BAKER & MCKENZIE

32nd Annual Asia Pacific Tax Conference

10 – 11 November 2016

JW Marriott Hotel Hong Kong

Tax Treaties

Recent Cases from Around the World

Chair: Thomas Linguanti, United States

John Walker, Australia
Jane Tang, China
Guillaume Le Camus, France
Peter Tan, Singapore
Matthew Lovatt, London

Australia and New Zeland

Tech Mahindra Limited v FCT [2016] FCAFC 130

- Company resident in India, which provided IT services to Australian clients from both a PE in Australia and from India, was liable to tax in respect of some of the income derived from the services provided from India ("Indian services"), under the Aus-India DTA
- Some of the Indian service payments in this case constituted "royalties" for the purposes of Article 12(3)(g) of the DTA, as:
  - technical knowledge or technology is only 'made available', and payment only constitutes a royalty under the first limb of Artivcle 12(3)(g) where there is a transfer of knowledge; *however*
  - the 'development and transfer' limb of Article 12(3)(g) is satisfied where technical services are provided that consist of the development and transfer of a technical plan or design, including software design and customisation of existing software applications

Tech Mahindra Limited v FCT [2016] FCAFC 130

- Court held that payment for certain categories of Indian services provided to Australian customers constituted “royalties” under Article 12 and therefore were liable to Australian tax.
- These payments were not attributable to the company’s PE in Australia.

Does Art 7 (business profits article) take priority over Art 12 (royalty article) by virtue of Art 12(4)? Relevant DTA provisions:

- Art 12(4):
  - "The provisions of paragraphs (1) and (2) shall not apply if the person beneficially entitled to the royalties, being a resident of one of the Contracting States (*India*), carries on business in the other Contracting State (*Australia*), in which the royalties arise, through a PE situated therein….and the property, right or services in respect of which the royalties are paid or credited are effectively connected with such a PE or fixed base. In such a case, the provisions of Article 7 shall apply."

Relevant DTA provisions (cont'd)

- Art 7(1):
  - "The profits of an enterprise of one of the Contracting States (*India*) shall be taxable only in that State (*India*) unless the enterprise carries on business in the other Contracting State (*Australia*) through a PE…the profits of the enterprise may be taxed in the other State (*Australia*) but only so much of them as is attributable to:
    - that PE; or
    - sales within that other Contracting State (*Australia*) of goods or merchandise of the same or a similar kind as those sold, or other business activities of the same or a similar kind as those carried on, through that PE)" (*Limited force of attraction rule*)

Relevant DTA provisions (cont'd)

- Tech Mahindra's arguments:
  - "Art 12(4) gives priority to Art 7- Australia's right to tax the income from Indian Services falls exclusively under Art 7. No need to address the question of whether the payments for Indian Services constitute royalties.
  - Under the "limited force of attraction rule", Indian Services income not subject to Australian tax because the business activities were carried out outside Australia in India.

Relevant DTA provisions (cont'd)

- Commissioner's arguments: (upheld by the Court)
  - Art 12(4) gives priority to Art 7 only where- the payments constitute royalties as defined in Article 12(3), **and** there is an effective connection between the payments and the Australian PE.
  - In this case, the payments for Indian services were not attributable to Australian PE. Therefore Art 12(4) does not apply, and payments are taxed under Art 12 instead of Art 7.

Seven Network Limited v FCT [2016] FCAFC 70

- Seven Network entered into a Signal Utilization Deed Payments with the IOC for the Olympic broadcase rights.
- Seven made payments to the IOC for the "use" of the "ITVR Signal", which was defined as "the international television signals (picture and sound), to be produced by the host broadcaster". The live ITVR fed by the host broadcaster to Seven by means of copper coaxial cable, which Seven then used to make broadcasts of the Olympic Games in Australia.
- Art 12(3) of the Aus/Swiss DTA provides:
  - *"The term 'royalties' in this Article means payments (including credits), whether periodical or not and however described or computed, to the extent to which they are consideration for the use of, or right to use, any copyright … or other like property or right …"*

Seven Network Limited (cont'd)

- Seven argued that the payments to the IOC were made in consideration for the right to access and use a live stream of encoded data, being the ITVR Signal. The nature of the ITVR Signal was not an "article or thing" in which visual images and sounds could be embodied.
- Court found in favour of Seven and held that copyright does not exist in a digital data signal, and did not attract copyright protection. Therefore these payments were not "royalties" under the Aus/Swiss DTA.
- Users and developers of content using digital technology should check whether they are protected by IP legislation.

