

## INTERNATIONAL TAX SERVICES

# TAX EXPRESS

## INTERNATIONAL

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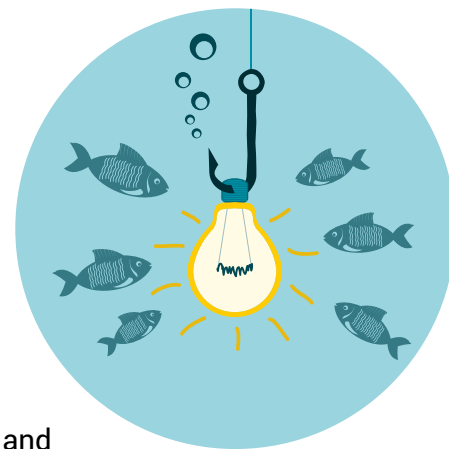
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## Baiting the Tax Hook to Attract Investment in Innovation and R&D in a Post-BEPS World

A recent international tax round table held at Alliot Group's EMEA Regional Conference in Berlin involved members of the alliance's International Tax Services Group who discussed the incentives each of their countries offers to attract investment into innovation and research and development (R&D). These centred on R&D tax relief and the favourable tax treatment of intellectual property ("Patent Box") on its exploitation. Tax experts also explained how national laws are evolving to ensure compliance with the OECD's Base Erosion and Profit Shifting initiative aimed at artificial IP tax regimes.



### Harmful tax practices?

Attractive tax incentives to encourage investment into a particular country are all part of free global competition between governments. However, the OECD's co-ordinated project to counter the manipulations of tax regimes (BEPS) is targeting countries which offer generous tax incentives without there being any meaningful economic activity. The essence is to ensure tax and tax reliefs attach to where the economic activity and profit is actually generated.

### The modified nexus approach explained

Marie-Lise Swinne, Partner at Tax Consult in Brussels, explained that this activity is defined as 'R&D activity' and the OECD's solution is that the so-called 'nexus principle' should be incorporated into all IP tax regimes globally: "The (modified) nexus approach introduces the device of restricting a company's IP profits that qualify for inclusion under an IP box regime based on the proportion of the company's R&D cost which is incurred directly in creating the IP."

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# Welcome

Tax Express International is Alliot Group's new tax newsletter for small and medium sized businesses and high net worth individuals facing the challenges but also seeking out the opportunities presented by the cross border tax landscape which continues to shift under our feet.

Three quick points. Firstly, there is much negativity in the media around tax. Yes, the media is rife with stories about tech giants falling foul of national tax authorities who accuse them of 'gaming' the system to pay minimal tax (*legally in most cases*). Whichever way we look at it, tax is only just catching up with the changing nature of global business models and the often intangible nature of the digital economy. Indeed, some companies have been aggressively applying domestic tax rules to shift profits to lower tax jurisdictions, largely through transfer pricing, but this is in no way tax evasion.

In any case, the international community has, through the G20 and OECD, taken great strides in recent years to coordinate action through national tax bodies to ensure that companies, large and small (*as well as private individuals*) with international interests, pay their fair share of tax wherever it is due. Our articles on permanent establishment and place of effective management explain how countries are implementing best practice international tax principles. And our video series on the different income tax systems in place around the world will give you insights into why good tax advice is essential whenever business crosses borders.

Secondly, rather than being viewed as punitive, tax should be seen as an opportunity. Use of local tax incentives and/or favourable tax regimes such as the patent box and R&D tax incentives discussed in this issue are important to ensuring cross border business success.

Thirdly, tax doesn't have to be boring! It may be more difficult to convince you of this, but we will do our best to explain what you need to know in layman's terms.

For more information on any of the issues covered or on how Alliot Group can help, please contact me ([david.gibbs@alliotts.com](mailto:david.gibbs@alliotts.com)) or visit our website ([www.alliotgroup.net](http://www.alliotgroup.net)) to locate an expert in a specific city or country.

*David*



**David Gibbs**  
Chair of International  
Tax Services Group

## 2017 Transfer Pricing Training

Amsterdam, Netherlands  
Friday 15 September  
Grand Hotel Amstelveen



Last few  
places  
available!

Join other Alliot Group international tax focused members at this one day international tax technical training course led by a transfer pricing training professional from the IBFD, an international authority in tax training.

For information, email  
[giles@alliotgroup.net](mailto:giles@alliotgroup.net)

[www.alliotgroup.net/internationaltax](http://www.alliotgroup.net/internationaltax) in

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# Baiting the Tax Hook to Attract Investment in Innovation and R&D in a Post-BEPS World (Cont'd)

Members of Alliot Group's International Tax Services Group outlined the incentives in their countries and, where an IP tax regime exists, the impact of recent OECD developments.

