WELCOME REMARKS FROM THE CONFERENCE DIRECTOR

Roy Rohatgi

Professor Roy Rohatgi

As Conference Director, I welcome you to our 23rd Annual Conference

Our 23rd Annual conference in 2018 continues from our previous conferences on BEPS IN ACTION. MLI was approved after the ratification of its fifth Instrument in March 2018 and became operational on July 1, 2018. It allowed tax treaty changes needed under BEPS recommendations to be made multilaterally by Member States.

Our conference again this year is a joint conference with IBFD in Amsterdam. We are grateful for their support. As in previous two years, it is also organized by us in cooperation with OECD, Paris. Pascal Saint-Amans from OECD is again our keynote speaker. He and his team of experts will make presentations and speak about the recent progress of the BEPS project with MLI in Action at our conference. This year he is accompanied by three of his BEPS experts at OECD Paris, namely John Peterson from Australia, Monica Bhatia from India and Jeffrey Van Hove from the States.

Day One includes several presentations in our plenary session by global experts on a wide range of issues relating to global developments in international tax and concludes with two high level panel discussions on (i) latest OECD recommendations on international taxation of digitized business and (ii) the recent tax reforms in the United States and their global impact. The panelists include several globally renowned speakers such as William Morris (PWC), Rodney Lawrence (KPMG Global), Mindy Herzfeld (Florida University) and Robert Stack (Deloitte) from the States, Robert Danon and Mike Williams from Europe and Christopher Xing and Akhilesh Ranjan from Asia. The panel leaders are Sol Picciotto (UK) and Mark Levey (US).

On Day Two, our session on BEPS in India includes a talk on" Recent Developments in International Taxation in India under BEPS" by Akhilesh Ranjan, Member, Central Board of Direct Taxes and Principal Chief Commissioner of Income-tax (International), India. Professor Parthasarathi Shome, an expert on Indian international tax, will chair a high-level panel discussion by tax experts from leading professional firms in India on "BEPS and Indian Tax Policy, Practice and Compliance in the Future". We have a book launch with presentation by Dr. Bibek Debroy, who is Chairman of the Economic Advisory Council to the Prime Minister of India, Mr. Narendra Modi, on his recent book ''Making of New India through Transformation under Modi Government".

Post lunch, there is a special session by Pascal Saint-Amans and visiting OECD Speakers on "Recent Challenges and Contributions by OECD to International Taxation" followed by an update on" Digitized Business: OECD Proposals" based on their latest Paris meeting. We have also invited Professor Robert Danon from Switzerland to speak on MLI and Tax Certainty in a session chaired by Bob Stack (former Deputy Assistant Secretary at the US Department of Treasury). This is followed by a panel discussion on "Tax Trends in Mergers and Acquisitions" and a high-level panel on current "Judicial Tax Perceptions of the Permanent Establishment".

The day ends with a special dinner to commemorate their 80th anniversary of IBFD this year. This celebratory reception and dinner will be held in the new Ballroom in one of the gardens of the hotel from 8 p.m. onwards. All conference delegates are invited. In addition to our delegates we have extended the dinner invitation to several clients of Deloittes in India who are attending a special session at a nearby hotel and wish to meet Pascal during his visit.

On Day Three, we start with our traditional early morning discussion on "Resolution of Tax Disputes in a post BEPS World". We have invited Hon'ble Justice P P Bhatt, President, Income Tax Tribunal, India to chair this Session. Mr. G S Pannu, Vice President, Income Tax Appellate Tribunal will be a part of the panel discussion. This is followed by a presentation by Professor Jeffrey Owens on "Likely Implications of the New Technologies on the future Tax Policy and Administration". It is followed by a panel discussion on how these new technologies transform the (i) tax system, (ii) tax administration and (iii) tax policies. The rest of Day Three includes several panel discussions on topics such as: (i) Recent Developments in the UN Model (with video presentation by Michael Lennard - secretary: UN Committee, New York), (ii) Protection of Taxpayers' Rights and Responsibilities under BEPS, (iii) Can BEPS lead to Tax Terrorism, and (iv) a discussion on Varying tax definitions of Permanent Establishment in recent Judicial decisions in India.

The conference ends with presentations and panel discussions on the use of modern technology to manage professional tax practices and services and the use of Blockchain technology to assist tax management and compliance. There is also a brief session on

the new Goods and Services Tax in India. The three-day event packed program also includes daily social get-togethers for networking every evening.

