



Double tax treaties in Asia Pacific: Updates and developments

The Dbriefs International Tax series

Chris Roberge / Claudio Cimetta / Radhakishan Rawal
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Agenda

- Multilateral Instrument (MLI) implementation
- Trends in recent Asia Pacific income tax treaties
- UN update
- Recent treaty cases
- Questions and answers

MLI implementation

MLI status update*

Asia-Pac MLI status table

Country	Status
Australia	In force
China	Signed
Hong Kong	Signed
India	Signed
Indonesia	Signed
Japan	In force
Korea	Signed
Malaysia	Signed
New Zealand	In force
Singapore	In force
Thailand	Intends to sign

- Globally, MLI has been signed by 89 countries
- Date of entry into force depends on completion of ratification procedures under local laws
- MLI provisions modify the operation of specified existing treaties (“covered tax agreements”)

* Based on OECD database at 28 June 2019

MLI key provisions overview

- **Mandatory provisions (BEPS minimum standards)**
 - Preventing treaty abuse: Preamble plus Principal Purpose Test (PPT) and/or Limitation On Benefits test (LOB)
 - Dispute resolution: Mutual Agreement Procedure (MAP) in accordance with OECD model and requirement for corresponding adjustments (best practice)
- **Optional provisions (reservations allowed)**
 - PE definition: expansion of agency PE definition, narrowing of specific activity exemptions, anti-fragmentation rule, and splitting-up of contracts
 - Corporate residency tie-breaker: by competent authority agreement
 - Dispute resolution: mandatory binding arbitration
 - Hybrid mismatches: transparent entities
 - Capital gains on land rich entities: expanded taxing rights

Note: equivalent provisions are now included in the OECD Model Treaty (2017 revised version), which is intended to form the basis for negotiation of future bilateral treaties.

Prevention of treaty abuse

Preamble, Principal Purpose Test (PPT) and/or Limitation On Benefits (LOB)

- **Preamble**

- As a minimum standard, jurisdictions should expressly recognize that the provisions of the treaty do not intend to create opportunities for tax evasion and avoidance

- **As a minimum standard, jurisdictions should implement one of the following three**

- PPT
- PPT plus LOB (LOB can be either simplified or detailed)
- Detailed LOB plus anti-conduit arrangement

- **PPT**

- A benefit under the (treaty) shall not be granted in respect of an item of income or capital if it is **reasonable to conclude**, having regard to all relevant facts and circumstances, that obtaining that benefit was **one of the principal purposes** of any arrangement or transaction that resulted directly or indirectly in that benefit
- Unless it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose** of the relevant provisions of the (treaty)

Choices made by Asia Pacific countries

PPT only				
Australia	China	Hong Kong	Japan	India*
Korea	Malaysia	New Zealand	Singapore	

Simplified LOB + PPT
Indonesia

* With intention to agree LOB bilaterally where possible

PPT guidance and considerations

- **OECD guidance**

- Bona fide exchanges of goods and services and movements of capital and persons
- Question of fact which can only be answered by considering all circumstances
- Merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes
- Inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit

- **Some considerations**

- Number, seniority, and relevant skills of personnel
- Real decision-making and substantive economic functions
- Active conduct of a business
- Not acting as a conduit
- Appropriate capital structure/balance sheet
- Volume of transactions
- Local business environment
- Transactions with third parties
- Contemporaneous evidence of purpose

Expanded PE definition

Positions of Asia-Pacific countries

Country	Expanded agency PE	Specific activity exemptions	Anti-fragmentation rule	Splitting-up of contracts
Australia	×	✓A	✓	✓
China	×	×	×	×
Hong Kong	×	×	×	×
India	✓	✓A	✓	✓
Indonesia	✓	✓A	✓	✓
Japan	✓	✓A	✓	×
Korea	×	×	×	×
Malaysia	✓	✓A	✓	×
New Zealand	✓	✓A	✓	✓
Singapore	×	✓B	×	×

Polling question 1

What impact do you think the MLI will make on your current organization structure?