## Belgium

**Marie-Lise Swinne**, Partner at **Tax Consult**, explained that since February 2017, new legislation has been introduced in Belgium with a new regime called the 'deduction for innovation income': *"This replaces the previous patent box regime which was repealed in June 2016 (albeit with a transitional period) as part of efforts to ensure full compliance with BEPS Action Point 6."*

Swinne added that the new regime provides an exemption of 85% of net income derived from innovation, but conditions apply: *"There is no longer a requirement for there to be a patent, but the exemption can only apply to income generated from R&D or from the development of new technology or innovation. The income must have been generated since July 2016 and must be included in the Belgian entity's taxable results. Also, it only applies to new developments or the improvement of existing IP rights and products."*

The income can be direct or indirect intangible income, so it can be a licence or an income derived from the product or service being sold. Swinne adds: *"The deduction applies also to software development companies which can identify a part of their income that derives from innovation – they enjoy exemption of 85%. The only stipulation is that the modified nexus approach must be applied - this means that the net income has to be assessed as being in proportion to the cost incurred by the Belgian entity or compared to the group cost for the development."*

This means Belgium's corporate tax rate of 33% may actually be reduced for some innovative companies through application of the exemption, resulting in a more favourable effective tax rate. Furthermore, Swinne outlined that unclaimed innovation income deduction can be carried forward for an unlimited period of time: *"Other attractive incentives can also be combined with this, such as the reduction of researchers' wage tax and the taxation of a proportion of earned income at a flat rate of 15% for individuals involved in developing the innovation."*

## Australia

**Jamie Towers**, partner at **Hanrick Curran** in Brisbane, explained that while Australia does not have a IP box regime, it is increasingly focused on innovation and offers a R&D tax incentive: *"This is set at two different rates – companies with revenues of less than AUD 20 Million can receive a 43.5% tax offset. In this scenario, with the corporate tax rate in Australia being 30%, the company can get back 43.5% as a tax refund. And even if a company does not pay tax, it can still receive a tax refund based on the amount spent on R&D. Over AUD 20 Million revenues, the equivalent tax offset rate is 38.5%."*

*Once R&D deductions exceed AUD 100 Million, a flat rate of 30% applies to the excess."*

## Poland

The absence of a specific IP box regime in Poland is, according to **Pawel Falkowski**, partner at **FL Tax** in Warsaw, compensated for by recently introduced R&D regulations: *"These offer significant benefits to taxpayers who, depending on the size of the company and the category of costs incurred, can effectively deduct 130-150% of their expenses incurred for R&D. The latest legislative draft indicates that the amount of deductible R&D costs will increase to 200% as early as 2018."*

However, Falkowski cautioned that *"Specialist tax advice should be sought to identify and classify the costs that qualify for deduction and to safeguard the R&D tax relief claim by ensuring that the proper records and documentation are gathered and the relevant binding rulings from the tax authorities are obtained."*

Falkowski compared Poland to Australia, in that even if a company does not pay tax and/or is making a loss, it may still be able to obtain a tax refund when certain conditions are met. Falkowski also commented: *"Additionally, the tax relief may be combined successfully with R&D grants, providing complementary benefits to the most innovative companies."*

## Germany

Germany does not have specific R&D tax incentives, according to **Georg Schleithoff**, tax consultant at **audalis** in Dortmund. On the contrary, Schleithoff explains that from 1st January 2018, the German Government announced the intended introduction of the 'Licence Deduction Limitation Rule': *"This rule would apply when licence income is subject to preferential low taxation, meaning below 25% and when substantial business activities of the licensor or development activities using own resources do not exist. In cases where the requirements are met (e.g. licence income is taxed at a rate of less than 25%, etc.) the deduction of the corresponding licence expenses will be denied in proportion to the amount of underpaid tax. Should the new rules enter into legislation, many multinationals will have to review, and possibly adjust, their licence and distribution structures."*

Germany is trying to encourage growth in the technology based sector, but is approaching it from the reverse angle according to **Sebastian Blandow**, partner at **TLC** in Berlin. He explained that a new programme has been launched to attract investment in R&D by allowing investors to deduct an amount of up to 20% of their initial investment when contributing capital to a startup up to an amount of Euros 500,000. *"This means a potential investor is entitled to receive a grant of up to Euros 100,000 per year. And when the investor decides to sell the shares once the company has become more profitable, he / she can receive tax relief of 25% on the capital gains received from the sale."*

## Israel

An innovation box regime is under consideration by the Israeli Government. **Avi Ben-Shimon**, partner at **Ben-Shimon, Elias & Co** in Tel Aviv, explained that there are already many benefits for technology companies that makes the country an attractive place for foreign investment and that the Government is making a concerted effort to keep technology in Israel.

*"For technology companies with less than US\$10 Billion annual revenues, a special tax rate of 12% (in periphery areas 7.5%) can be applied, rather than the usual 24% corporate tax rate. For technology companies with over US\$10 Billion annual revenues, a tax rate of 6% can be applied. For foreign investors in technology companies, a preferential 4% tax rate on dividends applies rather than the usual 25%-30% dividends tax rate."*

## Cyprus

**Antonis Partellas**, partner at **Alliott Partellas Kiliaris** in Nicosia, explained that the country has had a new IP box regime in place since 1st July 2016 that offers generous tax breaks, but only if specific criteria are met: *"Under the new laws, 80% of profits generated from qualifying assets can benefit from a profit deduction, with only the balance taxed at the corporate tax rate of 12.5%. This new legislation introduces a stricter definition of what constitutes IP, namely, patents, software and other assets which are legally protected. It no longer includes business names, trademarks, image rights and other IP rights used to market products and services."*

## Netherlands

**Maurice Kruidenier**, managing director at **Borrie** in Rotterdam, outlined the Netherlands' well-established innovation box regime which dates from 2007: *"Only 5% corporate income tax is payable on income derived directly from IP, instead of the regular corporate tax rate of 20-25%. It enables a company to get a discount on wage tax for people working on R&D. It is a two dimensional programme that offers reduced rates of corporate tax and wage tax."*

## Italy

**Giorgio Marcolongo**, partner at **Sorefisa** in Milan, explained that Italy's patent box regime allows a wide number of intangible assets to qualify, including software protected by copyright, patents, know-how such as processes, formulas, industrial, commercial or scientific information and designs and models that are potentially capable of legal protection.

