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In this issue:

Pressure mounts for nonresidents to file Indian tax returns

There is sometimes a misconception that a nonresident is required to file a tax return in India only if it has a taxable presence in India in the form of a permanent establishment (PE), and that it is not necessary to file a return if the income derived by the nonresident is either exempt from tax under an applicable tax treaty or if an Indian payer has withheld tax on the income. Two rulings issued by the Authority for Advance Rulings (AAR) in 2012 have sparked a fresh debate on the filing requirement. This article provides an overview of the tax return filing requirements in India, the current policy of the government and the consequences of failure to file a return.

Domestic law background

Determining taxability of income in India – A nonresident is taxable in India on income that accrues or arises in India, is deemed to accrue or arise in India or is received or deemed to be received in India. Under the Indian Income-tax Act, 1961, a taxpayer can opt to be governed by domestic tax law or the provisions of an applicable tax treaty, whichever is more beneficial to the taxpayer.

Annual income tax return – The circumstances in which a company (including a nonresident company) is required to file annual income tax returns in India are extensive. The typical situations in which a nonresident is required to file a return are where:

- The nonresident has a taxable presence in India in the form of a PE;
- The nonresident wishes to claim a refund of tax withheld on income earned in India;

- The nonresident is an investor, such as a foreign financial institution, that earns India-source income in the form of dividends, interest, capital gains, etc.;
- The nonresident receives India-source royalties or fees for technical services, regardless of whether tax is withheld on the income;
- The nonresident derives capital gains from the transfer of assets located in India;
- The nonresident is engaged in an offshore transaction involving the indirect, rather than the direct, transfer of shares in an Indian company and the transaction is taxable under Indian law; or
- The nonresident earns any other India-source income.

The annual income tax return must be filed with the tax authorities by the following dates:

Person	Due date
Category I	
Company	30 September of the assessment year
Person other than a company that is subject to audit	
Category II	
Taxpayer required to submit a transfer pricing report	30 November of the assessment year
Category III	
Other taxpayers	31 July of the assessment year

Failure to file – Noncompliance with the return filing requirements has the following consequences:

- Interest is chargeable at a rate of 1% for each month or part of a month for which a return is filed late;
- A penalty is imposed if a return is not filed on or before the last day of the financial year in which the return filing due date falls; and
- A penalty is imposed at a rate of 100% to 300% of the tax sought to be evaded for concealment of income.

The penalties are imposed at the discretion of the tax authorities. The taxpayer also is exposed to the risk of prosecution and imprisonment for a term ranging from six months to seven years, based on the amount of tax sought to be evaded.

In addition to the penalties described above, failure to file an income tax return also has ramifications for a taxpayer's ability to carry forward losses and there is a risk that the tax authorities will re-open tax assessments for the seven years before the year in which the failure takes place.

Precedent

The AAR has issued a number of rulings on the filing obligations of nonresidents with respect to income that is not taxable in India as a result of tax treaty relief. (Although these rulings are not binding on other taxpayers, they carry persuasive value.) Over time, the AAR has changed its views on this issue.

In older rulings, the AAR took the position that a nonresident must file an income tax return only if the taxpayer was liable to tax in India (e.g. *Veneburg Group*, *Dana Corporation*, *Amiantit International Holdings Limited*). The AAR subsequently held (*VNU International B.V.*) that a company (including a foreign company) is required to file a return regardless of whether it earns income or incurs a loss. In the VNU case, the AAR noted that Indian law specifically sets out instances in which a nonresident is not required to file a return and that this provision does not include the situation in which a nonresident is not taxable in India as a result of tax treaty protection. According to the AAR, where a state has the power to tax, even if a taxpayer has no income, it cannot be argued that the taxpayer has no liability to file a tax return.

The AAR issued two rulings in 2012 (*Castleton Investment Limited* and *Smithkline Beecham Port Louis Limited*) that addressed the tax return filing obligations of a nonresident. In both cases, the shares of an Indian company held by a Mauritius company were transferred to another nonresident outside India, pursuant to a group restructuring. The principal issue before the AAR was the taxability of the capital gains arising on the sale of the shares. The AAR held that the capital gains were taxable under Indian domestic tax law, but that relief from tax was available under the India-Mauritius tax treaty. With respect to the tax return filing requirement, the AAR observed that Indian domestic tax law requires every person whose total taxable income exceeds the maximum amount not chargeable to tax to file a return. The AAR also remarked that if a person intends to claim relief under a tax treaty, a claim must be made in the tax return or at the time of tax audit proceedings. The AAR held that the obligation to file a return is not eliminated simply because a taxpayer is entitled to treaty benefits and that the taxpayer must demonstrate to the tax authorities that it is eligible for such benefits, thus emphasizing the need to file a return.

Government initiatives

Alongside the change in the AAR's position with regard to the filing obligations of nonresidents, the government has been taking steps to target tax evasion and ensure that tax returns are filed.

A number of foreign companies have obtained a Permanent Account Number (PAN) in India to reduce the withholding tax burden on payments received from Indian customers. The domestic tax laws mandate that a company must furnish its PAN to the payer, or the withholding tax rate will be 20% rather than the 10%/15% rate that applies in most of India's tax treaties.

Press reports indicate that in February 2013, the Finance Ministry initiated a project to identify PAN holders that have not filed their tax returns. Information on PAN holders was collated from annual information return data, withholding tax returns and data received from the financial intelligence team. As a result, the Finance Ministry issued letters to approximately 105,000 foreign companies that had not filed income tax returns. Recent press reports indicate that the ministry is in the process of issuing letters to another 70,000 companies and that a compliance management group has been set up to follow up and track return filing and the payment of any tax due.