11

Chevron Australia Holdings Pty Ltd v FCT [2015] FCA 1092

- Transfer pricing (TP) implications of an intercompany loan between an Australian company and its US subsidiary
- Court held that the entities were not dealing with each other at arm's length
- Court rejected taxpayer's argument that the TP rules in Div 13 ITAA 1936 and the cross-border TP rules in Div 815 were constitutionally invalid
- Court ruled that Art 9 of the US DTA did not confer a separate and independent power to tax, a DTA is not a grant of stand-alone taxing power

12

Chevron Australia Holdings (cont'd)

- Statutory hypothesis test under Div 13 must include what has been shown to be relevant in the market/industry in question.
- The correct perspective is that of a commercial lender, the court looked at how a commercial lender would appraise the borrower's creditworthiness.

13

Chatfield & Co Limited v Commissioner of Inland Revenue [2016] NZHC 1234

- Chatfield acted as tax agents for various companies which were under investigation by the Korean tax authorities (NTS). The NTS asked the Commissioner to obtain and provide information relating to the Companies, pursuant to the Korean/NZ DTA (which the Commissioner complied with).
- Chatfield tried to obtain copies of those documents provided by the Commissioner.

14

Chatfield & Co Limited (cont'd)

- Court held that documents exchanged between tax authorities pursuant to a DTA , including the original request received by the Commissioner from NTS, is confidential.
- Court held that section 81 of the Tax Administration Act 1994 governs the confidentiality of these documents.

15

Michael William Diamond v Commissioner of Inland Revenue [2015] NZCA 613

- Mr Diamond was a New Zealand citizen who left to work as an overseas security consultant in 2003 (and continues to live overseas). Mr Diamond was separated from his wife at the time of leaving (and later divorced) and has children. His ex-spouse and children remained in New Zealand. He also holds New Zealand property investments (including some jointly with his ex-wife).
- The Commissioner sought to treat him as tax resident due to ownership of a New Zealand rental property which, in the Commissioner's view, amounted to a "permanent place of abode" (PPOA) in NZ.

16

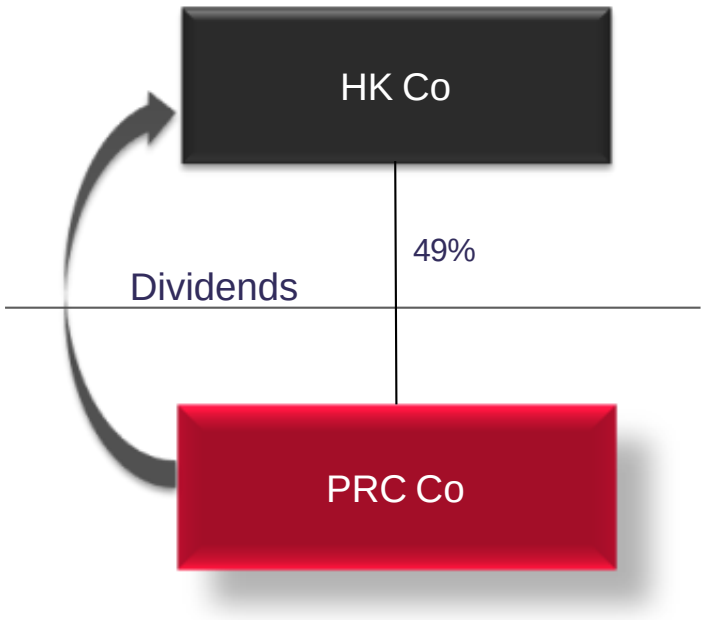
Michael William Diamond (cont'd)

- The Commissioner argued that a PPOA arose as Mr Diamond could live in the property. This was regardless of whether it was his home or whether he had actually lived there previously.
- The Court found that a New Zealand property which a person owns, but has never lived in, nor intends to live in, cannot be the foundation of their PPOA. Mr Diamond had insufficient connection to New Zealand for him to have a PPOA and be tax resident in NZ. He was therefore not subject to tax in New Zealand on his worldwide income.

17

China

Wuzhong Case: Hong Kong Company Denied Reduced Withholding Tax Rate for Dividends

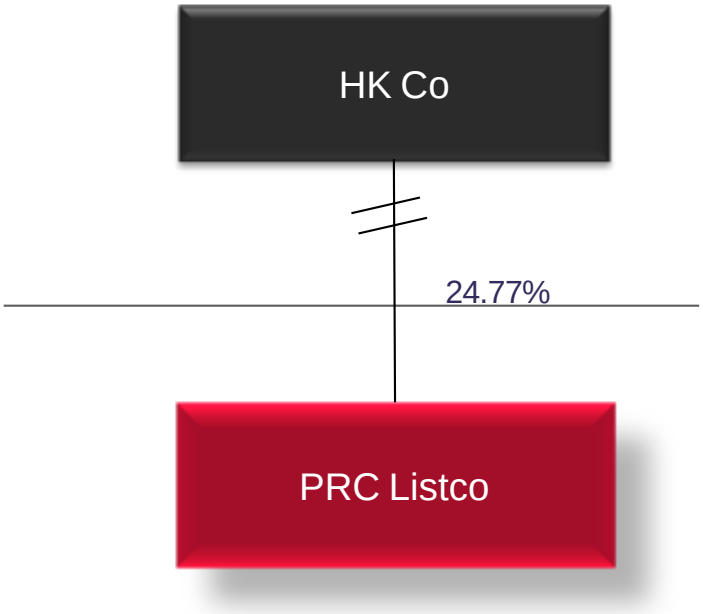


- RMB7.84 million collected in EIT
- Tax bureau “reminded” PRC Co that it has large amount of distributable profits and HK Co should pay WHT on its dividend income
- HK Co holding 49% equity applied for reduced WHT rate of 5% under the China-HK DTA