According to Marcolongo, Italy's patent box regime includes the indirect use, such as licensing for the use of any qualifying IP, and the direct use of any mentioned IP, where a ruling procedure is necessary.

*"A general exemption of 50% applies to income generated from R&D or from the development of new technology or innovation. The qualifying income is determined, for each IP, on the basis of the nexus ratio, meaning that the income that can benefit from the tax exemption is in proportion to the ratio of qualifying expenditure to total expenditure incurred to develop the assets."*

## UK

According to **Jackie Hendley**, Head of Tax at **Smith Cooper** in Birmingham, the UK Patent Box is similar to incentives on offer in Australia in that R&D tax credits are available to companies in the form of a tax deduction of 230% of the original cost, so an uplift of 130%: *"Deductions are applicable to the wages of those working on R&D and are based on the proportion of their time spent in this area. Consumables also benefit from deductions. If the company has losses, as long as PAYE income tax has been paid for these employees, money can be claimed back."*

**David Gibbs**, International Corporate Tax Partner at **Alliotts** in London, referred to the R&D Expenditure Credit ("**RDEC**") for large companies recently introduced in the UK: *"This allows a repayment – this is outside of the ordinary state aid rules - a lot of UK R&D has to fall within state aid rules because it is government funding. This new tax repayment means that a large company such as a global pharmaceuticals company that is making losses, can claim approximately 8% of its R&D spend as a cash refund. Furthermore, the amount that can be claimed is not capped."*

## Nigeria

**Godwin Osagie**, partner at **G.E. Osagie & Co** in Nigeria, explains that *"Nigeria's corporate tax rate is 30%, but when investments take place in specific sectors that involve R&D, a tax holiday will be granted ranging from 3-5 years. Dividends paid during the tax holiday are also tax exempt."*

Losses can be carried over for a period of at least four years during which *"the company is expected to recover these losses"*.

Tax incentives are on offer to individuals working in specific sectors, particularly expatriates: *"Expatriates are entitled to these incentives in return for transferring their skills to nationals. However, specific registrations need to be carried out to acquire the correct documentation."*

*"Additionally, companies with foreign investment of up to 25% of the share capital are exempted from paying minimum tax when losses are recorded in any financial year; this is applicable to all sectors."*

## Spain

As **Carlos Montesa**, partner at **Abbantia Abogados** in Seville points out, Spain has had a patent box regime since 2008 and made changes in July 2016 to incorporate the OECD proposals and nexus approach. Montesa comments: *"60% of net income that qualifies as being derived from qualifying IP and intangible assets is exempt from corporate income tax and the remaining 40% is taxed at the usual 25%."*

# Permanent Establishment: How to Know When & Where the Tax Line Has Been Crossed



It is human nature to try to avoid unnecessary costs, and the same behaviour pervades businesses. Indeed, recent media focus has settled on those global tech giants that generate millions in revenues in countries such as the UK but have found legitimate means to pay minimal tax on profits due to not having created what is referred to as a “permanent establishment” (PE) in these countries. While recognizing that tax systems have not necessarily kept pace with changing global business models and the digital economy, action is under way at the international level to provide greater clarity on what may be perceived as the artificial avoidance of PE by foreign companies. This has implications for any business, large or small, that operates outside its own borders.

In this article, members of Alliot Group’s International Tax Services Group aim to explain how PE is defined and the typical triggers that apply. They also emphasise that PE should not be viewed as a barrier to cross border trade and explain how businesses can manage their PE risk by, generally speaking, adhering to specific rules when operating in a different jurisdiction.

## What is permanent establishment (‘PE’)?

It is useful to give a theoretical example to explain how PE works. If ABC Widgets Ltd based in country A starts to export to country B, it will become subject to country B’s tax laws. However, if country B has an income tax treaty with country A, and this treaty contains a permanent establishment threshold test, then ABC Widgets Ltd will enjoy greater protection from taxation in country B as long as those activities do not trigger a specific threshold related to the amount of economic activity it has in country B. If this threshold is breached, a permanent establishment is deemed to exist and ABC Widgets Ltd will have created a taxable presence (*substance*) in country B.

## A concept rooted in history

Marie-Lise Swinne, partner at [Tax Consult](#) in Brussels, explains that PE is by no means a new concept: “The concept was first used in international tax law back in 1889 when the first bilateral tax treaty was concluded between the Austro-Hungarian Empire and Prussia. It has since been developed into a model to tackle cross border double taxation and tax evasion and an extensive network of bilateral tax treaties has been gradually established. The OECD Model Tax Convention incorporates the PE concept and has been an important driver in the development of tax treaties.”