Concluding remarks

Recent rulings mandating that nonresidents must file returns even if the income concerned is not taxable in India as a result of the application of a tax treaty leave no doubt that the AAR has changed its earlier, more relaxed position on this issue. Taken together with the government's initiative to target nonresidents that fail to comply with the tax return filing requirement, the AAR rulings clearly indicate that nonresidents doing business with India and claiming nontaxability of income in India consequent to treaty relief will have to pay greater attention to their Indian filing requirements. Nonresidents claiming tax treaty benefits in respect of India-source income should claim such benefits by filing an annual income tax return if they wish to avoid interest, penalties or even prosecution; obtain tax residence certificates from their countries of residence; and file a self-declaration in the new form 10F (see article in this issue on the form 10F requirement) to support their claims to treaty relief.

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Australia:
New tax treaty signed with Switzerland

On 30 July 2013, Australia announced that it had signed a new tax treaty and an accompanying protocol with Switzerland to replace the current treaty dating from 1980. The new treaty is not yet in force.

Highlights of the new treaty are as follows:

Limitation on benefits The protocol to the new treaty states that benefits of the treaty will not apply if one of the principal purposes for creating or assigning the property in respect of which the income is paid, or for becoming a resident of a contracting state, was to take advantage of the provisions of the treaty.

Dividends The treaty provides that dividends will be exempt from withholding tax if the beneficial owner of the dividends has directly or indirectly owned shares representing 80% or more of the voting power of an Australian payer company or 80% or more of the capital of a Swiss payer company for a 12-month period ending on the date the dividend is declared and the company that is the beneficial owner of the dividends:

1. Has its principal class of shares listed on a recognized stock exchange, as specified in the treaty, and regularly traded on one or more recognized stock exchanges;
2. Is owned directly or indirectly by one or more companies:
    a. Whose principal class of shares is listed on a recognized stock exchange and regularly traded on one or more recognized stock exchanges; or
    b. Each of which would be entitled to equivalent benefits under a tax treaty if it directly held the shares in respect of which the dividends are paid; or
3. Does not meet the requirements of (a) or (b) but the competent authority of the dividend-paying state determines that obtaining treaty benefits was not one of the principal purposes for creating or assigning the property in respect of which the income is paid or for becoming a resident of a contracting state.

Dividends also will be exempt from withholding tax if the beneficial owner of the dividends holds directly no more than 10% of the voting power in an Australian payer company or no more than 10% of the capital in a Swiss payer company, and the beneficial owner is one of the following:

- A specified government entity;
- A central bank of a contracting state;
- For Australia, an Australian resident deriving the dividends from complying superannuation activities; or
- For Switzerland, a pension scheme whose income is exempt from Swiss tax.

A 5% rate will apply if the beneficial owner of the dividends is a company that holds directly at least 10% of the voting power in an Australian payer company or a company that holds directly at least 10% of the capital in a Swiss payer company; otherwise, the rate will be 15%.

Interest   Interest will be exempt from withholding tax if it is derived by a financial institution that is unrelated to and dealing wholly independently with the payer (except in a back-to-back loan or similar arrangement). Interest also may be exempt from withholding tax if it is derived by:

- An Australian resident deriving the interest from complying superannuation activities;
- A Swiss pension scheme whose investment income is exempt from Swiss tax; or
- A specified government entity.

However, this exemption does not apply when the beneficial owner of the interest participates directly or indirectly in the management, control or capital or has a right to participate in the financial, operating or policy decisions of the issuer of the debt claim. Otherwise, the rate will be 10%.

Royalties   The withholding tax rate on royalties will be 5%.

Other   Certain income of a “temporary resident” in Australia may be exempt from Australian tax under Australian law. The protocol states that income that would otherwise be “relieved from tax” in Switzerland will not be eligible for treaty benefits if the income is exempt from Australian tax under the “temporary resident” rules.

The treaty also contains updated provisions dealing with mutual agreement procedures and the exchange of information.

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Czech Republic:
Fast-track visa initiative aims to encourage investment

The Czech Republic Ministry of Industry and Trade and CzechInvest, the investment and business development agency, launched an initiative on 1 July 2013 that provides for a fast-track visa procedure for certain foreign executives, managers and key personnel to facilitate the inflow of foreign direct investment and thereby increase the competiveness of the country as a business destination. The initiative – called the Welcome Package for Investors – aims to make the immigration procedure as expeditious as possible for key foreigners who need residence and work permits for investments in the Czech Republic.

The initiative is targeted at individuals from countries outside the EU that are exempted from visa requirements for 90 days under EU law (this includes individuals from Canada, Japan, Taiwan and the US, among other countries). The project is aimed mainly at companies engaged in production, information technology/software development and strategic services, and includes both newly established companies in the Czech Republic and companies already operating in the country. It covers managers and key specialists that will be employed by a newly established company or transferred from a foreign parent company to work at an entity in the Czech Republic.

To participate, a company must submit an application to CzechInvest and employ a certain number of employees, invest a certain amount in fixed assets or incur certain employee payroll costs, among other criteria.

The advantages of participating in the initiative include reduced processing time for obtaining a work permit (reduced from 40-60 days to 10 business days) and for obtaining a long-term visa (reduced from 90+ days to 30 calendar days).

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India:
More information required from nonresidents claiming treaty benefits

India's Central Board of Direct Taxes (CBDT) issued a notification dated 1 August 2013 announcing that nonresidents must furnish a new form (Form No. 10F) along with their tax residence certificate (TRC) to claim tax relief under an applicable tax treaty, unless the TRC already contains all required information.

