partnerships** are the mode most likely to be encountered [in para 1(2)(iv) of Article 4]....In determining whether a trust, **partnership** or any other body of persons is normally managed or controlled in Hong Kong, the criteria are the same as those adopted in determining the resident status of a company.

Tax Treaty Context – Certificate of resident status



INLAND REVENUE DEPARTMENT

Tax Treaty Section
Revenue Tower
5 Gloucester Road
Wan Chai, Hong Kong
GPO Box 132, Hong Kong
Telephone No. 2594 1500

Application for Certificate of Resident Status Company, Partnership, Trust or other Body of Persons

To : The Hong Kong Competent Authority

IRD File No. (if any) _____

I submit an application for a certificate of resident status for the purpose of claiming tax benefits under the Agreement between the Hong Kong Special Administrative Region of the People's Republic of China and _____
(state the name of "the Contracting Party") for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income / Income and Capital ("the Agreement"). (Note 1)

(1) Calendar Year(s) of Claim _____

(2) Particulars of Applicant

(a) Name of Company / Partnership / Trust / Body of Persons _____

(b) Particulars of Establishment of Company / Partnership / Trust / Body of Persons (Note 2)

(i) Place where it was incorporated / established _____

(ii) Date on which it was incorporated / established _____

(iii) Hong Kong Business Registration Number (if any) _____

(iv) Registration Number with the Hong Kong Companies Registry (if any) _____

(c) Business Address in Hong Kong _____

(d) Postal Address in Hong Kong _____

(e) Serial Number of the latest certificate of resident status issued (if any) _____

(f) Name and Telephone Number of Contact Person in Hong Kong _____

Singapore

Singapore

- Singapore-registered partnerships
 - Generally tax transparent.
 - Types: general partnerships, limited liability partnerships (**LLP**), limited partnerships (**LP**).
- While the partnership is required to file tax returns, the partners are subject to Singapore tax on their share of the profits, and on their individual residency status.
 - E.g., withholding tax on non-resident partners' share of certain payments to the partnership. C.f.: admin concession for partnerships with one resident partner.

Singapore

- Singapore-registered partnerships
 - Not a “person” or “body of persons” under Singapore law.
 - Will not qualify as a Singapore resident person or be issued a certificate of residency (**COR**) by the IRAS.
 - However, Singapore resident partners may apply for a COR.

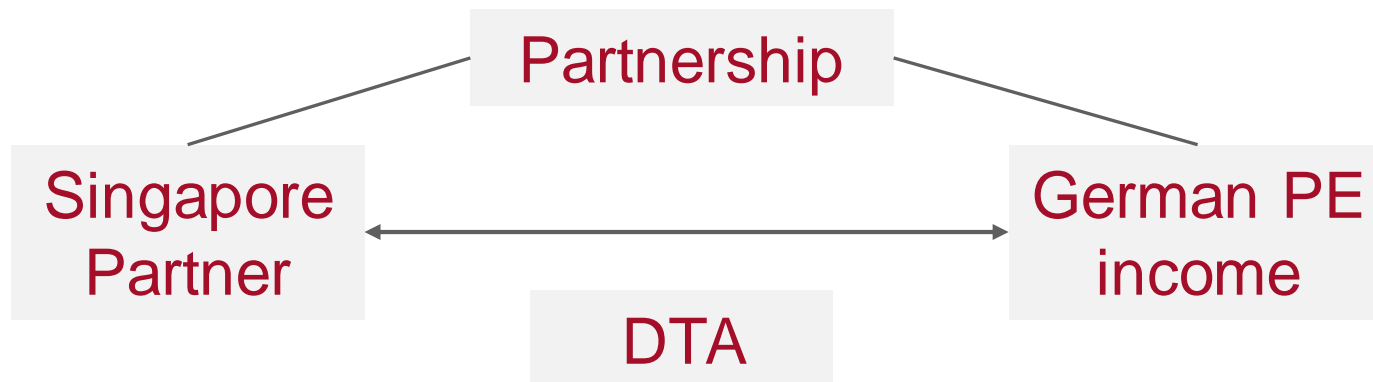
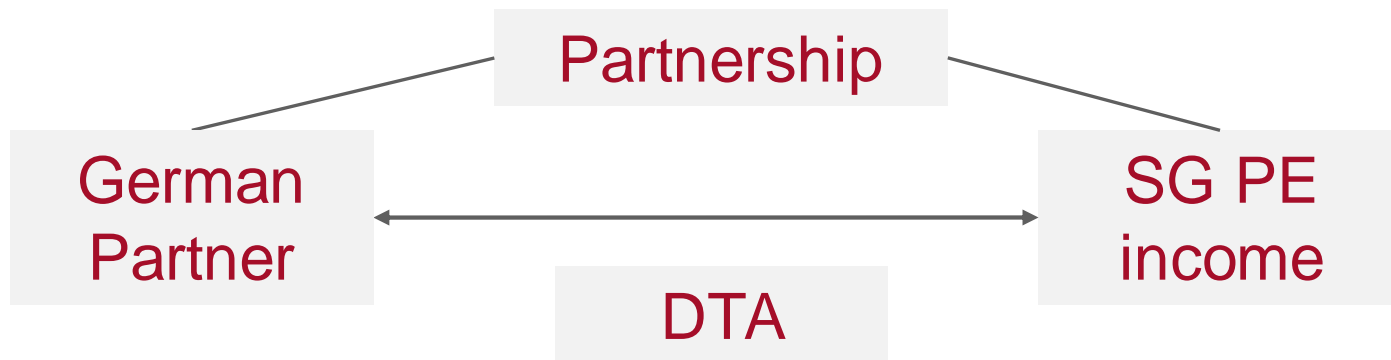
Singapore