## BEPS: at the heart of growing interest in PE

In recent times, national tax authorities have shifted their interest back to PE threshold testing as a result of the OECD’s Base Erosion & Profit Shifting (BEPS) project, specifically Action Point 7 which, as [Amie Cheung](#), Principal at [Lawrence Cheung CPA Company](#) in Hong Kong explains, “aims to limit the ability of foreign companies to artificially avoid tax in foreign countries where they are carrying on business.”

Double tax treaties are currently being revised to incorporate these recommendations. **Bruce Militzok**, partner at **Farkouh, Furman & Faccio** in New York comments:

*"Complex, fast-changing global business models, the growth of the digital economy and the increasing number of companies with internationally mobile staff have combined to force a re-examination of the way tax is levied on companies' cross border profits and transactions."*

BEPS Action Point 7 proposes to include changes in the next version of the OECD Model Tax Convention which will close the loopholes that allow foreign companies to artificially avoid creating a PE.

Swinne points to another major milestone in international tax developments – the signing of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("*Multilateral Instrument*" or "*MLI*") on 7th June 2017 by 67 countries:

*"The MLI will apply to the 2,365 existing tax treaties which have been listed. This convention modifies the current definition of PE and includes commentary on article 5 regarding the definition of a PE, the Specific Activity Exemption and the Splitting-up of Contracts."*

## Factors that can trigger a PE

**Sergio Torras**, partner at **Torras & Asociados** in

Barcelona cautions: *"When a company's operations extend into a foreign country, the issues mentioned below must be taken seriously to ensure that risk is managed and that a PE is not triggered inadvertently. Failure to do this could make the company liable to income tax or VAT."*

A tax treaty will tend to define the existence of a PE using the following two tests:

### 1. Fixed place of business PE test

The treaty will seek to determine if the company operates through a fixed place of business in the other country.

A fixed place of business is typically defined as including the following types of physical locations:

- Place of management
- Branch or office
- Workshop
- Factory
- A mine, oil or gas well, quarry or any place where natural resources are extracted.

However, there are specific activity exemptions to the PE definition, including:

- Use of a facility solely for the purpose of storage, display, or delivery of goods or merchandise owned by the company
- Maintenance of a stock of goods or merchandise belonging to the company solely for the purposes of storage, display, or delivery
- Maintenance of a stock of goods or merchandise belonging to the company solely for the purpose of processing by another company
- Maintenance of a fixed place of business solely for the purpose of carrying on, for the company, any other preparatory or auxiliary activity
- Maintenance of a fixed place of business solely for the purpose of buying goods or merchandise (*or collecting information*) for the company
- Maintenance of a fixed place of business solely for any combination of the activities listed above.



**Valérie Ménard** of **Hardy Normand et Associés** in Montreal comments:

*"As shown above, there are various options available to a company for doing business in a country that will legitimately not trigger a PE. Each situation will be looked at by the tax authorities on a case by case basis and assessment will consider carefully the language contained in the treaty."*

**Isabelle Paré**, Senior Manager at **Hardy Normand et Associés**

adds: *"When assessing if a company has a PE, it is critical to review the OECD's various comments as they contain many examples of situations where a PE would be created – there may be situations which are not covered in the treaty. The PE concept is much broader than we think."*

*"The OECD approach, which is used in treaties, is based on three key elements: there must be a place of business, it must be fixed and the business must be carried on through this specific fixed place of business. Some places of business may only meet two out of the three criteria listed above and would therefore not be a PE."*

### 2. Dependent agent PE test

A PE could also be created in the other country if a company uses a dependent agent that has the authority to close contracts on behalf of the company in the country.

Generally speaking, if the company uses an agent that is of 'independent status' and if transactions between the agent and the foreign company are carried out at arm's length, then the foreign company will not be deemed to have triggered the PE threshold.

Tests to determine whether the agent is working as an independent agent will tend to ascertain whether the agent is:

- Acting in the ordinary course of their business
- Financially independent from the foreign company
- Legally independent from the foreign company that is using their services.

**Pankaj Dave**, Senior Partner at **B.M. Chatrath & Co** in India explains: *"While most countries will only subject a foreign company to tax if that company has triggered PE through either a fixed place of business and/or a dependent agent PE in their country, some countries will have their own additional rules that should always be examined carefully. Furthermore, many countries' treaties have introduced a new category of PE for service companies under which a PE is deemed to exist when services are performed in the other country for more than a specified length of time or for a related company."*

**Marie-Lise Swinne**, partner at **Tax Consult** in Brussels also confirms that the Multilateral Instrument (MLI) that was signed on 7th June 2017 by 67 countries strengthens the dependent agent PE rules so that a PE will arise not only where a dependent agent concludes contracts in the name of the business, but also contracts for the transfer of, or for the granting of the right to use, property owned by that business, or for the provision of services by that business, where the agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the business.