Wuzhong Case (Cont'd)

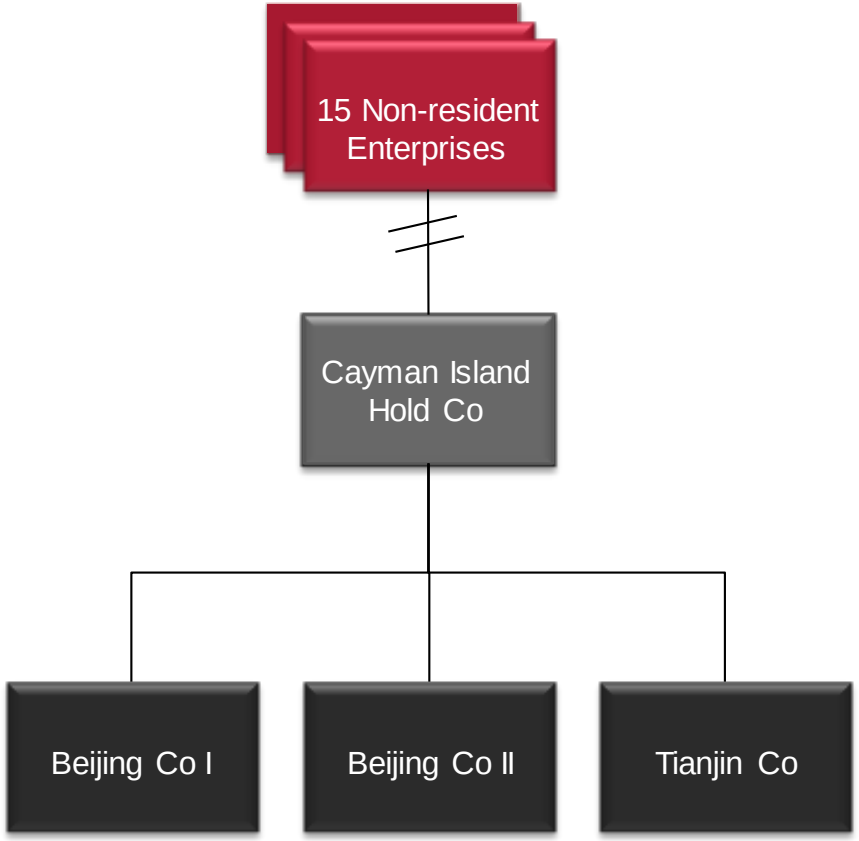
- Tax bureau decided HK Co is a conduit company and fails the "beneficial owner" requirement because:
  - HK Co could not provide a HK TRC
  - HK Co's main income was dividend
  - HK Co conducted almost no business activities and therefore incurred almost no operational expenses
  - HK Co's assets, staff and operations were not commensurate with its income

Huzhou Case: Capital Gains Tax Exemption Denied for Failing "Beneficial Ownership" Requirement



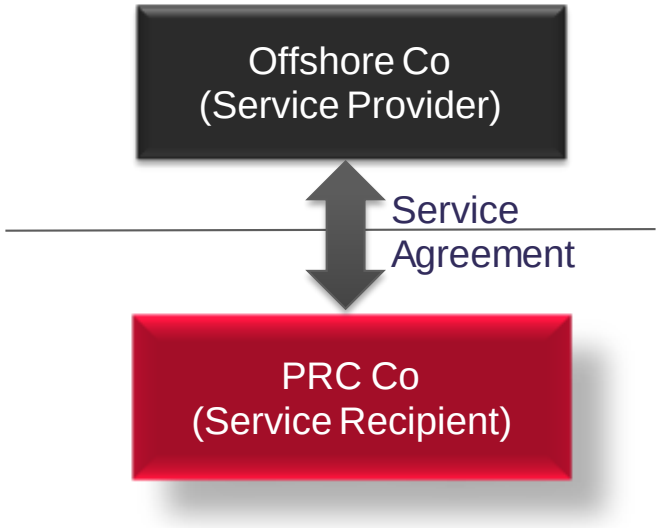
- RMB77.79 million collected in EIT
- Tax bureau saw PRC Listco public announcement on the sale
- HK Co claimed exemption from EIT on capital gains under China-HK DTA
- Tax bureau asserted that HK Co needs to satisfy "beneficial ownership" requirement to enjoy the exemption
- HK Co unable to prove that it had substantive operations

Haidian Case: 15 Non-resident Enterprises Taxed on Indirect Transfer



- RMB1.2 billion collected in EIT
- Transferors filed voluntary reports of the sale to the tax bureau
- 3 of the transferors were from treaty jurisdictions (Luxembourg, Singapore and Mauritius) with capital gains tax exemption for less than 25% shareholding
- Treaty safe harbor was not allowed
- Beneficial ownership requirement?