SOME IMPORTANT ADMINISTRATIVE POINTS

(PLEASE READ CAREFULLY)

Finally, we have a few administrative points:

Please go through our delegate binder. It should contain copies of our detailed conference program and brief biodata of all the speakers and presentation slides we have received in time for the preparation of the binder. Any additions and changes will be loaded on our website after the conference.

This year, along with our delegate binder which is provided to delegates over at the time of registration, we are using an App called FIT Event solely to manage our Conference Programme. The App has been powered by BDO, one of our Patron Supporters. The link to the App will be sent to you by email a few days before the conference. The app is available to both Android and IOS users and can be download from Playstore for Android and App store for IOS users. The app would also contain all the details of our conference with separate tabs for brochure, schedule, presentations, etc

As in prior years, we have our usual ''dos and don'ts'':

i. Time controls: We have nearly 100 speakers and around 500 delegates from India and abroad with a very packed program this year. Our program does not allow any time overruns! Please adhere to our program conference timetable both as speakers and as delegates. We assure you that we will maintain our tradition of starting on time and finishing on time.

ii. I request all of you (including myself) to put our mobiles on silent mode.

iii. Please place your visiting card in your delegate bags in case you misplace them.

iv. We have a non-smoking rule in the conference hall and the dining areas in the hotel.

We continue our goal to be an educational trust that encourages us to develop our knowledge of international taxation principles and global practices in our country and learn from those in other countries. I would now like to take this opportunity to thank all our sponsors. We are a charitable body and rely on our sponsors to support our cause both financially as well as assist us in our conferences and training activities.

We again plan to publish a Commemorative Issue highlighting the key features of our 2018 Conference, both in its content and presentation. We would be grateful for a summary and key points of the session, from the Speakers.

I wish all of you an enjoyable and fulfilling three days in pleasant surroundings and professional company. We also welcome and thank Pascal Saint-Amans for his efforts to attend our conference in his very busy schedule and the speakers from OECD as well as around the world who have come to speak to us about international tax relating to BEPS and its applications.

Finally, many thanks to all of you, our speakers, our delegates, our sponsors, our staff and all our helpers for making this conference possible.

EXHIBIT: TOPICS ADDRESSED BY SPEAKERS

(A) INDIVIDUAL SPEAKERS

Day One: December 6, 2018 (Thursday)

1030 – 1100	Parthasarathi Shome, Visiting Fellow, London School of Economics
	International Taxation: Resilience or Decline of Multilateral Instrument
1100 – 1130	Sam Sim : Executive Board Member, TEI, Singapore
	Digital Disruption to the Global Value Chain and the Future of Transfer Pricing
1130 – 1200	Mindy Herzfeld, Professor, University of Florida, (USA
	US Tax Reform & BEPS: A Symbiotic Relationship
1200 – 1230	John Peterson, Head of Aggressive Tax Planning Unit, OECD, Paris
	OECD/BEPS – Global Developments and Aggressive Tax Planning,
1230 – 1300	Ola Ostaszewska, IBFD European Knowledge Group,
Book Launch:	IBFD Publication of Basic International Taxation – Vol One (3rd.Ed.)

1400 – 1430	Monica Bhatia, Head of Global Forum Secretariat, OECD, Paris Exchange of Information (including Beneficial Ownership) under Action 13
1400 – 1500	Ian Young, Ex Chair, UK Charter Committee, HMRC, UK Review of Taxpayer's Charters and Taxpayer's Protection
1500 – 1630	Milind Kothari, Managing Partner, BDO India LLP, India Tax Technology-Tax Practice-Transformation & Disruption

Day Two: December 7, 2018 (Friday)

0900 – 0915	Akhilesh Ranjan, Member, CBDT and Principal Chief Commissioner of Income Tax (International)
0945 – 1015	Parthasarathi Shome, Visiting Fellow, London School of Economics International Taxation: The Economic and Legal Interface
1230 – 1300	Bibek Debroy, Chairman, Economic Advisory Council to Prime Minister of India Making of New India through Transformation under Modi
1400 – 1515	Pascal Saint-Amans, Director, OECD, Paris OECD's Challenges and Contributions to International Taxation with special reference to BEPS Project
1700 – 1815	Post BEPS Treaties and Tax Certainty under Multilateral Instrument Robert Danon, Professor, Lausanne University, Switzerland
1815 – 1930	Girish Vanvari, Founder, Transaction Square LLP, India Tax Trends in Mergers & Acquisitions

Day Three: December 8, 2018 (Saturday)

