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Global Tax Insights

Q2 2021

Building Better
Business Globally

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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.*

Sachin Vasudeva

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

CONTRIBUTED BY
Ariel Zitnitski
Zitnitski Weinstein & Co., Israel
E: az@zw-co.com

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

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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.

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

CONTRIBUTED BY
Ritika Khanna
SCV & Co. LLP, India
E: ritika.khanna@scvindia.com

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

CONTRIBUTED BY

Padmini Khare Kaicker and **Abhay Kumar**

B.K. Khare & Co., India

E: pbkhare@bkkhareco.com

E: abhayupadhyay@bkkhareco.com

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.

Spanish tax residency in COVID times

CONTRIBUTED BY
Adriana Vericat
ILV Silver, Spain
E: avericat@ilvsilver.com

> *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.

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

CONTRIBUTED BY

Dr Simone Wick

Dierkes Partner, Germany

E: swick@dierkes-partner.de

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.

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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.

Morison KSi

Proposed new tax residency rules in Australia

CONTRIBUTED BY

Jenny Wong and **Chris Wookey**
Leebridge Group, Australia
E: jenny.wong@leebridgegroup.com.au
E: chris.wookey@leebridgegroup.com.au

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.

DTAA between Israel and United Arab Emirates

CONTRIBUTED BY
Ariel Zitnitski
Zitnitski Weinstein & Co., Israel
E: az@zw-co.com

> *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*

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.

Morison KSi

The Next Step

Contact Morison KSi to discuss your needs

E: info@morisonksi.com

T: +44 (0)20 7638 4005

www.morisonksi.com

Morison KSi

6th Floor
2 Kingdom Street
Paddington
London, W2 6BD
United Kingdom

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