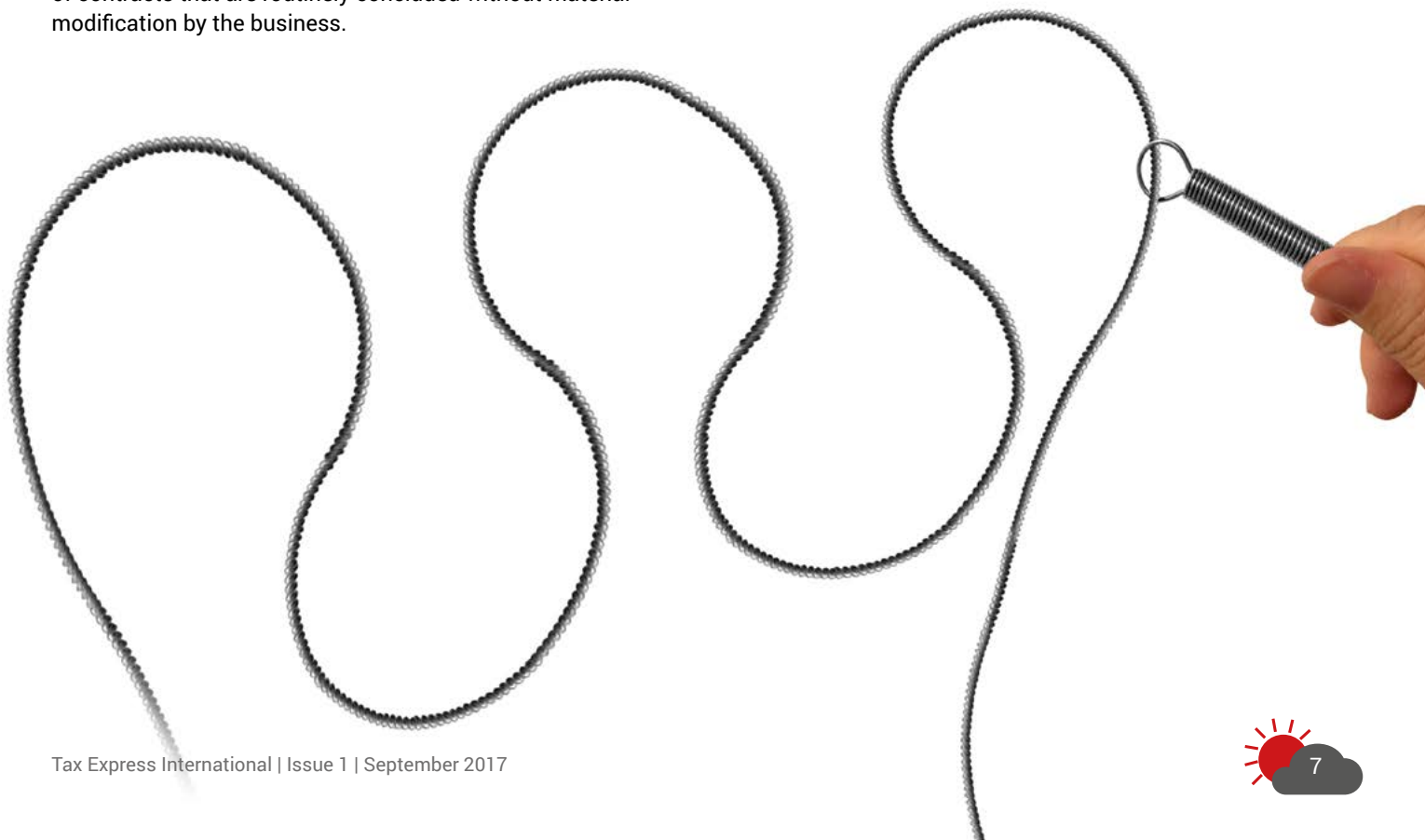
## 7 good reasons to ensure you manage PE risk effectively

- Peace of mind
- Mitigation of potential damage to your reputation
- Opportunities for tax efficiency and/or improvements to your internal controls
- Less risk of nasty surprises in the form of unexpected tax payments such as penalties and interest
- Reduced risk of challenges by tax authorities if procedures to manage risk can be shown to be in place. Such challenges will absorb valuable management time
- Avoid potential immigration issues for employees
- Circumvent regulatory issues in some industries in some countries.

## Worried about PE risk?

A PE risk review should form an essential part of any international company's broader tax control framework. Companies can operate in another country and legitimately not create a PE, so it should not be viewed as a disincentive to trade across borders but rather to ensure companies play fairly and are accountable!

Contact us ([giles@alliotgroup.net](mailto:giles@alliotgroup.net)) for more information on how our member firms can help your business to navigate the intricacies of cross border tax.



## Video reports:

# How is Foreign Income Taxed in Different Countries? Our International Tax Experts Explain

Generally speaking, one of two systems will be used by a country that taxes income: territorial or residence based. Under the territorial system, only local income – i.e. income from a source inside the country – will be taxed. Under the residence based system, residents of the country will be taxed on their worldwide (*local plus foreign*) income, with non-residents only being taxed on their local income.

Those countries that use a residence based system typically allow deductions or credits for tax paid by residents to other countries on their foreign income. Many countries will agree tax treaties to eliminate or at least reduce double taxation to decrease their worldwide tax liabilities.

In the videos below, four international tax experts from around the world explain which system applies in their country and how international companies and their owners might look to reduce their worldwide tax liabilities.