Finance Act, 2012 introduced the requirement for a nonresident claiming relief under a tax treaty to obtain a TRC in a prescribed format from the tax authorities in its country of residence. Finance Act, 2013 amended this requirement by eliminating the prescribed format, but requiring a nonresident to continue to obtain a TRC and to maintain other documents and information as specified by the Indian tax authorities. The CBDT has now announced that, as from 1 April 2013, a nonresident must provide the additional information specified in new Form No. 10F along with the TRC in order to claim treaty benefits. The CBDT notification requires nonresidents to provide information in Form No. 10F that was originally required to appear in a TRC.

Form No. 10F must provide the following information (unless the TRC already contains all this information):

- Status (individual, company, firm, etc.);
- Nationality (for an individual) or country or specified territory of incorporation or registration (for an entity);
- Tax identification number in the country or territory of residence; if there is no such number, the taxpayer should provide an alternative unique number that identifies the person in its country or territory of residence;
- Period for which the residence status stated in the TRC is applicable; and
- Address of the taxpayer in its country or territory of residence during that period.

Additionally, a nonresident should preserve any documents necessary to substantiate the information provided in Form No. 10F, since the Indian tax authorities may require the nonresident to provide these documents to support its claim for treaty relief.

Before making a payment to a nonresident in a transaction subject to withholding tax, an India resident should require the nonresident to provide Form No. 10F along with its TRC to demonstrate that it qualifies for the lower withholding tax rate provided under the applicable tax treaty.

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India:
Draft safe harbor transfer pricing rules released

India's Central Board of Direct Taxes (CBDT) released draft transfer pricing "safe harbor" rules on 14 August 2013, as part of an initiative by the government to reduce the number of transfer pricing audits and protracted disputes. Under the safe harbor, the Indian income tax authorities will accept certain transfer prices declared by the taxpayer. The draft safe harbor rules follow the recommendations of the expert committee with respect to the taxation of development centers and the information technology sector.

The key features of the draft safe harbor rules are as follows:

- The rules will apply for fiscal years 2012-2013 and 2013-2014;
- The rules will apply only if a taxpayer opts to be governed by the safe harbor rules before the due date for filing the annual income tax return;
- The rules will not apply to transactions entered into with an associated enterprise located in a no tax or low tax jurisdiction (i.e. a jurisdiction that has a tax rate of less than 15%) or a "notified" country* (i.e. a country that does not effectively exchange information with India);
- A taxpayer opting to use the safe harbor rules will be required to comply with India's transfer pricing documentation rules and will not be permitted to invoke the mutual agreement procedure under a relevant treaty;
- The safe harbors for operating profit margin in relation to operating expenses for certain key transactions are as follows:
    - Provision of software development services (other than contract R&D)/information technology-enabled services where the total value of the international transaction does not exceed INR 1 billion (about USD 17 million): 20% or more;
    - Provision of information technology-enabled services that are knowledge process outsourcing services other than contract R&D where the total value of the international transaction does not exceed INR 1 billion: 30% or more;
    - Provision of specified contract R&D services wholly or partly relating to software development: 29% or more;
    - Manufacture and export of core auto components: 12% or more; and
    - Manufacture and export of non-core auto components: 8.5% or more.
- Where the safe harbor rules are not applicable to a taxpayer engaged in the provision of contract R&D services with insignificant risks, the transactional net margin method will be considered the most appropriate method for the determination of the arm's length price unless the taxpayer can demonstrate that it is not feasible to apply this method in the particular case.

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Luxembourg:
Guidance issued on minimum income tax regime

The Luxembourg tax authorities issued a circular on 1 August 2013 to clarify the scope of the minimum income tax and various criteria related to the tax regime. Introduced in 2011, the minimum tax initially was designed to cover administrative costs related to the management of tax files, but the tax has been revamped with new rules applying as from 2013.

All "collective entities" with a statutory seat or central administration in Luxembourg are liable to the minimum income tax, regardless of whether or not they are regulated (before 2013, only unregulated collective entities were subject to the minimum tax). Luxembourg permanent establishments (PEs) of foreign companies are outside the scope of the minimum tax on the grounds that, in principle, foreign companies have their statutory seat or central administration outside Luxembourg.

The amount of minimum tax due depends on the composition of the balance sheet of the Luxembourg collective entity. For this purpose, collective entities are divided into two categories:

- Tax resident entities that have qualifying holding and financing assets exceeding 90% of their balance sheet assets are liable to a flat minimum income tax of EUR 3,210; and
- Tax resident entities, other than those that hold mainly financial items (broadly, operating companies), are subject to a progressive minimum income tax that depends on the total assets on their balance sheet. The tax ranges from EUR 535 (for total balance sheet assets up to EUR 350,000) to EUR 21,400 (for total balance sheet assets exceeding EUR 20 million), including the unemployment fund surcharge.

The circular clarifies the following topics:

Liability to the tax – The minimum tax due is not reduced even if the taxpayer is not subject to corporate income tax for the full year. Liquidated or new entities will owe the full minimum tax. Where an entity is liquidated, taxation will occur upon completion of the liquidation process, provided the process does not exceed three years. Otherwise, taxation occurs every year on the basis of the balance sheet for the corresponding year.

Effect of tax treaties – The accounting value of assets producing income that is taxable only in another country under a tax treaty will be excluded from the calculation of total balance sheet assets. As a result, the accounting value of real estate and the accounting value of a Luxembourg entity's PE situated in a treaty country will be excluded from the calculation of the taxable base for the application of the minimum income tax.

Advance payments – The minimum income tax is viewed as an advance payment of corporate income tax and payments will not be refunded by the Luxembourg tax authorities. In practice, the minimum tax will be due if a Luxembourg collective entity is in a tax loss position or owes less corporate tax than the minimum income tax. In such cases, the amount paid can be offset indefinitely against future corporate tax liabilities.