0900 – 1030	Justice P Bhatt, President, Income Tax Tribunal, India Resolution of Tax disputes in the post BEPS World
1100 – 1300	Professor Jeffrey Owens, Vienna WU University, Austria Likely Implications of the New Technologies on Future Tax Policy and Administration
1730 – 1800	Jon West, Vice President of Blockchain Engineering, Thomson Reuters, USA Future of Blockchain Technology

(B) PANEL DISCUSSIONS

Day One: December 6, 2018 (Thursday)

1500 – 1630	Use of Modern Technology to manage Professional Tax Practices and Tax Compliance, and to provide Advisory Services to Clients: and their future Impact on the Profession & Tax Administration.
1730 – 1930A	International Taxation of Digitized Business: Current Scenario
1730 – 1930B	Recent Tax Reforms in the United States (2017): their Current Status and their Impact on other major Global Tax Systems

Day Two: December 7, 2018 (Friday)

1045 – 1230	BEPS and Indian Tax Policy, Practice and Compliance in Future
1515 – 1630	International Taxation of Digitized Business: Recent OECD Proposals (December 2018).
1700 – 1815A	Post BEPS Treaties and Tax Certainty under Multilateral Instrument: Can Tax Certainty be achieved with a Policy of Abuse Prevention in post BEPS World?
1815 – 1930A	Tax Trends in Mergers and Acquisitions.
1700 – 1930B	Varying Tax Perceptions for determining Permanent Establishment and the Approach of the Judiciary towards them.

Day Three: December 8, 2018 (Saturday)

0900 – 1030	Resolution of Tax Disputes in the post BEPS World - What are the New Legal Measures and Approaches in Domestic and International Laws recommended under BEPS Action 14? A Critical Review.

1100 – 1300A	Likely Implications of the New Technologies on future Tax Policy and Administration (Examples: Artificial Intelligence, Robotics, Analytics, Virtual Reality, Block Chain, etc.)
1100 – 1200B	(i) Dependent Agent Permanent Establishment under BEPS: Is it a Permanent Establishment Under Action 7? (ii) Does Permanent Establishment as a Tax Concept have a long-term future in Model treaties?
1200 – 1300B	Compare BEPS Actions 8 to 10 on Transfer Pricing with "Arm's Length Method" under Article 9 and with OECD's Revised Guidance on "Transactional Profit Split Method". Will it eventually lead to "formulary apportionment" under the Mutual Agreement Procedure?
1400 – 1630A	Recent Changes in the UN Model and its Future Role in a BEPS World. Video Recording by Michael Lennard followed by Panel Discussion
1400 – 1630B	Brief Review of Taxpayers' Rights and Responsibilities in the Era of Automatic Exchange of Information. Can BEPS lead to Tax Terrorism and should it be avoided? What is Tax Terrorism?
1700 – 1730A	Blockchain Technology: Its Use and Abuse
1800 – 1845A	Permanent Establishment through Digital Presence: Will it work?
1700 – 1845B	Goods and Services Tax in India - A Current Update

SPECIAL EVENT

This year marks the 80th Anniversary of International Bureau of Fiscal Documentation (IBFD) established in 1938 in The Netherlands, a sister organization of International Fiscal Association. To celebrate, we have organized a special dinner on Day Two evening (8 pm onwards) in our hotel grounds (Ballroom 4 and 5). We look forward to your presence.

THANKS

We owe a special thanks to all our Speakers and Supporters. In particular:

(i) Our conference collaborators, OECD and IBFD for their support. Special thanks are due to:

- OECD Speakers from Paris: Pascal Saint Amans (Director) - Monica Bhatia - Jeffrey van Hove - John Peterson
- International Bureau of Fiscal Documentation (IBFD) - Belema Obuoforibo (Director, Knowledge Centre) - Ola Ostaszewska (European Knowledge Group) Sorrell Hidding (Marketing) - Craig West (South Africa)

(ii) Our Special Overseas Speakers:

United States: Mindy Herzfeld (US) - Rodney Lawrence (US) - Mark Levey (US) - Robert Stack (US) - Edson Uribe (Mexico) - Jon West (US)

United Kingdom: Murray Clayson (UK) - Jeffrey Owens (UK) - Neil Pennington (UK) - Sol Picciotto (UK) - Mike Williams (UK) - Ian Young (UK) -

Europe: Clive Baxter (Denmark) - Petruzzi Raffaele (Austria) - Robert Danon (Switzerland)

India: Rajat Bansal – P P Bhatt - Bibek Debroy – Pramod Kumar – G S Pannu - Akhilesh Ranjan – Pragya Saksena

Others: Michael Lennard (UN) - Rajesh Ramloll (Mauritius) - Sam Sim (Singapore) -

(iii) Our Financial Supporters (in particular)

Patron Sponsors: Milind Kothari (BDO India) and Nishith Desai (Nishith Desai Associates) for their financial and professional support. BDO and Tata Communications this year for providing their technology, expertise and facility and for developing and installing an APP to manage our conference program.