Scan the QR codes below to watch the short video interviews



**David Gibbs**  
International Corporate  
Tax Partner, Alliotts,  
London, UK

*"If a business in the UK sets up overseas, and has an establishment there, it will pay tax there. The difference companies need to look at from a cross border tax perspective is whether they simply have a branch of their UK company or a separate legal entity or subsidiary."*

[david.gibbs@alliotts.com](mailto:david.gibbs@alliotts.com)

Watch the full interview



**Bruce Miltzok**  
Partner, Farkouh,  
Furman & Faccio,  
New York, USA

*"In contrast to some countries, if you are incorporated or reside in the U.S., you are taxed on your worldwide income, no matter where it has been earned. You could also be subject to tax in the local jurisdiction."*

[bmiltzok@ffcpas.com](mailto:bmiltzok@ffcpas.com)

Watch the full interview



**Jamie Towers**  
Partner, Hanrick Curran,  
Brisbane, Australia

*"Residents of Australia are taxed on their worldwide income, so they also pay tax in Australia. However, they will also receive a tax credit for any tax that is paid in the foreign country."*

[jamie.towers@hanrickcurran.com.au](mailto:jamie.towers@hanrickcurran.com.au)

Watch the full interview



**Valérie Ménard**  
Partner, Hardy Normand  
et Associés,  
Montréal, Canada

*"If a branch is used, Canadian tax residents will be taxed on their worldwide income, so their income will indeed be taxed in Canada."*


[vm@hna.ca](mailto:vm@hna.ca)

Watch the full interview



Note: A QR code reader app needs to be installed on your smartphone or tablet to view the videos.





# Key points: The 2017/18 Australian Federal Budget

**Jamie Towers** of **Hanrick Curran** provides a summary of Australia's 2017/18 Federal Budget published on 9 May 2017 for international companies and foreign investors.



## A missed opportunity

*"The Government again missed the opportunity to provide real tax reform, although it committed to passing the reduction in company tax rates announced in last year's budget for all companies."*

Jamie Towers, partner at Hanrick Curran in Brisbane, and a key member of the alliance's International Tax Services Group, has picked out below the tax related major measures announced in the Budget that will be of interest to foreign businesses and individuals. Please note that this presents Hanrick Curran's understanding of the Government's announcements that have not been introduced into law and this information should not be relied upon without taking further detailed advice.

## Key points: 2017/18 Federal Budget

### Business

The Government has again committed to its 2016/2017 budget measure of reducing the company tax rate for all companies to 25%. This measure was passed by the Senate, but only for businesses with turnover of less than AUD10 million (*rising to AUD50 million*). The Government plans to extend these measures to all companies and eventually lower the company tax rate to 25%.

### Foreign residents

Foreign and temporary residents will be denied access to the Main Residence tax exemption on their Australian properties. This will significantly disadvantage New Zealand citizens who have not applied for Australian permanent residency and are currently considered temporary residents. Existing properties will be grandfathered until 30 June 2019.

The Capital Gains Tax (*CGT*) withholding tax rate on real property sold by non-residents will increase from 1 July 2017 to 12.5% (*currently 10%*) and will apply to properties worth more than AUD750,000. Due to the lower threshold, this will be of significant interest to developers as these measures can apply to Australians who do not register to confirm their residency.

A levy equivalent to the Foreign Investor Application fee (*currently AUD5,000 p.a.*) will be imposed on foreign owners of a property that is not occupied, nor made available for rent for more than six months of the year. This will apply to new purchases of residential investment properties by foreign persons after 9 May 2017. A 50% cap on foreign ownership will be imposed on vendors of new property developments to ensure sufficient supply remains for Australians.

### Foreign worker levy

The Government recently announced changes to the 457 Visa System making it more difficult for businesses to bring foreign workers into the country.

From March 2018, additional levies will apply to businesses employing foreign workers. Small Business will pay an up-front fee of AUD3,000 for employees on a 186 visa, plus AUD1,200 per foreign worker per year for employees on a temporary skill shortage visa. Large Business (>AUD10M turnover) will pay AUD5,000 up front plus AUD1,800 per foreign worker per year from March 2018. These rules replace the current training / levy obligations.

### Multinational tax avoidance

Jamie Towers, commenting on Australia's leadership on the international scene in terms of combating tax evasion and ensuring tax transparency, comments:

*"The Australian Government has done much over the past couple of years around this area including aligning Australia's laws with OECD best practice and going beyond that by introducing Multinational Anti-Avoidance Laws (MAAL) including a Diverted Profits Tax to apply from 1 July 2017. The MAAL will be further strengthened through its application to structures involving partnerships and trusts, not just companies."*

### Individuals

No new tax rates have been announced for individuals for 2017/18. However, the Budget Deficit Recovery Levy will end on 30 June 2017 as legislated. Therefore, the top marginal tax rate including Medicare Levy will be 47% from 1 July 2017.

Investment into affordable housing will become more attractive from 1 July 2018 with the availability of a 60% Capital Gains Tax (*CGT*) concession on certain properties sold. This will apply where housing is provided to low income tenants via a registered community housing provider with rent discounts applied.

Similarly, managed investment trusts (*MIT*) will be allowed to invest in affordable housing. Where a property is held by a MIT for more than 10 years, the *CGT* discount on sale will be increased to 60%. As distributions from MITs are taxed at 15% to foreign investors, this may encourage foreign investors to invest in affordable housing.

### For more information

Please contact Jamie Towers ([jamie.towers@hanrickcurran.com.au](mailto:jamie.towers@hanrickcurran.com.au)) at Hanrick Curran in Brisbane.