Tax consolidation – All Luxembourg collective entities that are in a consolidated group for tax purposes are subject to the minimum income tax (payable by the parent entity). However, the aggregate amount due by the tax consolidated group will be limited to EUR 21,400. The right to benefit from the nonrefundable advance payments for future tax years is granted only to the head of the consolidated group.

Credits and losses – Each taxpayer subject to the minimum income tax must pay the tax, even if it can benefit from tax credits (such as those available for investments, recruitment of unemployed persons, etc.). The circular provides rules to follow when a taxpayer may use several forms of relief, and illustrates these in examples.

The minimum income tax does not affect losses – losses remain deductible against existing income and can be carried forward indefinitely.

The guidance in the circular was necessary to clarify certain interpretation issues, particularly with respect to the application of tax treaties (e.g. whether real estate and PEs of Luxembourg companies in countries with which Luxembourg has a tax treaty would be excluded from the determination of the minimum income tax base). The circular demonstrates the willingness of the Luxembourg tax authorities to consider pertinent issues and that they are able to respond quickly to concerns of the business community.

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Mexico:
Guidance issued on payments to tax havens and availability of foreign tax credits

The Mexican tax authorities (SAT) issued guidance on 25 June 2013 clarifying when the 40% withholding tax on payments made to residents of low tax jurisdictions applies and the availability of foreign tax credits.

Payments to residents of preferential tax regimes

Under the Mexican Income Tax Law (MITL), a preferential tax regime or "tax haven" (REFIPRE) is defined as a jurisdiction whose residents are taxed at a rate that is less than 75% of the rate that would be paid under the MITL (i.e. less than 22.5% for 2013).

The REFIPRE concept was included in the MITL when Mexico abandoned a "black list" of low tax jurisdictions (although the list is still in existence) and adopted controlled foreign company (CFC) rules. Provisions related to REFIPREs were included in a section of the law relating to the taxation of Mexican residents (and nonresidents with a permanent establishment (PE) in Mexico) with investments in CFCs. This placement seemingly would indicate that only Mexican residents and PEs that invest in CFCs are subject to the REFIPRE rules. However, a provision relating to tax havens also has been included in the section of the MITL addressing the taxation of nonresident individuals or entities without a PE in Mexico that derive Mexican-source income (article 205); under this rule, such income is subject to a 40% withholding tax rate (instead of the rate that otherwise would apply under domestic law) if the recipient of the income is a resident of a tax haven.

The inclusion of this provision in article 205 created a debate as to whether the provisions concerning REFIPREs applied only to investments by Mexican residents (or PEs) in CFCs, or if the rules also would apply to any nonresident with Mexican-source income that paid taxes at a rate of less than 22.5% in its own country, irrespective of its ownership structure. According to the latter interpretation, a transparent vehicle or entity, such as a disregarded entity or trust that does not pay taxes in its own jurisdiction, would fall within the definition of a nonresident subject to the REFIPRE rules. The new guidance clarifies that the 40% withholding tax applies only to payments made to CFCs that are controlled by Mexican residents or PEs of foreign companies in Mexico; thus, the 40% rate does not apply to payments made to nonresidents that are not considered CFCs from a MITL perspective.

Foreign tax credits

Mexican residents are taxed on worldwide income and are granted unilateral relief from double taxation in the form of a foreign tax credit. Article 6 of the MITL provides that when a Mexican resident pays tax abroad at a rate higher than that provided for in an applicable tax treaty with respect to a specific item of income, the Mexican resident may not claim a foreign tax credit for the excess tax paid until a mutual agreement procedure under the relevant treaty is concluded. According to the new guidance, a foreign tax credit attributable to withholding tax in excess of the relevant rate provided in a treaty may not be claimed until the competent authorities of the treaty partner countries conclude an agreement under the mutual agreement procedure and the Mexican resident has formally accepted the outcome of such procedure.

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Mexico:
Treaty with Colombia enters into force

The tax treaty signed by Mexico and Colombia on 13 August 2009 was approved by the congresses of the two countries and published in the Federal Official Gazette on 11 July 2013 for Mexico and in the Official Journal on 2 August 2012 for Colombia. The treaty will apply as from 1 January 2014.

The salient features of the new treaty are as follows:

- In addition to income taxes, the covered taxes article includes Mexico's business flat tax and the Colombian equity tax.
- Dual residence of entities will be resolved through a mutual agreement procedure between the Colombian and Mexican governments; if no agreement is reached, treaty benefits will not apply. In the case of individuals, residence conflicts will be resolved under a test that aims to determine the place where the individual has his/her habitual abode.
- The treaty allocates taxation rights to the source or residence country for various types of income (e.g. income from immovable property, interest, royalties, capital gains and business profits, among others):
    - Dividends will be taxable only in the state of residence of the recipient. Mexico does not levy withholding tax on dividends and Colombia levies tax only if the profits out of which the dividends are paid have not been taxed at the corporate level.
    - The treaty default withholding tax rate on interest will be 10%, with a 5% rate applying to interest paid to banks or insurance companies; exemptions will apply to certain types of interest. The general withholding tax rate on interest in Mexico is 30%, with a lower rate of 4.9% applying on interest paid to/by registered financial institutions and a higher rate of 40% applying on payments made to tax havens. The domestic rate in Colombia is 33% if the loan term does not exceed 12 months; otherwise, the rate is 14%.
    - The treaty rate on royalties, technical assistance and consulting services will be 10%. Under Mexico's domestic rules, royalties (including payments for technical assistance and consulting services) generally are subject to a 25% withholding tax, with a 30% rate applying to royalties paid for the use of patents and trademarks, and a 40% rate applying on royalties paid to recipients in tax haven jurisdictions. Colombia levies a 33% withholding tax on 80% of the gross amount of royalties paid, and a 26.4% tax when the royalties relate to software.
    - Special rules are provided for the alienation of shares. The treaty allows for source country taxation of capital gains derived from the sale of shares in the source country, provided that, within the 12-month period before the alienation, the seller held directly or indirectly at least 20% of the capital of the other company. The rate in such cases is capped at 20% of the gain.
    - Indirect transfers of real estate through a sale of shares will be subject to the above rules when the value of the shares being transferred is more than 50% derived from real property located in the other state. Mexico generally levies a 30% tax on capital gains and Colombia levies a 10% tax.
- When both countries are entitled to tax a particular item of income, the treaty establishes reciprocal credit methods to eliminate double taxation. Each state will grant a tax credit for tax paid in the other state, up to the amount of tax chargeable in the former state on such income, subject to rules provided in the treaty.
- The treaty includes an exchange of information clause that is aligned with the 2010 version of the OECD model treaty, including provisions related to information in the hands of financial systems and trust-type bodies.
- The treaty contains several anti-avoidance rules, including a limitation on benefits clause that will operate to deny treaty benefits if the income is paid under an arrangement whose main purpose is to enjoy the benefits of the treaty (a "conduit" arrangement) or in cases of general abuse of the treaty.