Nanjing Case: Technical Service PE



- RMB5.89 million in EIT and RMB31 million in IIT collected
- PRC Co was a manufacturer and received technical support services from Offshore Co with respect to certain production equipment
- Tax bureau noticed accumulated service fee payments of Euro22.3 million from tax recordal information submitted for outward remittance

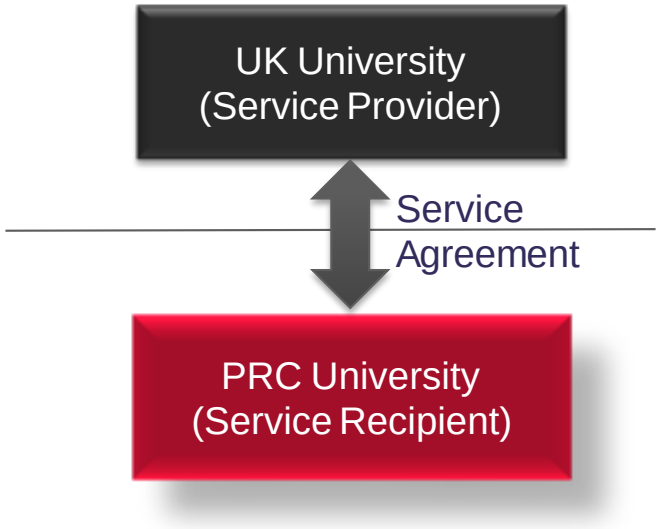
Nanjing Service PE Case (Cont'd)

- PRC Co initially denied that Offshore Co sent employees to China. Tax bureau proved presence of employees by:
  - Supplemental agreement term on personnel allocation
  - Interview with PRC Co business and HR personnel
  - On-site visit when foreign company employee was present
- Tax bureau asked for list of employees providing services in China and time period. Verified against selected passports
- Exceeded time threshold to result in service PE
  - EIT collected at 15% deemed profit rate
  - Payroll cost of relevant employees deemed to be borne by the PE. IIT collected from relevant employees
  - Did not collect turnover tax

Beijing Service PE Cases

- Case 1: RMB23 million tax and late payment surcharges; Case 2: RMB40 million tax and late payment surcharges
- Focused audit effort of Beijing local tax bureau on IIT
- Sino-foreign joint ventures in car manufacturing, offshore shareholder sent employees to China to provide technical and after-sales support over multiple projects
- Each employee did not spend more than 183 days in China, but collectively exceeded 183 days / 6 months in China
- Constituted service PE of offshore parent
  - Employees' salary deemed to be borne by PE
  - No treaty exemption. Subject to IIT irrespective of time period spent in China and offshore salary payment
  - Data exchange to state tax bureau to follow up on EIT and turnover tax?

Ningbo Case: UK University Taxed on Income from Sino-foreign University



- RMB10.88 million collected in EIT
- Well-known university, UK university had not paid any tax, became audit target
- Provided teaching and management staff, teaching materials and assessments, administrative systems

Ningbo Case (Cont'd)

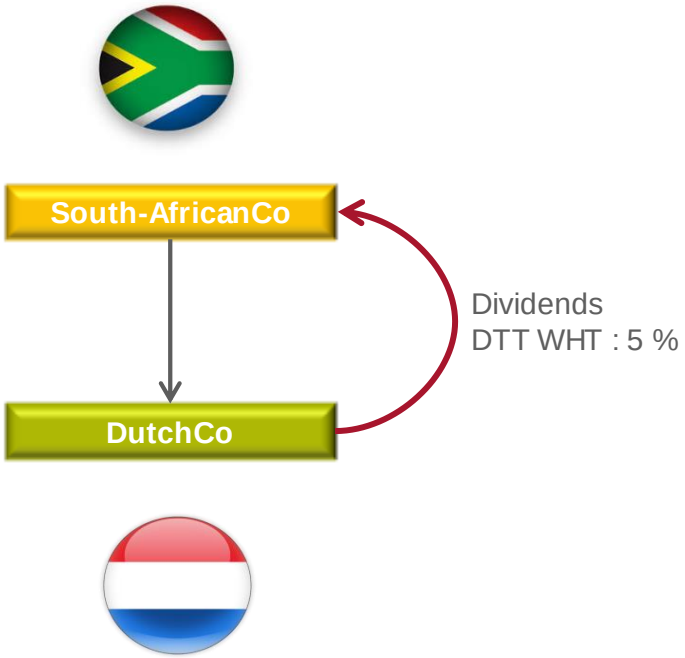
- Quality guarantee fees
  - Provision of "proprietary technology" and related guidance and support services to ensure international quality
  - Mixed royalty and service income, examine contents and charges of each project and records of onshore/offshore services
- Salary of teaching and administrative staff
  - Staff presence results in service PE despite concurrent PRC employment agreements with the PRC University
  - UK University argues no attributable profits as simple reimbursement of payroll cost
  - Tax bureau applied deemed profit taxation at 15% deemed profit rate because UK University cannot provide accurate accounts and supporting documents for the PE