- Foreign-registered partnerships
 - E.g., US LLCs, Dutch CVs
 - Unclear how foreign partnerships are classified and whether tax transparent treatment will apply.
 - Is it a “person” or “body of persons” that qualifies as a resident for treaty purposes?
 - What about hybrid partnership entities?
 - Singapore may follow the foreign classification and tax treatment of the partnership in its country of establishment.

Singapore

- Certain Singapore tax treaties specifically provide for treaty benefits to apply to partners and partnerships.
 - E.g., the Germany-Singapore tax treaty
 - Article 7(7) provides that the business profits of partners resident in one country are only taxable in the other country to the extent that the profits are attributed to a PE in the other country, i.e., a “look-through” is applied to the partnership.
 - Article 25 on non-discrimination applies to German and Singapore nationals (which are defined under Article 3(h) to include partnerships of either countries).

Illustration of Article 7(7) of the Germany-Singapore treaty



Singapore – Three problem scenarios in the treaty context:

1. Singapore partner of a Singapore-registered partnership derives income from a non-Singapore source.
 - As the partnership is not a legal person, IRAS will not grant a COR to the partnership.
 - However, IRAS may issue a COR to any partner who is a Singapore resident.
 - Will a foreign tax authority accept the COR and apply the treaty to the partnership's income, or the partner's share?
 - Will foreign tax credits be available to the Singapore partner on the foreign tax levied at the partnership level?

Singapore – Three problem scenarios in the treaty context:

2. Singapore partner of a foreign partnership derives income from a third country.
 - Will IRAS apply a “look-through” to the Singapore partner?
 - Will IRAS issue a COR to the Singapore partner, and will this COR be recognised in the third country?
 - Will foreign tax credits be available to the Singapore partner on foreign tax (if any) paid in:
 - a) the third country;
 - b) the country of establishment of the foreign partnership?
 - Will the domestic exemption on foreign sourced branch profits apply to partnership profits received by the partner?

Singapore – Three problem scenarios in the treaty context:

3. Foreign partner (resident of a treaty partner country) derives business income from Singapore through a:
 - A. Singapore partnership
 - Will the foreign partner qualify as a resident of the treaty partner country and avail itself under the treaty?
 - B. Foreign partnership
 - Will there be a “look-through” to the foreign partner?
 - Will treaty benefits be available to the partner / partnership (assuming a treaty exists with the partnership’s country of establishment)?