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OECD releases white paper on transfer pricing documentation

The Organization for Economic Development and Cooperation released a 42-page white paper on transfer pricing documentation on 30 July 2013, as part of its project on transfer pricing simplification, and invited interested parties to submit comments by 1 October 2013.

The white paper sets out:

- An overview of the existing guidance and initiatives, including local country documentation regimes and guidelines adopted by international organizations (such as the EU "masterfile" concept and the Pacific Association of Tax Administrators' documentation package). The section also includes a summary of comments from business representatives on the burdens imposed by differing documentation requirements.
- The purposes of transfer pricing documentation requirements; it lists three reasons for transfer pricing documentation: to allow tax authorities to conduct an informed risk assessment, to ensure that taxpayers have given appropriate consideration to transfer pricing in their tax returns and to provide to the tax authorities all information that might be required for a thorough transfer pricing audit.
- Suggestions for modifications to transfer pricing documentation rules to meet the goals of simpler compliance for business and more useful information for tax authorities. The OECD proposes a two-tier approach – the "Coordinated Documentation Approach" – that would involve a masterfile provided to all relevant tax authorities and a local file. The masterfile portion of the documentation would provide "big picture" information to enable tax authorities to undertake a risk assessment, whereas the local file would supplement the masterfile with information regarding individual transactions and their functional and economic analyses.
- Development of a coordinated approach to documentation. This area is the least developed so far, and the OECD acknowledges the challenges of local requirements within national tax systems. Further work is proposed.

The OECD's invitation to comment aims to launch a global discussion on how transfer pricing documentation rules can be improved, standardized and simplified. The OECD also invited comments on whether other mechanisms can be developed to comply with the transfer pricing documentation elements of the Base Erosion and Profit Shifting (BEPS) action plan.

The OECD will hold a public consultation on the white paper in November 2013.

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Peru:
Income tax rules revised for enactment of Repo Transactions Act

The Peruvian government enacted the Repo Transactions Act (Law No. 30052) on 27 June 2013 to establish a comprehensive and secure legal framework for repo transactions.

Repo transactions are financial transactions in which securities (usually referred to as collateral) are temporarily transferred in exchange for cash. Repos are internationally recognized as one of the most important channels for generating cash, particularly in the interbank market. However, the absence of specific provisions in Peru governing the legal arrangements for these transactions has impeded the optimal development of the market for this type of instrument.

To improve the monetary market and increase the liquidity of the negotiable securities held by participants in the Peruvian capital market, Law No. 30052 develops a comprehensive set of legal rules applicable to repo transactions and clarifies the income tax treatment governing them. These rules will enter into force after the 180-day period that the National Superintendence of Banks and Insurance (SBS), the National Superintendence of the Securities Market (SMV), the Economy and Finance Ministry (MEF) and the Peruvian Central Bank of Reserve (BCRP) have to publish the related regulations.

Current income tax treatment applicable to repo transactions

Repo transactions currently are listed by the Securities Market Act (SMA) as transactions that exchange brokers can perform. Regulations on these transactions have been issued only at an administrative level (i.e. they were issued by regulatory agencies and lack the authority of legislation approved by parliament), and they cover only repo transactions implemented through centralized mechanisms of negotiation (regulated by the SMV) or implemented outside these mechanisms with the participation of a financial entity (regulated by the SBS).

In an effort to encourage the use of repos in the capital markets, a previous tax reform package (Law No. 29645) provided that as from 1 January 2011, regardless of the legal characterization provided by the SMV/SBS regulations on securities trading activities, repo transactions would be treated as financing transactions for income tax purposes and would be subject to the following rules:

Classic repo transactions and sell/buy-back agreements – Because these arrangements are treated as financial transactions, the income obtained by the initial cash provider (i.e. the difference between the amount received in the final transfer and the amount paid for the initial transfer) has the nature of an interest payment. The tax liability arises when the final transfer is completed.

The amounts of the initial and final transfers do not affect the tax basis of other financial instruments held by the borrower or the initial cash provider.

The taxpayer that derives income during the trade from the securities transferred is the borrower. Any income derived from amounts provided by the initial cash provider to the borrower due to the application of the SMV/SBS regulations is disregarded for tax purposes.

Securities lending transactions – Transactions of this nature are regulated by the SMV (because they must be implemented through a centralized mechanism) and they also qualify as financial transactions. Consequently, the income obtained by the security lender (i.e. the difference between the initial sales price and the repurchase price) has the nature of an interest payment. The tax liability arises when the second transfer (the repurchase) is finalized.

The sales price and the repurchase price do not affect the tax basis of other financial instruments held by the security lender or the borrower.