Ningbo Case (Cont'd)

- Quality guarantee fees
  - Provision of "proprietary technology" and related guidance and support services to ensure international quality
  - Mixed royalty and service income, examine contents and charges of each project and records of onshore/offshore services
- Salary of teaching and administrative staff
  - Staff presence results in service PE despite concurrent PRC employment agreements with the PRC University
  - UK University argues no attributable profits as simple reimbursement of payroll cost
  - Tax bureau applied deemed profit taxation at 15% deemed profit rate because UK University cannot provide accurate accounts and supporting documents for the PE

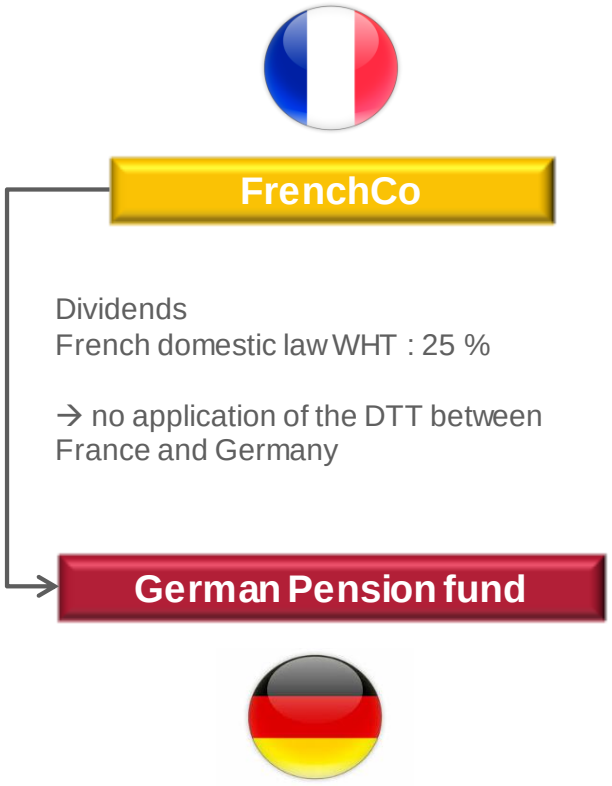

France

I. MFN clause (Dutch district court, October 29th, 2015)



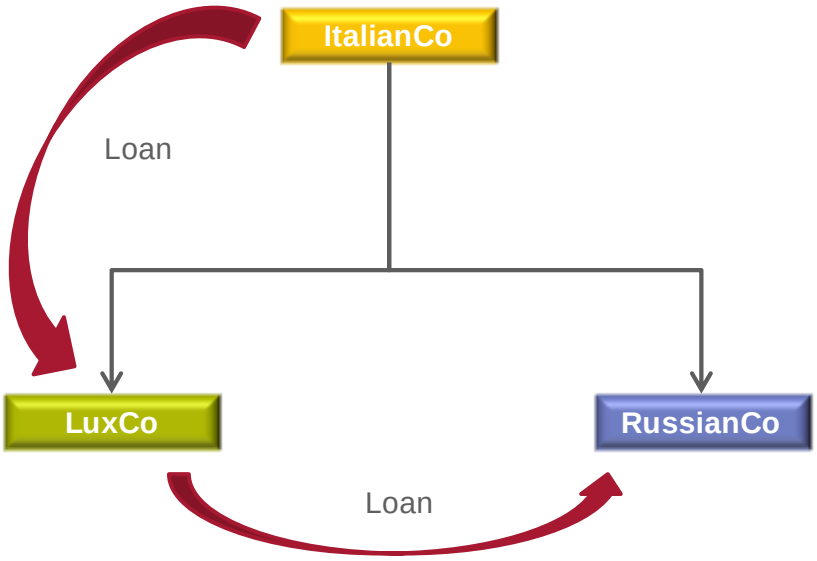
- Under the NL-SA tax treaty, dividend distributions are subject to a 5% WHT if (i) the recipient qualifies as a beneficial owner and (ii) holds more than 10% of the shares of the company paying the dividend;
- Most favored nation clause (MFN) in the DTT as amended by a protocol in 2008:
  - Automatic application of a lower WHT rate if SA and a third country conclude a treaty which provides for a lower WHT rate or an exemption;
  - Application of the MFN clause only if the more beneficial tax treaty is concluded after the date of the NL-SA DTT.
- The DTT between SA and Sweden was amended through a protocol in 2012 that introduced a MFN clause and contained to limitation regarding the date on which the more beneficial tax treaty with a third State was concluded;
- The DTT between SA and Kuwait executed after the NL-SA treaty provides for an exemption of WHT;
- Therefore, the court ruled that dividends paid under the SA-SW treaty, and consequently also under the SA-NL treaty, should be exempt from WHT.