- Critical (at least 50% of treaties or investments)
- High (30%-50%)
- Medium (15%-30%)
- Low (less than 15%)

Trends in recent Asia Pacific income tax treaties

Bilateral treaty update 2018/2019

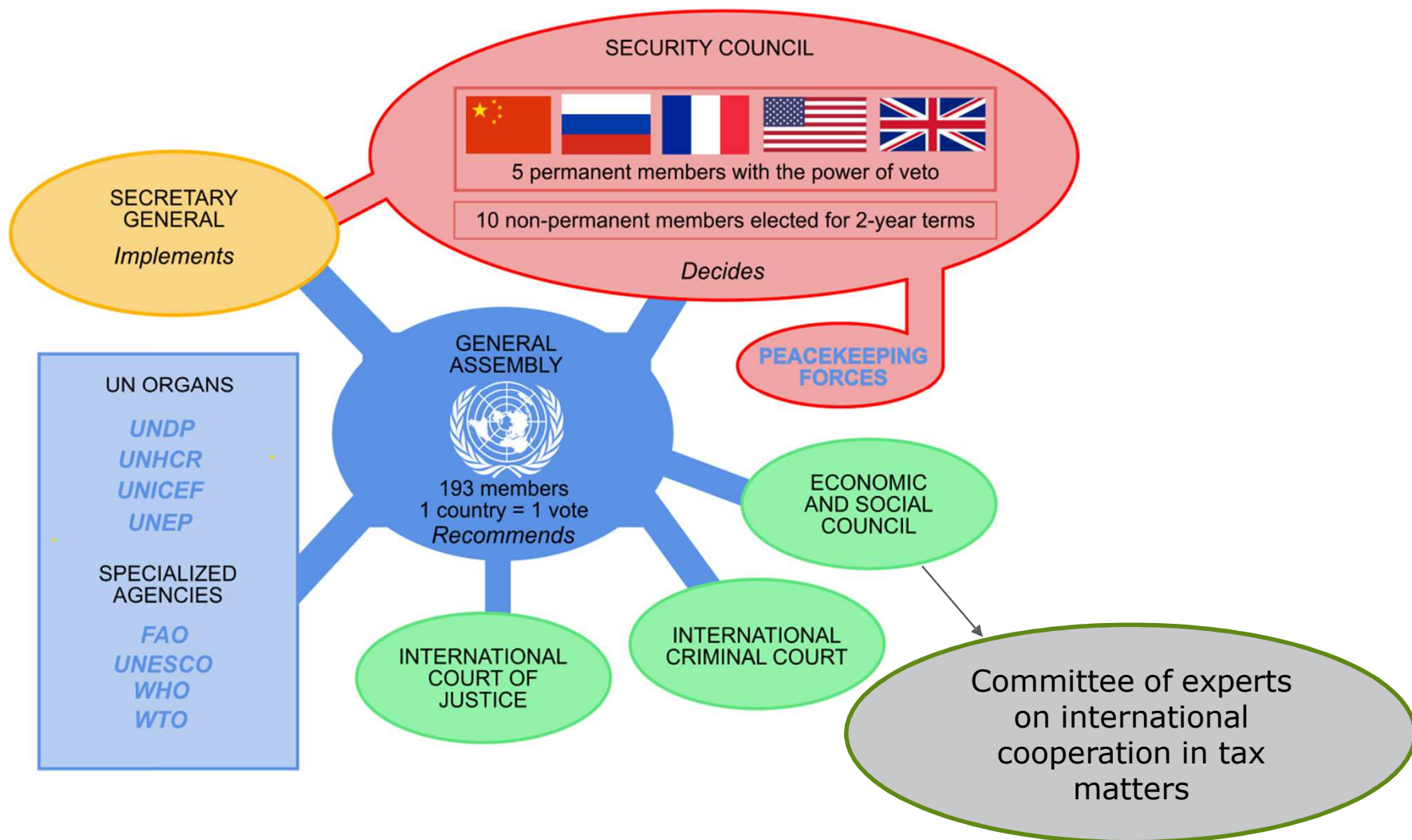
Jurisdiction	In-force (effective date)	Pending (signature date)
Cambodia	<ul style="list-style-type: none"> • Brunei (1 January 2019) • China (1 January 2019) • Vietnam (1 January 2020) 	<ul style="list-style-type: none"> • Indonesia (ratified 12 December 2018) – conclusion date 13 October 2017 (Cambodia), 23 October 2017 (Indonesia) • Hong Kong (20 June 2019)
China	–	<ul style="list-style-type: none"> • Angola (9 October 2018) • Argentina (2 December 2018) • Chile protocol (29 May 2018) • Congo (5 September 2018) • Gabon (5 September 2018) • India protocol (26 November 2018) • Spain (28 November 2018) • Cambodia (1 January 2019) • New Zealand (1 April 2019) • Italy (23 March 2019)
Hong Kong	<ul style="list-style-type: none"> • Finland (1 April 2019) • India (1 April 2019) • Saudi Araba (1 April 2019) 	<ul style="list-style-type: none"> • Cambodia (20 June 2019)
India	<ul style="list-style-type: none"> • Hong Kong (1 April 2019) • Iran (17 February 2018) • Kazakhstan (1 April 2018) 	<ul style="list-style-type: none"> • Brunei (28 February 2019 for exchange of information) • China protocol (26 November 2018) • Zambia (11 April 2018) • Kyrgyzstan protocol (14 June 2019)