If the borrower transfers the securities received to a third party, the tax basis is determined based on the purchase price paid for the replacement securities that the borrower acquires to transfer to the security lender. The taxpayer that derives income during the trade from the securities transferred is the security lender. Any income derived from amounts provided by the borrower to the lender due to the application of the SMV regulations is disregarded for tax purposes.

However, despite the tax clarifications made by these provisions, the absence of a specific legal framework regulating the transfer of securities and the applicable consequences of a transfer discouraged the use of these transactions in practice. Law No. 30052 now governs the general legal treatment applicable to repo transactions, and additional guidance should be published shortly based on the parameters that have been established.

Tax rules introduced by Law No. 30052

Law No. 30052 expressly recognizes that during the term of the agreement there is a temporary transfer of the property rights concerning the securities that are involved in the repo transaction. Thus, the uncertainty regarding the risk of loss of the collateral due to a civil action in case of a potential default of the counterparty has been eliminated.

Only transactions complying with the requirements set forth by Law No. 30052 will benefit from the new legal framework. Law No. 30052 provides that the MEF and the BCRP may have regulatory authority over certain transactions, in addition to the SBS and SMV. Consequently, transactions may now be implemented outside centralized mechanisms of negotiation (regulated by the SMV) with the participation of an entity authorized by the MEF or BCRP and still be subject to the legal regime and tax rules developed for traditional repo transactions.

Law No. 30052 covers, in general, three types of repo transactions:

1. Classic repo transactions – In a single transaction, the seller transfers securities to the buyer in exchange for a specified amount (initial amount) and agrees to repurchase the same securities (or others with the same class and characteristics) on a subsequent date, in exchange for another amount (final amount).
2. Sell/buy-back agreements – This involves a pair of transactions (a sell and a buy). The seller transfers securities to the buyer in exchange for a specified amount (initial amount) and agrees to repurchase the same securities (or others with the same class and characteristics) in a separate transaction on a subsequent date, in exchange for another amount (final amount).
3. Securities lending transactions – In a single transaction, the seller transfers securities to the buyer in exchange for a specified amount of money or other securities (initial amount) and the buyer agrees to transfer back the same securities (or others with the same class and characteristics) on a subsequent date, in exchange for another amount or the securities originally received by the seller (or others with the same class and characteristics) (final amount).

Transactions described in a and b above also are allowed within the regulatory authority of the SBS (in addition to the SMV) and are subject to the tax treatment provided by Law 29645 to classic repo transactions and sell/buy-back agreements. For these purposes, the term "seller" is equivalent to "initial cash provider," and "buyer" is equivalent to "borrower."

Transactions described in c above are subject to the tax treatment provided by Law 29645 to securities lending transactions. For these purposes, the term "seller" is equivalent to "security lender," and the term "buyer" is equivalent to "borrower."

As mentioned above, the legal regime provided by Law No. 30052 is extended to other transactions of a similar nature, to be determined by the SBS, SMV, BCRP or MEF. Accordingly, these other transactions also should be characterized as financing transactions subject to the tax rules developed for traditional repo transactions.

Legislative authority is provided to the SBS, SMV, MEF and BCRP to develop regulations on the legal treatment applicable to these arrangements within 180 days as from 28 June 2013. These provisions would replace the regulations issued by the SMV/SBS that currently are in force; therefore, complementary guidance on the tax treatment of these arrangements also is expected.

Comments

Law No. 30052 establishes a legal framework for repo transactions that should provide certainty to potential investors and that eliminates the legal constraints that they faced when dealing with this type of transaction, particularly those due to the risk of a potential recharacterization of the transaction at the judicial level in case of default by the seller of the securities.

It is expected that, with the new provisions, repo transactions progressively will replace uncollateralized transactions carried out in the financial markets. This should encourage the growth of the financial sector and improve access to financing sources for participants owning negotiable assets with sovereign risk that lack sufficient credit lines without borrowing against this collateral.

The negotiable securities market also should benefit by allowing investors to obtain liquid resources through short-term repo transactions, without affecting their long term investments.

Considering the expected enhancements that Law No. 30052 will provide for repo transactions, companies should re-evaluate the advantages of using these transactions as an alternative source of financing and plan accordingly.

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United States:
IRS releases draft instructions for FATCA registration

The US Internal Revenue Service (IRS) has issued draft instructions for the requestor of Form W-9, a form that persons required to file an information return with the IRS use to request the taxpayer identification numbers of US persons, including persons to whom they have made payments.

The instructions highlight the changes in the previously released draft Form W-9, including new fields, updated lists of payees exempt from back-up withholding, a list of the payees and account holders exempt from FATCA reporting and an updated certification that any FATCA exemption code entered on the form is correct, among other items. The instructions also include the requirements for using a substitute version of the Form W-9 in lieu of the official form; withholding agents may need to update their procedures and systems to comply with the new requirements, and any required updates will likely need to be in place within six months after the Form W-9 is finalized (to meet the new FATCA compliance deadlines, this likely means by 1 July 2014).

The IRS also announced that its online registration system is now open for foreign financial institutions that are required to register with the IRS for FATCA purposes.

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In brief

China – The State Administration of Taxation and the State Administration of Foreign Exchange (SAFE) jointly issued a bulletin in July 2013 that will ease the administrative procedures for carrying out certain foreign exchange transactions involving offshore payments. The new rules, which will apply as from 1 September 2013, abolish the tax clearance certificate requirement for outbound payments exceeding USD 30,000 (or its equivalent) made with respect to trade in services and certain other items. Instead, domestic organizations and individuals that make such payments exceeding USD 50,000 (or its equivalent) will be required to submit a "Tax Filing Form" and relevant transaction documents to the competent state tax authorities. A copy of the form must be provided to the bank before an offshore payment can be made. In conjunction with the bulletin, the SAFE issued a circular that simplifies the administrative procedures for making payments offshore for services and certain other items, and that eliminates the requirement to present a tax clearance certificate to a bank when making a payment offshore for trade in services.