II. Can a tax exempt entity be resident for treaty purposes? (French administrative Supreme Court, November 9th, 2015)



- The Geman Pension fund claimed the benefit of the 15% WHT provided by Article 9 of the DTT;
- French tax authorities refused its application as the German pension fund was exempt from German CIT;
- Issues: May a German pension fund, exempt from CIT because of its status or activity, be considered to be liable to tax and therefore, a resident under Article of the DTT?
- The French Administrative Supreme Court:
  - refused the application of the 15% WHT as the German punsion can not be considered as a resident under the meaning of the DTT;
  - it ruled that Article 2 of the DTT which defines the scope of the treaty must be interpreted in accordance with the treaty main object, i.e. the avoidance of double taxation;
  - Therefore a person not subject to taxation in the contracting state by reason of their status or activity can not be considered to be liable to taxation therein.
- **The French Administrative Supreme Court rendered an other decision on the same day regarding the same issue. It concerned a Spanish Pension Fund.**

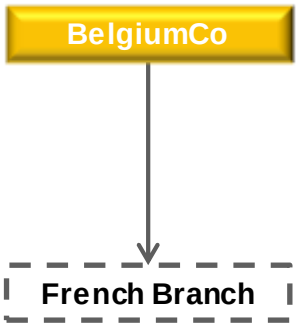
III. Beneficial owner (Moscow Arbitration Court, March 3rd, 2016, Intesa Bank)



Under the DTT between Luxembourg and Russia: WHT on interests: 0%

- The Court judged that:
  - DTT between Italy and Russia is applicable as the beneficial owner is the ItalianCo;
  - A 10% WHT should have levied as provided by the DTT between Italy and Russia.
- The Court ruled based on the following:
  - the terms of the RussianCo debt to the LuxCo were identical to the Luxco debt to the ItalianCo, including the amount, currency and term of the debt;
  - Purpose of the loans given by the ItalianCo to the LuxCo was to finance the RussianCo;
  - the interest received from the RussianCo was transferred to the ItalianCo "immediately almost in full".
- The ItalianCo was deemed the beneficial owner of the entire income even if a portion of the interests remained in Luxembourg.

IV. Effective place of management (French administrative Supreme Court, March 7th, 2016, Compagnie internationale des wagons-lits)



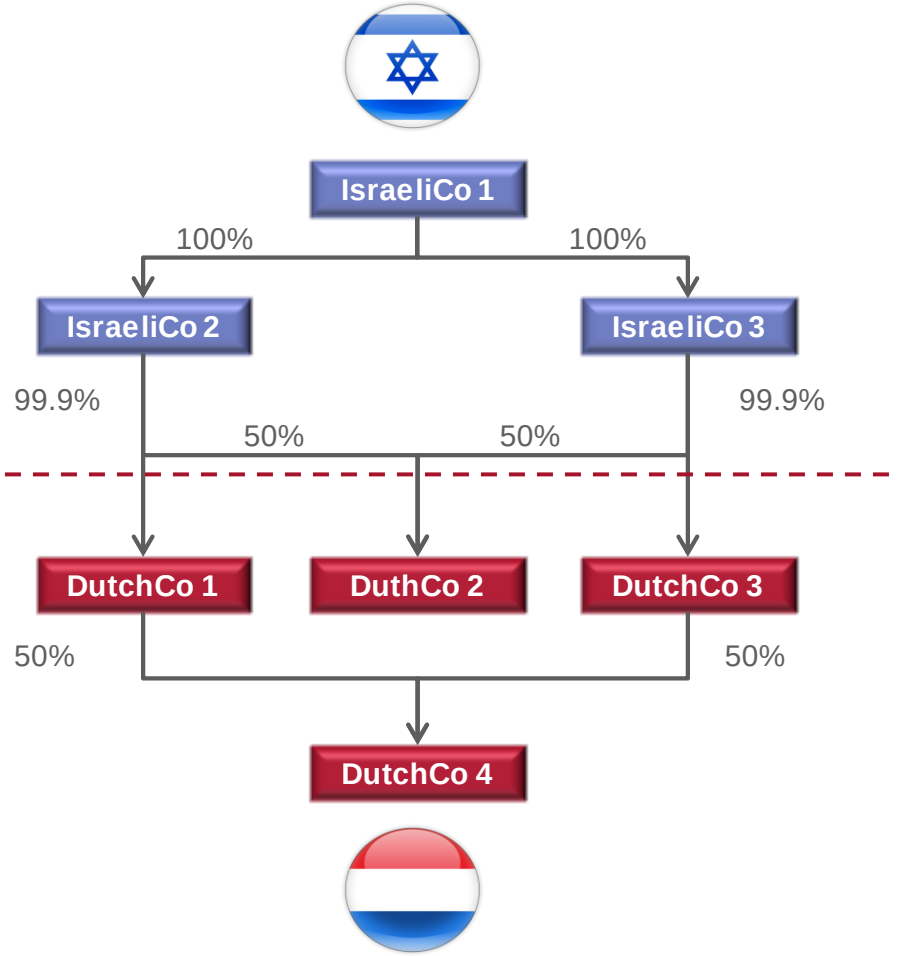
- French branch carried out railway activities;
- Railway activities taxable in France (PE) under Article 4 of the DTT.