Bilateral treaty update 2018/2019 (Cont'd)

Jurisdiction	In-force (effective date)	Pending (signature date)
Japan	<ul style="list-style-type: none"> • Austria (1 January 2019) • Denmark (1 January 2019) • Estonia (1 January 2019) • Iceland (1 January 2019) • Lithuania (1 January 2019) • Russia (1 January 2019) 	<ul style="list-style-type: none"> • Colombia (19 December 2018) • Croatia (19 October 2018) • Ecuador (15 January 2019) • Spain (16 October 2018)
Korea (Rep.)	–	<ul style="list-style-type: none"> • Czech Republic (12 January 2018) • Singapore (13 May 2019) • Switzerland protocol (17 May 2019) • Turkmenistan Protocol (17 April 2019)
Philippines	<ul style="list-style-type: none"> • Mexico (1 January 2019) 	–
Singapore		<ul style="list-style-type: none"> • Brazil (7 May 2018) • Gabon (28 August 2018) • Kenya (12 June 2018) • US Exchange of Information (13 November 2018) • Korea (13 May 2019) • Greece (30 May 2019)
Vietnam	<ul style="list-style-type: none"> • Cambodia (1 January 2020) • Latvia (1 January 2019) • Macau (1 January 2019) 	<ul style="list-style-type: none"> • Croatia (27 July 2018)

UN update

Introduction to UN tax committee's operations



Recent UN developments

- **Update of the UN model (2017, released May 2018)**
 - New Article 12A – fees for technical services
 - BEPS related changes in the model
 - Changes to the UN commentary
- **Other developments (work in progress)**
 - Work on digital economy
 - Taxation of Collective Investment Vehicles (CIVs)
 - Development projects
 - Environment tax issues
 - Update of UN model and other manuals/handbooks
 - Extractive industries
 - Transfer pricing
 - Negotiation of tax treaties, etc.

Polling question 2

Which action item will affect your business the most?

- Action 4 – interest deductibility
- Action 5 – harmful tax practices
- Action 6 – treaty shopping
- Action 7 – permanent establishments

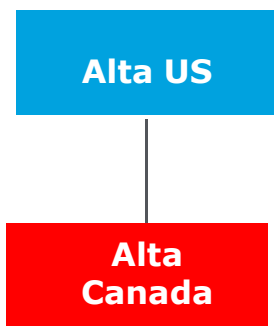
Recent treaty cases

Alta Energy Luxembourg S.A.R.L. vs. The Queen

Alta Energy Luxembourg S.A.R.L. vs. The Queen

Facts

2012 reorganization



1. 2012 restructuring

- In a 2012 reorganization, Alta US inserted AEL, a Luxembourg s.a.r.l to hold the shares of Alta Canada
- Taxable transaction, with the tax filing position that $ACB = FMV$

2013 sale



2. 2013 sale to Buyco

- In 2013, AEL sold shares of Alta Canada, recognizing a substantial capital gain
- AEL claimed an exemption under Article 13(4) of the Canada-Luxembourg Treaty (the treaty)