Indonesia – A regulation that became effective on 1 July 2013 introduces a 1% final income tax on business activities (trading and services) income earned by corporate (other than permanent establishments of foreign companies) and individual taxpayers whose gross income does not exceed IDR 4.8 billion in a fiscal year. The 1% final income tax does not apply to the following taxpayers: (1) corporate taxpayers that have not yet commenced commercial operations; (2) corporate taxpayers whose annual turnover exceeds IDR 4.8 billion within one year after commencing commercial operations; and (3) individuals that use facilities that can be assembled/disassembled in carrying out their trading or service activities. Taxpayers that pay tax under another regime also are not subject to the 1% final tax. The Ministry of Finance is expected to issue detailed guidance on the criteria for commercial operations and the calculation, settlement and reporting of the 1% income tax.

Portugal – Portugal has introduced a temporary extraordinary tax credit regime aimed at promoting investment. The new regime, which applies as from 17 July 2013, allows a tax credit of up to 20% of qualifying investment (e.g. investment in new property, plant and equipment) up to a maximum investment of EUR 5 million. The credit may be used to offset taxable income for the 2013 tax year and may not exceed 70% of the company's tax liability; any excess tax credit may be carried forward to the following five years. The credit is available for investments made between 1 June and 31 December 2013, but cannot be used simultaneously with other incentives of a similar nature.

Spain – The European Commission has opened an in-depth investigation to verify whether the new interpretation of a Spanish scheme allowing tax deductions in connection with the acquisition of shareholdings in non-Spanish companies is in line with EU state aid rules. The Commission had found the original version of the scheme incompatible with the state aid rules because it gave the beneficiaries a selective economic advantage over their competitors performing domestic acquisitions. The opening of an in-depth investigation gives interested third parties an opportunity to submit comments on the measure under assessment.

Switzerland – The Swiss Federal Supreme Court (SFSC) has issued a decision confirming that the place of supply of online dating services provided by a nonresident entity is in Switzerland if the services are provided to Swiss resident persons. The SFSC had to consider whether online dating services are rendered directly in the physical presence of individuals, in which case the place of supply would be deemed to be the place where the person rendering the service has its place of business. The SCFC rejected this interpretation because the services were provided exclusively via the internet and, therefore, did not require any physical meeting between the supplier and the customer. The SFSC concluded that online dating services are "telecommunications and electronic" services for VAT purposes. Since the provider of the services (a US entity) renders the telecommunication/electronic services to Swiss resident non-VAT taxable recipients, the exemption from Swiss VAT registration does not apply. (All non-Swiss providers of telecommunication and electronic services to nontaxable recipients must register for Swiss VAT if annual turnover exceeds CHF 100,000.)

Taiwan – In the course of compliance reviews, the tax authorities in Taiwan have been focusing on the VAT treatment of exported services and the application of the zero rate VAT. The zero rate applies to services relating to exports and to services provided in Taiwan but used outside Taiwan. Some companies in Taiwan, including multinational companies with operations in Taiwan, supply services used outside Taiwan to companies located outside Taiwan and could apply for the zero rate VAT, but they apply the standard 5% VAT rate. In these cases, the service provider may apply for a refund of the overpaid VAT within five years from the date of payment. Conversely, Taiwanese companies supplying services used in Taiwan to companies located outside Taiwan may be incorrectly zero-rating the supply of services, risking the imposition of a penalty of up to five times the unpaid VAT. Companies should consider reviewing the VAT treatment of export services to clarify the nature of the services and determine which VAT rate should apply.

Vietnam – The government has issued a decree that contains guidance on the tax administration of various issues, including the foreign contractor withholding tax (FCWT) and advance pricing agreements (APAs). A foreign contractor is now required to provide a summary of its contract in Vietnamese as a part of the FCWT declaration dossier (it is no longer necessary for the contractor to provide a copy of its business or professional license). An APA will be valid for a maximum period of five years and can be extended for an additional five-year period and can be revoked at the request of the tax authorities or the taxpayer.

Tax treaty round up

At the end of each month, *World Tax Advisor* provides an update on recent tax treaty developments, with a focus on items that directly affect the withholding tax rates of the key jurisdictions covered by the Deloitte International Tax Source (DITS). Additional coverage may include stated negotiating priorities and other important tax treaty trends.
URL: http://www.dits.deloitte.com

Unless otherwise noted, the developments discussed below are not yet in force.

Australia-Mauritius – The 2010 treaty entered into force on 31 May 2013 and will apply as from 1 July 2014 in Australia and as from 1 January 2014 in Mauritius. The treaty does not cover dividends, interest and royalties, so domestic rates will continue to apply.

Australia-Switzerland – See article in this issue.
URL: http://newsletters.usdbriefs.com/2013/Tax/WTA/130823_2.html

Cyprus-Portugal – The 2012 treaty entered into force on 16 August 2013 and will apply as from 1 January 2014. When in effect, the treaty provides for a 10% withholding tax on dividends, interest and royalties.

Hong Kong-Kuwait – The 2010 treaty entered into force on 24 July 2013 and will apply as from 1 April 2014. When in effect, the treaty provides that dividends will be exempt if paid to a government or government institution; otherwise, the rate will be 5%.The rate on interest and royalties will be 5%.

Luxembourg-Poland – The 2012 protocol to the treaty entered into force on 25 July 2013 and will apply as from 1 September 2013 for withholding taxes and as from 1 January 2014 for all other tax matters. When in effect, the protocol provides for a 0% rate on dividends paid to a beneficial owner that holds directly at least 10% of the share capital of the distributing company for a continuous period of 24 months before the dividends are paid; otherwise, the rate will be 15%. The rate on interest and royalties will be 5%.