- According to the French tax authorities, the French branch also performed functions of a holding company;

  ⇒ Allocation of the holding activity to the French branch.

- Article 4 of the DTT:
  - "Industrial and commercial profits shall only be taxable in the Contracting state in which a permanent establishment is situated";
  - 4 (a): the term "PE" shall include especially a place of management.
- The French administrative Supreme Court:
  - place of management mentionned in Article 4 (4) (a): where the most senior members of a company take the strategic decisions which determine the conduct of the company's business as a whole;
  - the place where the board of directors is situated may be an indication as to whether there is a place of management but is not sufficient itself.
- The Court ruled that, even if the head office of the company was located in Belgium and that 3 meetings of the board of directors had been in held in Belgium, the holding activity of the company was carried out through the French branch:
  - Holding company functions were carried out in France;
  - strategic decisions prepared in Paris;
  - Most of board members located in Paris;
  - no premises of the company in Brussels.

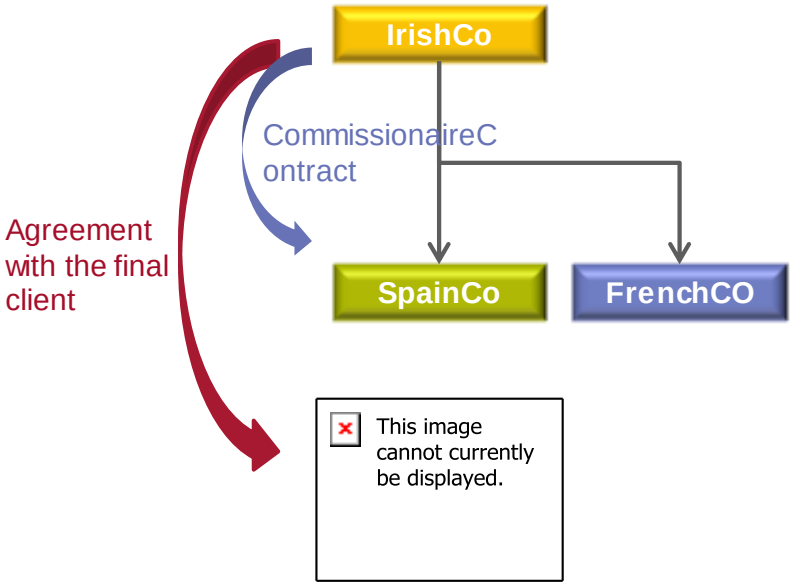
V. Non discrimination and tax grouping (Dutch Court of Appeal, April 26th, 2016,



- The Court ruled that Dutch subsidiairies held by a common Israeli parent company can form a fiscal unity (between the Dutch companies only) based on the non-discrimination provision in the Netherlands-Israel tax treaty though such unity is not allowed under current Dutch law;
- According to the non-discrimination provision, a Dutch company held by an Israeli company cannot be:

  (i) subject to other or more burdensome taxation; and
  (ii) is compared to "similar" Dutch companies with a Dutch resident shareholder.

VI. Commissionnaire structure (Spanish Supreme Court, June 20th, 2016, DELL)



- The IrishCo has a PE in Spain through its Spanish subsidiary;
- **Fixed place of business since the IrishCo has the actual control of the activities and staff of the Spanish subsidiary:**
  - Promotion, sale and attraction of customers;
  - Orders management and reception and control product's distribution;
  - Marketing and advertising in Spain;
  - Storage and logistics…
- **The Court also considers that the principal-commissionnaire agreement between the IrishCo and the Spanish subsidiary generates a PE under the concept of "dependent agent"**:
  - dependence of substantial scope and not merely ancillary between the activities of both entities;
  - lack of legal and economic independence;
  - lack of autonomy of the commissionaire in taking decisions on sales of the IrishCo's products.
- According to the Court, provisions of the DTT have to be interpreted taking into account the current environment, which is "*a globalized market where multinational companies try to shift the profits obtained in other States to one of low taxation*".