3. Reassessment/appeal

- Canadian Revenue Authority (CRA) reassessed to deny the claimed treaty exception

Alta Energy Luxembourg S.A.R.L. vs. The Queen

Issues and analysis

- **Issues**

1. Does General Anti-Avoidance Rule (GAAR) apply to deny the treaty benefit?
2. How would this impact a future PPT test?

- **Analysis**

- Canadian tax authority argued that (amongst other things)
 1. The restructuring resulted in an abuse of the capital gain taxation provisions of the Income Tax Act of Canada and the treaty
 2. AEL was a conduit
 3. The 2012 restructuring amounted to “treaty shopping”

Alta Energy Luxembourg S.A.R.L. vs. The Queen

Analysis

- **Conclusion**

- GAAR does not apply
- AEL could not have been a conduit
- Interesting comments
 - Minister cannot rely on application of the GAAR to remedy what finance now believes is an unintended gap in the treaty
 - While the purpose of the treaty is to avoid double taxation, the treaty is a multi-purpose instrument and that the specific purposes of the articles alleged to have been abused needed to be determined not just some overarching principle
 - The OECD model treaty does not contain a carve-out for immovable property and treaty negotiators are assumed to have known that Luxembourg would not tax
- CRA has appealed the decision

Alta Energy Luxembourg S.A.R.L. vs. The Queen Analysis

- **Meaning post MLI and for PPT**

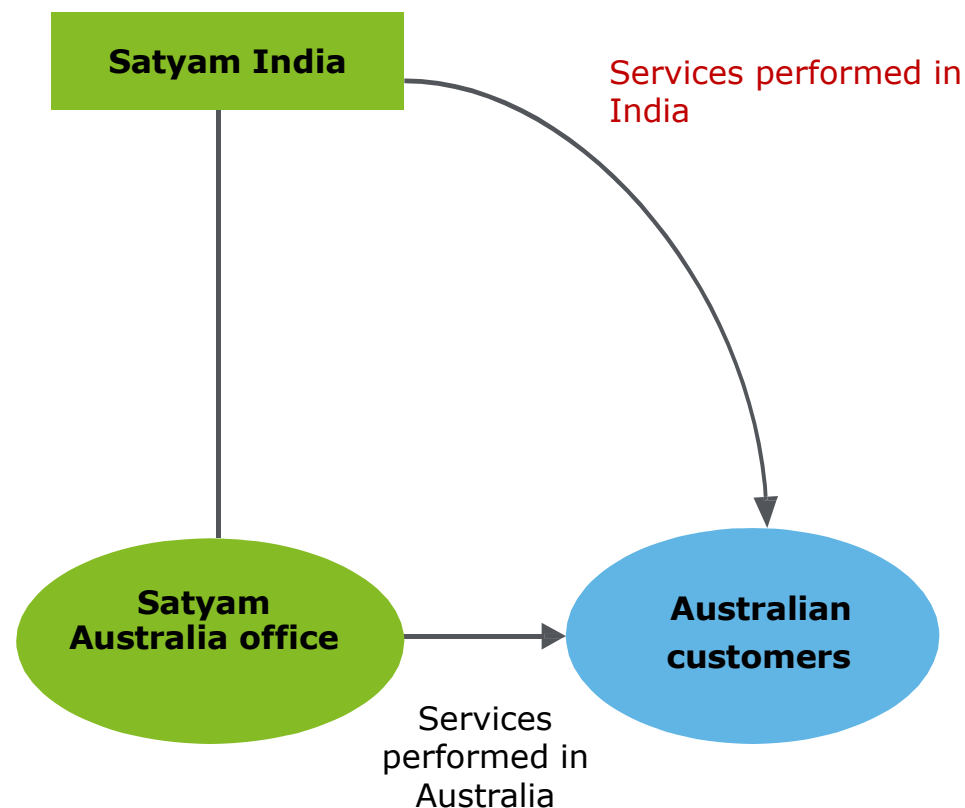
- Canada's GAAR has many similar elements to the PPT test
- "Object, spirit, and purpose" vs. "in accordance with object and purpose"
 - Notwithstanding that there is a benefit and it may be a principal purpose, still need to define the object and purpose
 - Possibly the same result as
 - This is what the treaty negotiators bargained for
 - They knew, or ought to have known, the outcome
 - Purposefully excluded any LOB or other criteria