(iv) All our other speakers, our delegates, our staff and our well-wishers for supporting our conference in this 23rd year of our conference.

Professor Roy Rohatgi (FIT Conference 2018)

December 6 - 8, 2018

BRIEF REVIEW OF TAXPAYERS' RIGHTS AND RESPONSIBILITIES IN THE ERA OF AUTOMATIC EXCHANGE OF INFORMATION; TAX TERRORISM

Ms Shefali Goradia

Session Chairman: Ms Shefali Goradia

Panel Leader: Mr Arvind Datar

Panelists: Mr Craig West, Ms Monica Bhatia, Mr Pranav Sayta, Mr Ashutosh Dikshit, Mr Rahul Navin, Mr Edson Uribe, Mr Ian Young

The session opened with Ms Shefali Goradia briefly describing the importance gained by this topic in today's context. Many countries have taken steps to officially set-out taxpayer rights and duties and in some others, Courts have been laying out principles in judicial rulings. Largely, the expectation is that once taxes are paid, taxpayer should be at peace; however, this fundamental principle needs increasing attention in today's world, with the changes being introduced by BEPS and the free flow of information between countries. Spreading awareness about taxpayer rights and responsibilities has become increasingly important and will lead to the next framework of policy setting in India and across the world.

Ms Monica Bhatia remarked that while the discussion is centered around 'taxpayer rights', this term could be potentially misleading, as a person may be a taxpayer in one jurisdiction but the information being shared could be arising in another jurisdiction (such as persons holding bank accounts in a jurisdiction of which they are not resident) and hence, the question arises whether the latter jurisdiction is responsible for protecting and enforcing the 'taxpayer's rights' in respect of such a person who is not really taxpayer of that jurisdiction. She explained that a wider interpretation should be given to the term 'taxpayer rights', to encompass such situations as well and should be treated as akin to basic human rights for protecting people anywhere, if they are ultimately paying their taxes honestly where such taxes are required to be paid.

Mr Craig West then made a presentation giving an overview of the exchange of information mechanism and the different forms of information exchange.

He discussed the concerns that taxpayers have with regard to exchange of information, such as confidentiality, improper use of the information or information being taken and applied to 'out of context' situations, information leaks / cyberattacks which could also lead to safety concerns or social embarrassment, taxpayer profiling (resulting in cultural or religious biases), etc. He then provided an overview of taxpayer's rights and responsibilities with regard to exchange of information and what should be the best practices for exchange of information procedures, including notification to taxpayer at the appropriate time and taxpayers' ability to review and verify the information and whether controls should be built under treaty or domestic law. He also discussed the differences between exchange of information on request and automatic exchange, the latter being more sensitive and hence, requiring separate level of safeguards to be built in.

All panellists agreed that safeguards need to be built in to address the above concerns, particularly in the case of automatic information exchange. Mr Ashutosh Dikshit pointed out that while in case of Country-by-Country Reporting, taxpayers know from the beginning what information they are reporting, however, in case of the Common Reporting Standard, the taxpayers have no knowledge about the information being shared and hence, it may be prudent to build safeguards under domestic law for the latter scenario.

Mr Datar mentioned that right to privacy (which would include informational privacy) is a fundamental right, as upheld in a ruling on constitutional rights by the Supreme Court of India. Mr Ian Young also gave a brief presentation on taxpayer charter and the rights and responsibilities of taxpayers with regard to exchange of information. The panel also discussed about whether it should be the responsibility of the Government in curbing the much prevalent 'trial by media' in today's times, which causes unwarranted reputational damage to the taxpayer even before any wrongdoing is proven in Court.