Korea

Tax Treaty Cases

- Samsung Total (Supreme Court 2015Du2451 July 14, 2016)
  - Supreme Court overturned the high court's finding that an intermediary UK holding company (UK Hold Co.) that owned the shares of and received dividends from a Korean company should be disregarded as a conduit company for purposes of applying Korea-UK tax treaty benefits. The Supreme Court held that UK Hold Co. had sufficient substance and control over the received dividends to be considered the substantive/beneficial owner of the dividends. This case is one of the few cases in the past 6-7 years in which the Supreme Court ruled in favor of the taxpayer in a treaty benefits case.

Tax Treaty Cases

- Samsung Electronics (Intellectual Ventures) (High Court 2015Nu47043, May 24, 2016)
  - This high court overturned the district court's finding that an Irish company established for the purpose of holding intellectual property from which it received royalty payments from a Korean entity is the beneficial owner of the royalties for purposes of the Korea-Ireland tax treaty. This case is particularly interesting because of the district court's beneficial ownership finding. The case is interesting when juxtaposed against the Samsung Total case and begs the question as to whether the district court's finding was an anomaly or a harbinger of future trends.

Tax Treaty Cases

- TMW Fund (High Court (on remand from Supreme Court) 2015Nu976, June 9, 2016)
  - The high court, on remand from the Supreme Court, reversed its earlier finding that an intermediary German GmbH was the beneficial owner of dividend income received from Korean company. The Supreme Court applied Korea's substance-over-form rule and determined that the GmbH did not have sufficient substance or dominion and control over the dividends to be the substantive owner of the income. This case follows the trend of most of the recent tax treaty cases in which the court ruled against the taxpayer.

Singapore

United Kingdom

Commercial know-how

- UK/India Treaty*: TNT Express Worldwide (UK) Ltd. (2016)*
- TNT major operator in logistics business (freight, parcel and document distribution).
- Agreement to provide its Indian subsidiary with management, financial and admin. support, automated process and systems services.
- India claimed payments under service agreement were royalties, under Indian domestic law and art. 13 of Treaty, for commercial know-how.
- Only some payments fell into this category **BUT** TNT had not segregated the services in the agreement.
- Result: all payments subject to withholding tax (art. 13 of Treaty and para 11.6 of the OECD commentary on article 12 of the Model Treaty).

Problems with partnerships (1)

- UK/Russia Treaty: decision of the Moscow Arbitration Court (unnamed, released 2015).
- UK LLP allocated expenses to its Russian PE.
- Allocated costs non-deductible under Russian domestic law but under Treaty, PE's business profits can be reduced by reasonable allocation of foreign enterprise expenses.
- But partnership disqualified from treaty benefits under art. 3.
- Russian domestic law prevailed to disallow allocated expenses; would have been deductible if directly incurred by PE, rather than being allocated to it.

Problems with partnerships (2)

- UK/India Treaty: *P&O Nedlloyd Ltd v ADIT (2015)*
- UK partnership between P&O (UK) and Nedlloyd (Netherlands).
- Operated ships in international traffic, including India.
- Indian-derived income taxable on non-residents under Indian domestic law.
- Partnership claimed exemption under art. 9 of Treaty, Indian tax authorities claimed partnership not liable to UK tax, so not entitled to Treaty benefits.
- Art. 3.2 of Treaty (removed by 2012 protocol) included partnership as person if taxable under Indian law.
- Court held partnership entitled to Treaty benefits so exempt from tax.
- Decision leaves some questions unanswered.

Hybrid entities: US LLCs

- UK/US Treaty: *Anson v.HMRC* (2015)
- UK Supreme Court ruled that ruled that the profits of a US LLC accrued to its members as they arose, and not only on distribution (contrary to established HMRC practice).
- Treaty question: was UK resident member of LLC entitled to double tax relief for the US tax paid on his share of the LLC's profits?
- Under art. 23.3 (of the 1975 Treaty), UK resident's profits deemed to arise in the US when Treaty allowed the US to tax them.
- Under art. 7.1 of Treaty, the US could tax the LLC's profits since they were attributable to a US PE under art. 5.
- Those profits were the same profits on which the LLC member was assessed to UK income tax.
- Credits for the US federal and state taxes were therefore due.

www.bakermckenzie.com

Baker & McKenzie has been global since inception.
Being global is part of our DNA.

Founded in 1949, Baker & McKenzie advises many of the world's most dynamic and successful business organizations through more than 11,000 people in 77 offices in 47 countries. The Firm is known for its global perspective, deep understanding of the local language and culture of business, uncompromising commitment to excellence, and world-class fluency in its client service.