Satyam Computer Services Ltd vs. FCT

Satyam Computer Services Ltd vs. FCT

Facts and issues

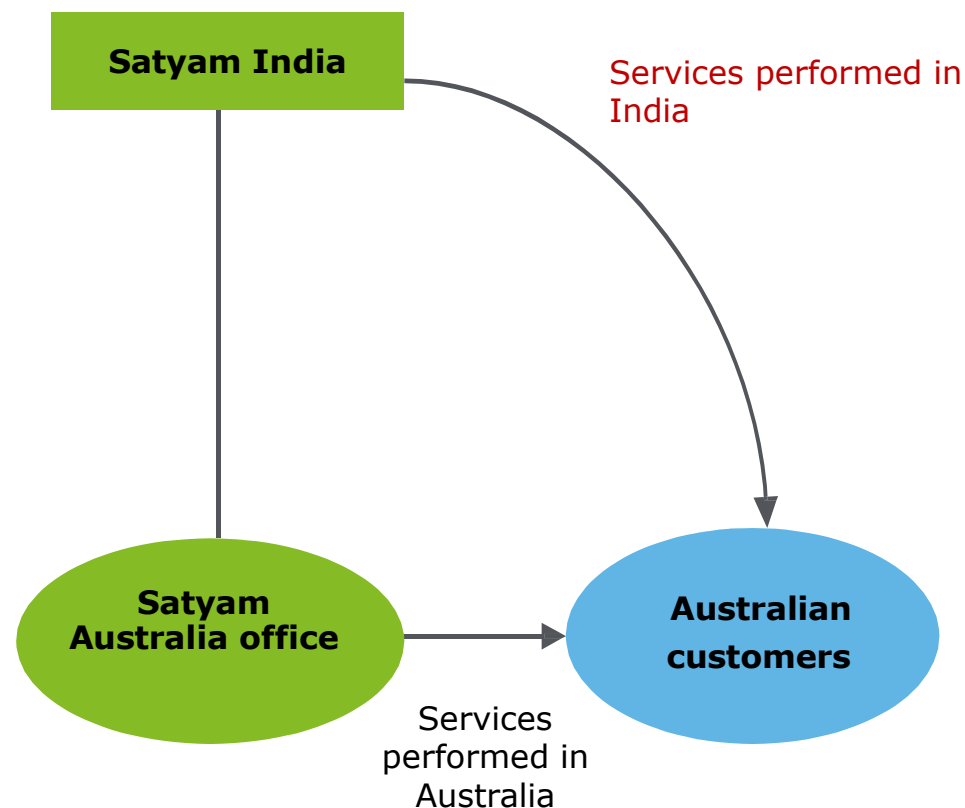
- Satyam is a resident of India
- Satyam provided software and IT services to Australian customers through
 1. Employees located at offices in Australia
 2. Employees located in India