# Place of Effective Management (PoEM): India's Government Issues Guidelines

**Pankaj Dave**, Senior Partner at **B.M. Chatrath & Co** in India, provides an update on how the OECD's Place of Effective Management (*PoEM*) framework is being implemented in India to prevent tax evasion by determining the residency of companies with global operations.



## What is the Place of Effective Management rule?

The PoEM rules entered into effect in India on 1 April 2015 but it is only recently that the Central Board of Direct Taxes (CBDT) issued its own guidelines to test the residential status of a foreign company for tax purposes.

The rules establish specific criteria to determine the place of effective management of a company in situations where the multinational has a presence in two or more jurisdictions but may be using their residential status to avoid paying taxes in India. Where a company has a presence in different jurisdictions, the company would for treaty purposes, be resident in the jurisdiction in which its place of effective management is situated. This test is suggested in the OECD model tax treaty's tie-breaker rule to determine the residential status of a corporation.

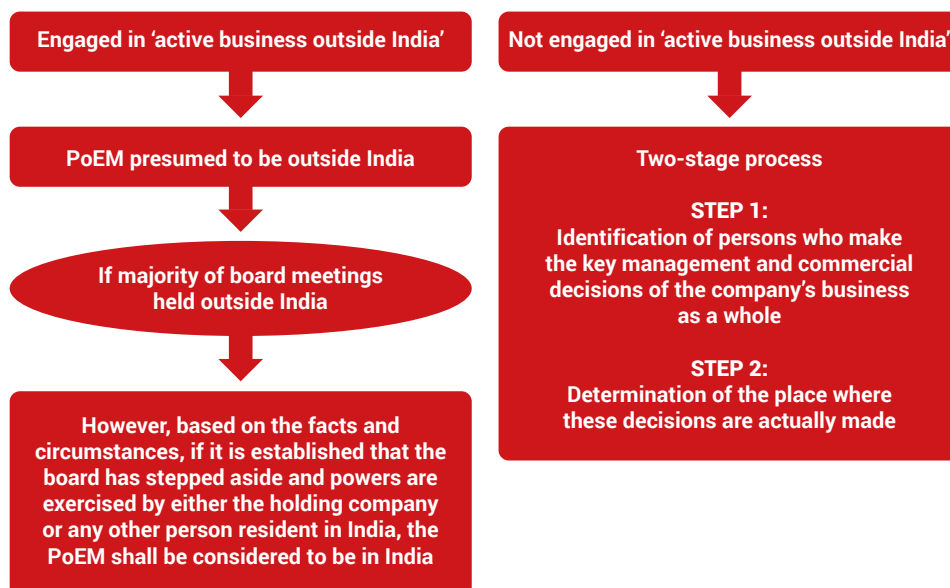
## The determination of 'active business'

Pankaj Dave, Senior Partner at B.M. Chatrath & Co, comments: *"The Place of Effective Management (PoEM) of a company depends on the place where the company is engaged in 'active business' and on the conduct of the entity's board."*

## New rules aim to determine where control really lies

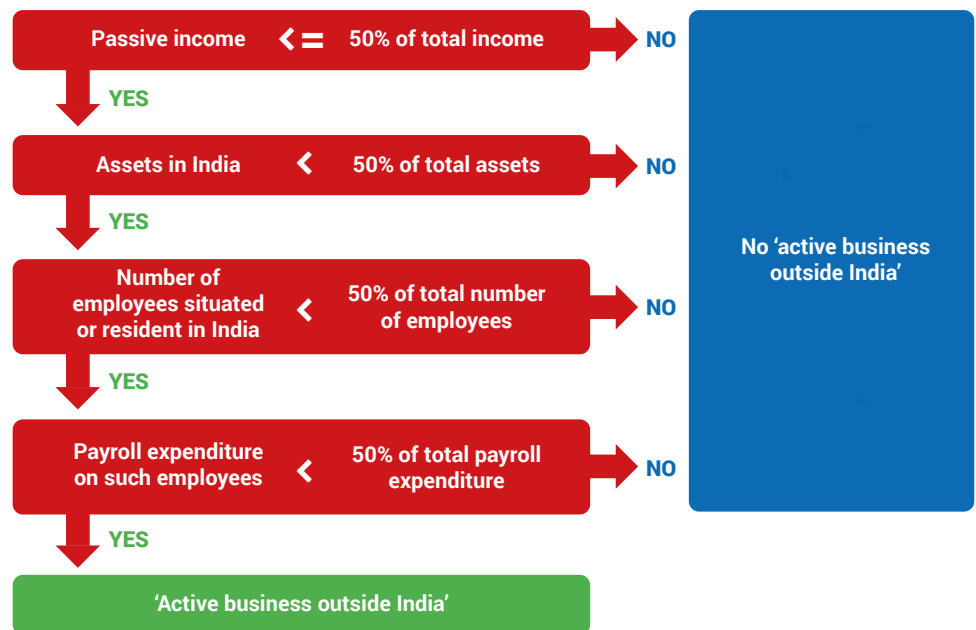
The CBDT, via a press release dated 24 January 2017, clarified that the intent is not to target Indian multinationals which are engaged in business activity outside India, but instead to target shell companies and companies which are created for retaining income outside India when real control and management of affairs is located within India.