Malta-Turkey – The 2011 treaty entered into force on 13 June 2013 and will apply as from 1 January 2014. When in effect, the treaty provides for a 10% withholding tax where dividends are paid by a Turkish company to a Maltese company, provided the recipient company holds directly at least 25% of the capital of the payer company. The rate in all other cases will be 15%. Dividends paid by a Maltese company to a Turkish company will be exempt from tax in Malta that is chargeable on dividends, in addition to the tax chargeable in respect of the profits of the company. Further, Malta tax chargeable with respect to distributed profits of the company may not exceed 15% if the distributed profits consist of gains or profits earned in any year in respect of which that company is in receipt of a benefit under the measures regulating aid to industries in Malta, as long as the recipient submits returns and accounts to the Malta tax authorities in respect of its income liable to Malta tax for the relevant year of assessment. The rate on interest and royalties will be 10%.

New Zealand-Vietnam – When in effect, the treaty signed on 5 August 2013 provides for a 5% withholding tax on dividends paid to a company that holds directly at least 50% of the voting power in the payer company; the rate will be 15% in all other cases. The rate on interest and royalties will be 10%.

Poland-Slovakia – When in effect, the protocol signed on 1 August 2013 provides that dividends will be exempt if paid to a company that holds directly at least 10% of the capital of the payer company on the date the dividends are paid, and has held the participation or will have done so for an uninterrupted 24-month period within which that date falls; otherwise, the rate will be 5%. The rate on interest will be 5%. The withholding tax rate on royalties will not be affected by the protocol.

Russia-United Arab Emirates – The 2011 treaty entered into force on 23 June 2013 and will apply as from 1 January 2014. The treaty applies only to the federal and local government, central bank and wholly state-owned financial or investment organizations, institutions or other entities; it does not apply to privately held companies. When in effect, the treaty provides that dividends and interest paid to the other contracting state or its financial and investment institutions will be exempt from withholding tax. The treaty does not contain any provisions on royalties.

United Kingdom-Panama – When in effect, the treaty signed on 29 July 2013 provides that dividends will be exempt from withholding tax if the beneficial owner of the dividends is (a) a company whose capital is wholly or partially divided into shares and that holds directly at least 15% of the capital of the payer company, provided that (i) the shares of the dividend recipient are regularly traded on a recognized stock exchange; (ii) at least 50% of the shares of the dividend recipient are owned directly or indirectly by one or more individuals who are residents of either contracting state or by one or more companies whose shares are regularly traded on a recognized stock exchange and that are residents of either contracting state or that would be entitled to similar or more favorable benefits under a tax treaty; (iii) the dividend recipient conducts an active trade or business in the contracting state of its residence (other than making or managing investments for its own account, unless the recipient is a bank or insurance company); or (iv) the dividend recipient does not meet the requirements of (i), (ii) or (iii) but the competent authority of the contracting state that would grant the benefits determines that it was not a main purpose of any person concerned with the establishment, acquisition or maintenance of the company to obtain the benefit of the withholding tax exemption; (b) a contracting state or one of its political subdivisions or local authorities; or (c) a pension scheme. Otherwise, the rate will be 15%. Interest will be exempt from withholding tax if it is paid on a credit sale of merchandise or equipment or if the beneficial owner is a pension scheme. A 5% rate will apply if the interest (1) is paid by a bank in the ordinary course of its banking business, on a quote Eurobond or by a contracting state or one of its political subdivisions or local authorities; or (2) is beneficially owned by an individual, a company whose principal class of shares is regularly traded on a recognized stock exchange, certain unrelated financial institutions or a company that does not fall into any of these categories where the competent authority of the contracting state that would grant the benefits determines that it was not a main purpose of any person concerned with the establishment, acquisition or maintenance of the company to obtain the benefit of the withholding tax exemption. Otherwise, interest will be subject to the domestic withholding tax rate. The rate on royalties will be 5%.

Vietnam-Tunisia – The 2010 treaty entered into force on 6 March 2013 and will apply as from 1 January 2014. When in effect, the withholding tax rate on dividends, interest and royalties will be 10%.

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Brazil

Guidance issued on spread for transfer pricing purposes

The Brazilian Ministry of Finance issued a ruling on 2 August 2013 that defines and clarifies the "spreads" that should be taken into account for transfer pricing purposes. The spreads apply to interest charged in the context of related party financial transactions. [Issue date: 3 August 2013]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/a457e9722aa40410VgnVCM3000003456f70aRCRD.htm?id=us:em:na:wta:eng:tax:082313
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/Global%20Tax%20Alerts/2013/dttl_tax_alert_Brazil_030813.pdf?id=us:em:na:wta:eng:tax:082313

OECD

New OECD Draft on Transfer Pricing Aspects of Intangibles

On 30 July 2013, the OECD issued a revised Discussion Draft on Transfer Pricing Aspects of Intangibles for public consultation. This is part of the OECD's ongoing project to update and clarify the intangibles chapter of the "*Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*" and it is much changed from the initial draft issued in June 2012. This work is a key part of the OECD's broader project to address BEPS within the international tax system. [Issue date: 6 August 2013]

URL: http://www.deloitte.com/view/en_GX/global/services/tax/cross-border-tax/transfer-pricing/transfer-pricing-alerts/df1d6a0bd4750410VgnVCM2000003356f70aRCRD.htm?id=us:em:na:wta:eng:tax:082313
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/transfer-pricing/dttl_tax_tpalert_2013_22-060813.pdf?id=us:em:na:wta:eng:tax:082313

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