Specifically in the Indian context, Mr Rahul Navin mentioned that the taxpayer's rights such as legal certainty, principles of equality and taxation on the basis of capacity to pay, right to due process and procedures, an independent judiciary, confidentiality of information provided by taxpayers etc. have been enshrined in tax laws and administrative procedures

of the tax department which are broadly followed by the revenue authorities. Section 138 of the Indian Income-tax Act, 1961 ('Act') provides for information given by taxpayers to be kept confidential and section 280 of the Act provides for prosecution of tax officer if the obligation under section 138 of the Act is breached. He stated that taxpayer's rights need to be balanced with the need of the Government to protect its tax base and thus, information related to taxpayers having global business and assets are now being exchanged by countries both on request and on automatic basis. Under the international standards of information exchange, before making a request, the taxpayers may be informed except in exceptional situations where the requesting country gives valid reasons for not informing the taxpayer (such as if evasion is anticipated). Of course, after information exchange, if information is to be used for making an adjustment, the taxpayer will have to be informed as per principles of natural justice, an essential component of taxpayers' rights.

In this context, the panel also discussed whether banks / financial institutions should tip off taxpayers about information exchange and whether 'privileged communication' status should also be granted to information shared by clients with their chartered accountants under the principles of "client attorney privilege".

Ms Monica Bhatia talked about the work done by the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, where they reviewed the readiness of 100 countries to receive information based on confidentiality standards applied on the lines of FATCA; about onethird of the countries did not satisfy the tests and the Global Forum is working with about 20 countries currently to help them become ready to receive information. She mentioned that if a jurisdiction does not satisfy the Global Forum's review standards, then other jurisdictions are not obliged to share information with such jurisdiction.

In the context of tax terrorism, the panel discussed the concepts of retrospective vs retroactive taxation. Mr Pranav Sayta mentioned that the difference is best explained by the Canadian court as follows: retroactive provision operates as of a time prior to insertion of that provision in the statute whereas retrospective provision operates only in the future i.e. after its enactment but may impose certain different results in respect of an event which occurred before its enactment. He gave numerous examples of retroactive and retrospective changes in the Indian taxation framework – for instance, the amendments made by (Indian) Finance Act, 2012 to section 9 of the Act which apply with effect from April 1, 1961, would qualify as retroactive taxation. On the other hand, the amendment introduced by (Indian) Finance Act, 2018 for removing the tax exemption on long term capital gains on sale of listed equity shares with effect from April 1, 2018 (with grandfathering for gains upto January 31, 2018) would qualify as a retrospective provision, since it is applicable from a date after its enactment but would impact the taxation of listed equity shares already purchased by a taxpayer in the prior years. Similarly, the amendment of India-Mauritius tax treaty, the introduction of thin capitalization rules in the Act, the new transfer pricing guidelines, etc. would all be examples of retrospective taxation. If a tax holiday available under the Act for a specified duration is, hypothetically, repealed (even for businesses already having availed it for part of the original specified period) with effect from a future date, it would amount to retrospective taxation but if it were to be repealed from a prior year itself, then it would amount to retroactive taxation. All panellists agreed that retroactive taxation fundamentally works against taxpayer's rights and a fair taxation framework, and should be avoided by the Governments. Retrospective taxation, on the other hand, may be acceptable in certain cases.

Mr Edson Uribe then made a presentation on the concept of Mexican Tax Ombudsman, which is a very effective mechanism implemented by Mexico to protect taxpayer's rights and prevent tax terrorism. The ombudsman acts as an independent third party acting as a watchdog of the relationship between taxpayers and tax authorities, providing a level playing field and assuring that everybody abides by the rules. In Mexico, the tax ombudsman safeguards taxpayers' rights by (i) serving as an intermediary during the process of drafting of tax rules by the Government, to provide a voice to all stakeholders, (ii) acting as an impartial mediator on the request of the taxpayer during scrutiny proceedings, (iii) investigating conduct of tax authorities on a complaint filed by the taxpayer and issuing non-binding recommendations to the tax authorities (which if ignored without valid reason by the authorities, may be made public in the news).

Mr Ashutosh Dikshit pointed out that India has a concept of tax ombudsman too, though it has not

turned out to be as effective (one of the reasons could be that the ombudsman has to be an exIndian revenue officer and needs to have made a complaint with the supervisor of the erring revenue officer for a period of one month before the ombudsman can initiate any action). Mr Datar suggested that one way to improve the independence and hence, effectiveness of the Indian tax ombudsman could be to make the ombudsman report to a ministry other than the Ministry of Finance, for instance, the Ministry of Law. Mr Craig West also suggested giving wider powers to the ombudsman to initiate his own investigation. It was also suggested that while the recommendations of the ombudsmen in most cases would be non-binding, there should be a mechanism to publish such recommendations in public domain to enhance their impact.