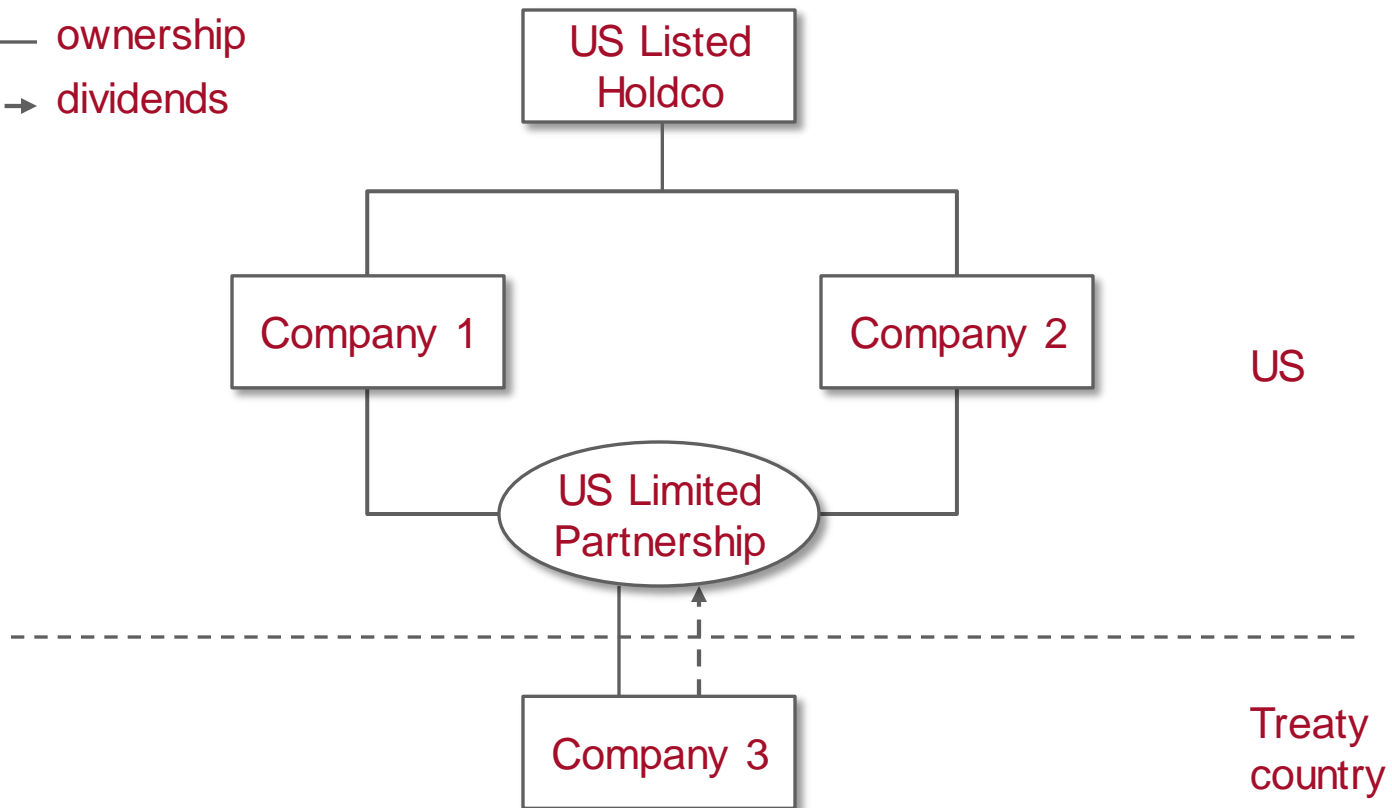
Issues from a US
perspective

Setting the Stage

- Practical issues from perspective of US MNC with operations in Asia
- Cross-border issues involving non-resident partnerships
 - US partnership
 - partnership established in non-DTA country
- The intersection of domestic law and double tax agreements
 - complex and difficult problems