Satyam Computer Services Ltd vs. FCT

Analysis – offshore services

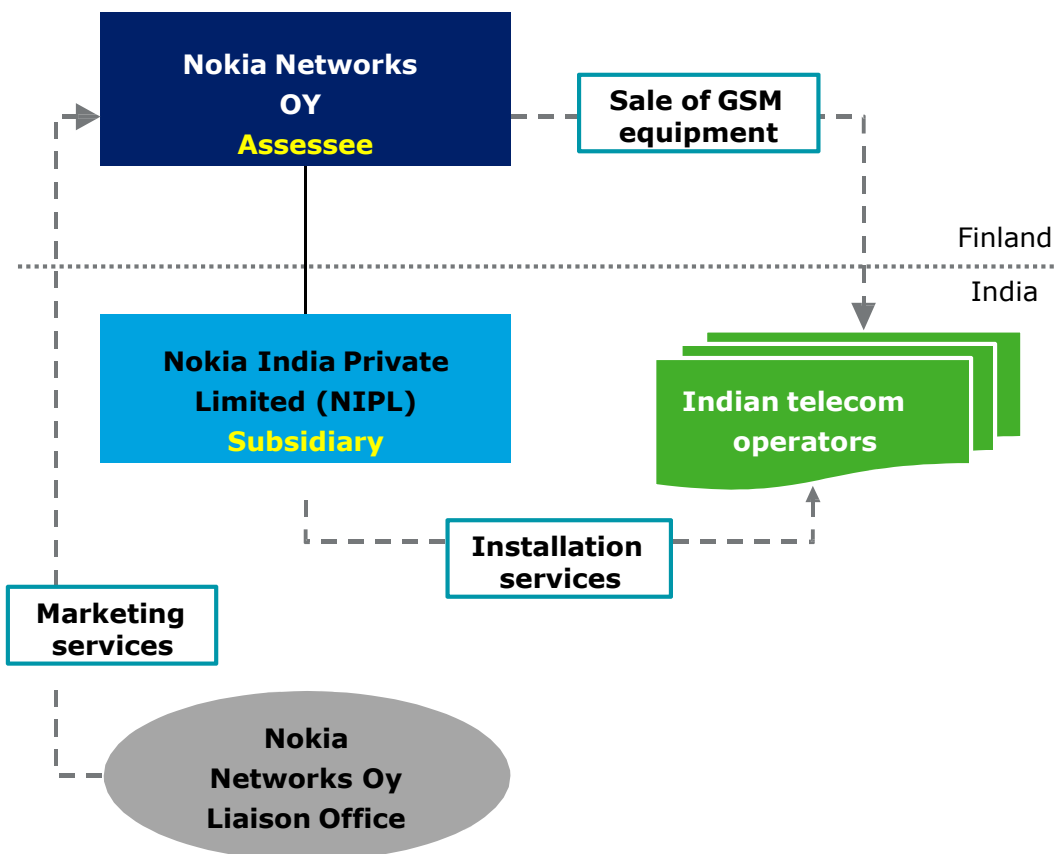
- Business profits article not applicable
- “Royalties” according to the treaty (broad definition) but not under domestic law (narrower)
- Therefore the fees “may be taxed” in Australia (Article 12)
- Therefore the fees are **deemed** to have an Australian source for treaty **and domestic law** purposes (Article 23(1))
- Therefore the fees became taxable under domestic law as Australian sourced income earned by a foreign resident



Nokia Networks OY vs. JCIT

Nokia Networks OY vs. JCIT

Alter ego subsidiary PE



- **Findings – minority view**
 - Subsidiary company PE
 - No significant activity of its own
 - Activity mainly for parent
 - Alter ego
 - Virtual projection

Nokia Networks OY vs. JCIT

Features of “alter ego” conclusion

- Installation work by I Co. only if the machines sold by foreign parent
- I Co. shown as having significant experience, although recently incorporated
- Key employees of I Co. were all employees of the F Co. seconded to India
- Performance guarantee given by F Co. for I Co. work
- 51% ownership to be continued
- No consideration for the performance guarantee
- Notice by clients to F Co.

Nokia Networks OY vs. JCIT

Features of “alter ego” conclusion (Cont’d)

- Cost plus 5% compensation to I Co. by F Co.
- Quarterly billings not done
- Installation work related losses of I Co. artificial – arm’s length payment by parent
- Incorporation of I Co. was a device to artificially block creation of a PE
- Alter ego subsidiary PE – a PE under Article 5(1) and not Article 5(5)

Questions and answers

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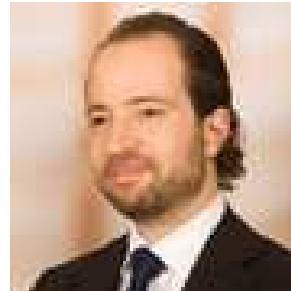
Evolution of regulations impacting inbound/outbound investments in China, India, and Vietnam

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Contact information



Chris Roberge
Tax Partner
Deloitte Hong Kong, China
chrisroberge@deloitte.com.hk



Claudio Cimetta
Tax Partner
Deloitte Melbourne, Australia
ccimetta@deloitte.com.au



Radhakishan Rawal
Tax Partner
Deloitte Mumbai, India
rradhakishan@deloitte.com

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