COMPARE BEPS ACTIONS 8 TO 10 ON TRANSFER PRICING WITH "ARM'S LENGTH METHOD" UNDER ARTICLE 9 AND WITH OECD'S REVISED GUIDANCE ON "TRANSACTIONAL PROFIT SPLIT METHOD".

T P Ostwal

Will it eventually lead to "formulary apportionment" under the Mutual Agreement Procedure?

Session Chairman: Vijay Iyer, India

Panel Leader: T P Ostwal, India

Panellists: Rahul Mitra, India - Petruzzi Raffaele, Austria - Sanjeev Sharma, India - Hasnain Shroff, India.

1. INTRODUCTION

1.1 The Organization for Economic Co-operation and Development's (OECD) BEPS project has brought about a paradigm change in taxation of cross border transactions, focusing on themes of substance, transparency and coherence.

1.2 FIT Conference discussed the issue of profit split method in the cases where business activities of the parties are so highly integrated that, to understand the implications, transaction needs to be delineated.

2. Action 8: Intangible

2.1 Development under Action 8 looked at transfer pricing issues relating to transactions involving especially hard-to-value intangibles, since misallocation of the profits generated by valuable intangibles has contributed to base erosion and profit shifting. Mr. Vijay Iyer termed Action 8 as **"Birth of a new Arm's Length Principle"** based on the following aspects

- **Legal ownership** of intangibles, by itself, does not entitle to any remunerations respectively returns from exploiting the intangibles
- The remuneration of each entity performing functions related to the development, enhancement, maintenance, protection and exploitations **(DEMPE)** of the intangibles will depend upon the **relative value** of the contribution, including to what extent they are ***de facto*** **managing the risk** associated with the intangible.

- **Control over risk** - Risks should be allocated to enterprise that **exercises control** and has **financial capacity** to assume the risk
- Entities providing simply the funding **without controlling the specific financial risks** are entitled to no more than a risk-free return for its funding activities

2.2 Current and future approach in determination of transfer prices

Current determination of transfer prices is a four step process

Step 1: Functional- and Risk Analysis

Step 2: Entity Characterization

Step 3: Method Selection

Step 4: Determination of Transfer Prices based on Arm's Length Profits at the level of Routine Entities

Future determination of transfer prices (with respect to risk)

Future determination of transfer prices is a 3 step comprehensive process

Step 1: Analysis of Actual Functions and Risks assumed ("Substance over Form")

Step 2: Six-step framework for analyzing risk

- Identification of economically significant risks with specificity
- Determination of contractual assumption of the specific risk
- Functional analysis in relation to risk
- Interpreting steps 1–3
- Allocation of risk
- Pricing the transaction, taking into account the consequences of risk allocation

Step 3: Determination of Transfer Prices based on (Overall) Profit Allocation Taking into Account an Arm's Length Risk & Reward

2.3 Key principles of income allocation

Further, Mr. Vijay Iyer also deliberated the key principles of income allocation

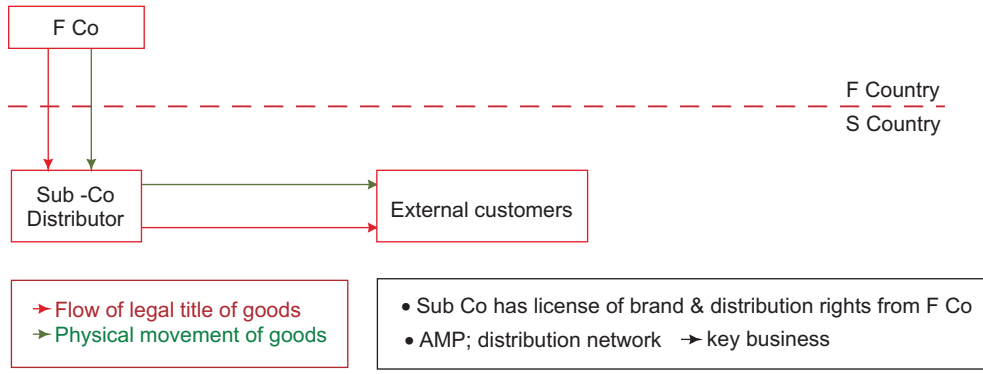
1. Entitlement of profit or loss relating to differences between actual and expected profits will depend on
   a. which entity/entities assume(s) the risks that caused the differences <u>and</u>
   b. whether the entity/entities are performing important functions (DEMPE functions) <u>or</u>
   c. contributing to the control over the economically significant risks
2. Not performing any of the DEMPE functions and not exercising control over the financial risk