The flow chart opposite provides a broad overview of the test's guiding principles in India



## Test analysis to determine substance and control

To determine whether or not the company is engaged in 'active business outside India', the guiding principles establish the tests opposite:



The final guidelines also specify:

- Which total income should be taken into consideration
- Computation of the total assets to be taken into consideration
- The number of employees to be considered
- Computation of the term 'payroll', and
- The sources of income to be included as 'passive income' – i.e. income from the purchase/sale of goods from/to the company's associated enterprise and income from royalties, dividends, capital gains, interest or rental income.

Dave explains that place of effective management is defined to mean "a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made."

## Key definitions

### Passive income

An entity's passive income is defined as the aggregate of:

- Income from transactions where both purchase and sale of goods is from/to its associated enterprises; and
- Income from royalties, dividends, capital gains, interest or rental income.

### The Head Office

The head office of a company is the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located.

### The Senior Management

The senior management of a company would mean the person(s) generally responsible for developing and formulating key company strategies and policies and for overseeing the implementation of those strategies on an on-going basis.

## When company is not in active Business outside India

Where a company is not engaged in 'active business outside India', the determination of PoEM would be a two-stage process as shown in the chart above. The guidelines provide for the following factors/parameters which shall be taken into account:

The location where a company's board regularly meets and makes decisions may be the company's place of effective management provided that:

- The board retains and exercises its authority to govern the company; and
- The board does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.

In cases where the board has delegated its authority to committee(s), the location where the members of such committee(s) formulate the key strategies, shall be of relevance for the determination of PoEM.

The involvement of the shareholders to the extent mandated by company laws shall have no relevance in the determination of PoEM. Furthermore, secondary factors such as the place where main and substantial activity is carried out or the place where the accounting records of the company are kept, shall also be taken into consideration.

### Other considerations

Certain principles which have to be kept in mind while determining the PoEM of a company, are listed below:

- Any determination of the PoEM will depend upon the facts and circumstances of a given case
- The principles as laid down for determining PoEM are for guidance only
- No single principle will be decisive in itself
- Since 'residence' is to be determined for each year, PoEM is required to be determined on a year to year basis
- The actual conduct and activities performed by the

company over a period of time during the previous year need to be considered

- De facto decisions prevail over de jure decisions
- If it is determined that PoEM is in India as well as outside India, then PoEM shall be presumed to be in India if it has been mainly/predominantly in India.

### Exceptions

The following are not conclusive evidence of the existence of PoEM of a foreign company in India:

- Foreign company completely owned by an Indian company
- Existence of Permanent Establishment ('PE') of a foreign entity in India
- Residence of directors of the foreign company in India
- Presence of local management in India in respect of activities carried out by a foreign company in India; and
- Existence in India of support functions that are preparatory and auxiliary in character.

### Factors that determine that the company is engaged in active business outside India

#### Meetings

The PoEM shall be presumed to be outside India if the majority of Board meetings are held outside India.

#### Board of Directors

However, if the Board of Directors stands aside and does not exercise its powers, and such powers are instead exercised by the parent company or any other person resident in India, the PoEM shall be considered to be India. Should the Board of Directors follow the principles laid down by the parent entity in respect of all its global companies, and they are not specific to one entity, it shall not be constituted as a case of the Board standing aside.

#### Administrative safeguards to avoid litigation

To avoid unwarranted litigation, the guidelines incorporate administrative safeguards. Before proposing to hold a company as a resident of India on the basis of PoEM provisions, but also before initiating such proceedings, the AO must seek approval from the Principal Commissioner. This ensures a two-stage check within the department.

### Unresolved points

- The definition of passive income where it states that it includes income from transactions where the purchase and sale of goods is from/to associated enterprises. Clarification will be needed on whether the word 'goods' means only goods or includes services
- The second condition stated for 'active business outside India' whereby not less than 50% of the total employees should be situated or resident in India
- The guidelines seek to clarify that the employees to be considered for the above shall include persons who, though not employed directly by the company, perform tasks similar to employees. Again, there may be divergent views on whether a contractual employee, representative agent, professional employer organization, etc. are intended to be covered or not
- The guiding principles are for the determination of PoEM for a company. However, it would be interesting to see if they also bare some relevance in the event of structures set up in a non-corporate form, e.g. a partnership.

### Where the guidelines do not apply

The guidelines shall not apply to companies with annual turnover or gross receipts of less than INR 50 crores (500 M Indian Rupees).

### Conclusion

It will be interesting to see the approach taken in cases where the quantitative thresholds, for 'active business outside India' are met. Just because they meet the thresholds, one cannot contend with certainty that the PoEM is not in India. It is advisable to look beyond the thresholds to ensure that actual conduct is substantiated by documentation.

It is important to reiterate that the process of determination of PoEM is a factual one driven by substance over form. It is imperative to demonstrate the 'place' where decisions are, in substance, taken and to identify the persons actually driving the decision making process.

For more information, contact Pankaj Dave (pankajdave@bmchatrath.com).

Alliott Group's International Tax Services Group facilitates access to expert tax advisors in many of the world's commercial centres across some 70 countries. Visit our website ([www.alliottgroup.net](http://www.alliottgroup.net)) to find an international tax professional or in the first instance, contact Giles Brake ([giles@alliottgroup.net](mailto:giles@alliottgroup.net)) at Alliott Group's Executive Office.