US Partnership Structure

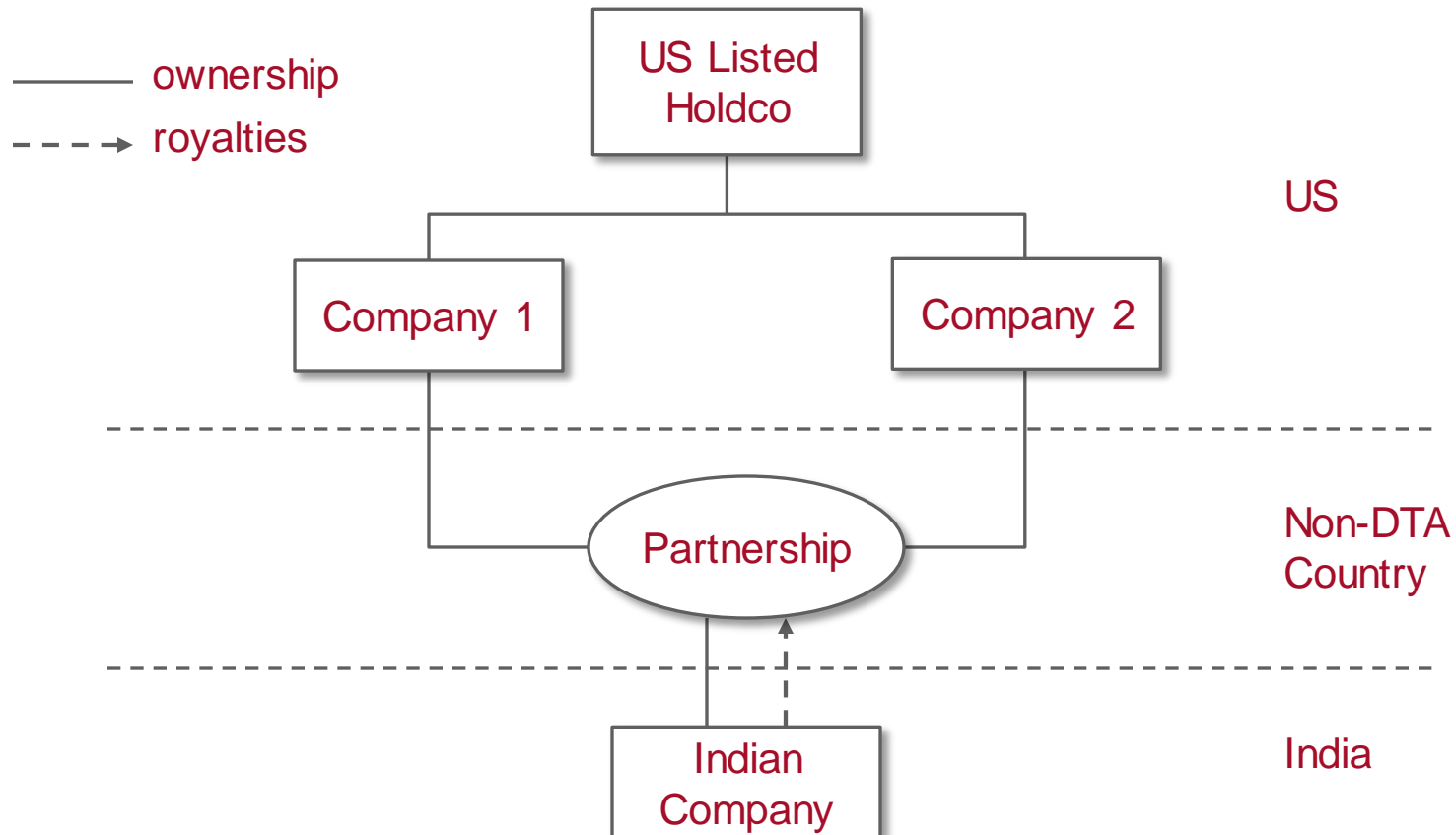
— ownership
- - - -> dividends



Issues Created by US Partnership

- US DTA re dividend WHT
 - 0% if own > 80% interest and satisfy LOB
 - 5% if own > 10% interest
 - but “...the person who is beneficially entitled to the dividends is a company...”
 - 15% if a US resident beneficially entitled to the dividends
- Is the LP treated as company in the US – does it need to be a taxable unit to qualify as a company under the DTA?

Partnership Established in Non-DTA Country



Issues Created by Partnership in Non-DTA Country

- Indian domestic tax treatment of partnership
 - separate taxable entity
 - tax residence certificate required for DTA protection
- India-US DTA
 - Applicability?
 - Previously partnership had been assessed as PE under DTA

Final Section 956 Partnership Regulations

- Retains partnership anti-abuse rule. U.S. property held by a partnership controlled (applying attribution rules) by a CFC is deemed held by CFC if principal purpose of **creating, organizing, or funding by any means** the partnership is to avoid section 956
- Property held by a partnership is attributed to partners - but look to liquidation value of partner's interest to determine amount attributed
- Obligation of foreign partnership treated as obligation of each partner to extent of partner's share (based on liquidation value) of obligation **subject to "but for" distribution rule**

Notice 2015-54

- If US transferor contributes property with built-in gain to partnership in which a related foreign person is partner, gain will be recognized unless:
 - Partnership adopts remedial allocation method for built-in gain with respect to contributed property (and subsequently contributed built-in gain property);
 - Partnership allocates all items with respect to contributed property in same proportion each taxable year;
 - Certain reporting requirements are satisfied; and
 - US transferor recognizes built-in gain upon acceleration event.
- Section 482 and penalty provisions apply to controlled transactions involving partnerships

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