will generate no more than a risk-free return

3. **Action 10: Other High-risk Transaction**

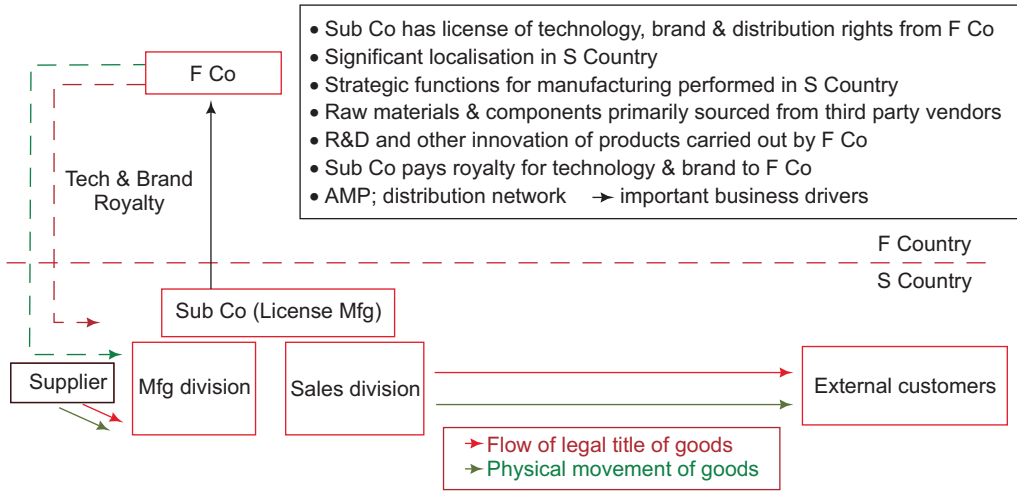
3.1 Work under Action 10 focused on other high-risk areas, including the scope for addressing profit allocations resulting from transactions which are not commercially rational for the individual enterprises concerned (re-characterisation), the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most monetarily important activities of the MNE group, and neutralising the use of certain types of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with value creation. Mr. Rahul Mitra examined the said topic by way of two enlightening case studies.

Case Study 2: Distributor



Ratios	Taxpayer	Average of comparable companies
SG&A/ Turnover	40%	16%
AMP/ Turnover	15%	3%
Gross Margin	45%	18%
Net Margin	5%	2%
Berry Ratio	112.5%	112.5%

Case Study 3: Licensed Manufacturer



3.2 Emerging Issues in PSM

Though the revised Guidance has answered a lot of the issues as far as applicability of PSM is concerned, several issues, as under, are yet to be addressed. Mr. TP Ostwal, the panel leader pointed out some of those issues which are as under:

1. It may be difficult to measure the relevant revenue and costs for all the associated enterprises participating in the controlled transactions, which could require stating books and records on a common basis and making adjustments in accounting practices and currencies.

2. When the transactional profit split method is applied to operating profit, it may be difficult to identify the appropriate operating expenses associated with the transactions and to allocate costs between the transactions and the associated enterprises other activities.

3. Depending on the facts of the case, other indicators that the transactional profit split may be the most appropriate method could include a high level of integration in the business operations to which the transactions relate and /or the shared assumption of economically significant risks (or the separate assumption of closely related economically significant risks) by the parties to the transactions. **It is important to note that the indicators are not mutually exclusive and on the contrary may often be found together in a single case.**

4. The Revised Guidance points to employee compensation as an appropriate profit splitting factor for trading profits. The basis for this is that the performance of trading personnel, particularly traders, risk managers, specialised marketers, the so-called "front office" high-value functions, is critical to the profitability of global trading and, as a result, compensation of these functions is generally related to performance and value add. The revised guidance does not provide for the meaning of performance related compensation and relevance of adjustments.

5. How latest development such as master file and local file compliance would help the tax authority in determining profit split factor.

6. Unavailability of comparable data is one of the basic premises of applicability of PSM. However, while applying contribution analysis, the division of profits is to be determined or supported by comparable data (External Data). This appears to be a contradiction.

7. In determining the relevant profits, it is essential to first identify and accurately delineate the transactions to be covered by the transactional profit split method, and from this identify the relevant income and expense amounts for each party in relation to those transactions. This might turn out to be a complex exercise.

8. What are the factors which one should consider in determining whether the profit to be split should be gross profit or operating profit?

9. The meaning of operating profit and gross profit is not specifically provided and therefore, may be interpreted differently by tax payer and tax authorities.

10. While using assets based profit splitting factors, what all assets should be taken into consideration? What should be the treatment of self-developed intangibles and other intangibles already depreciated which may not be reflected on the balance sheet at all?

11. Whether market would also be an intangible? If no weightage is given to market then it would not be acceptable by the developing countries such as India, China, Brazil etc.

12. While using cost based profit splitting factors, what all costs should be taken into consideration? Guidance on allocation of indirect cost is not available.

13. When you split profit, whether losses should also be split. No guidance is available on the same.

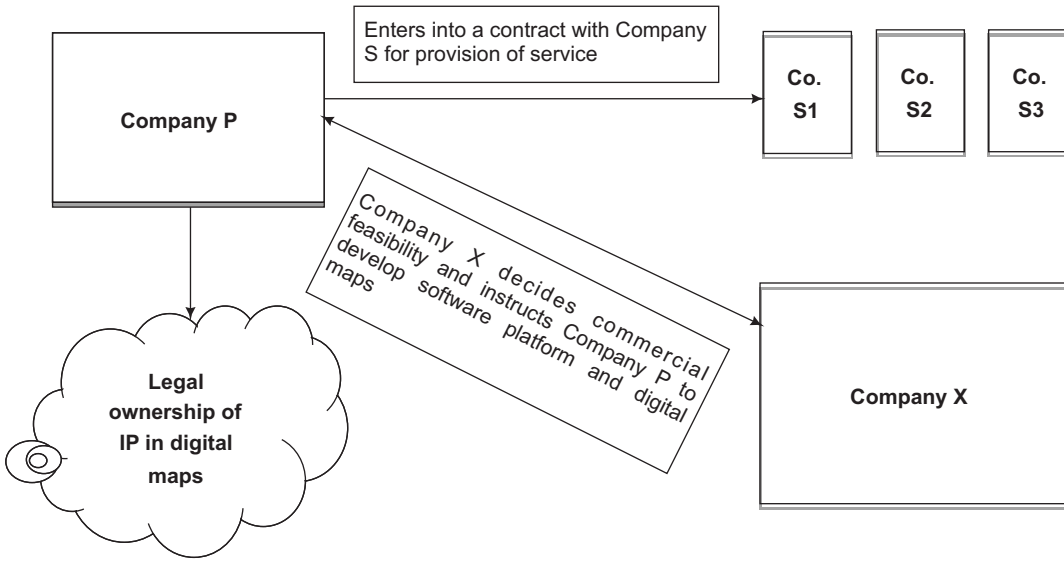
4. Action 9: Risk and Capital

4.1 Mr. Hasnain Shroff then proceeded to discuss the nuances of Action 9. Effort under Action 9 considered the contractual allocation of risks, and the resulting allocation of profits to those risks, which may not correspond with the activities actually carried out. Action 9 additionally tended to the dimension of the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity assumed by the funding company. In a nut and shell, Action 9 provides for the following:

- Emphasis on the need to accurately delineate a transaction and to ensure that the actual conduct of parties is reflected in contractual arrangements
- Transactions can be disregarded for TP purposes where they lack commercial rationality
- Contractual allocations of risk to be respected only when they are supported by actual decision-making i.e. exercising control over these risks coupled with financial capacity to assume such risks
- 'Cash boxes' or entities merely providing funding without performing significant activities- entitled only to risk-free returns to the extent of their capital contributions, if they have no de-facto control on the associated risks.

For a better understanding of the topic, Mr. Hasnain Shroff presented a case study

Case Study 1:



Structure Mechanics:

Company P:

- Invests in development of software platform based on inputs from Company X
- Produces digital maps (i.e. map data) for countries as per demand in various markets, as specified by X
- Legal owner of the IP in software platform and in map data.

Company X

- Identifies commercial opportunities for the map data / digital maps developed by Company PE.
- Provides specifications on the features to be built into the software platform.
- Instructs company P to develop software platform and digital maps of various countries based on survey / research of customers
- Has a product development division which decides on which countries to target, and the technology to rely upon (i.e. 2D, 3D and 4D)
- Maps based on research and survey done in various countries through outsourced centers

Companies S1, S2, S3

- Develops marketing and sales strategies
- Markets the digital maps to various third party customers (e.g. OEM manufacturers, auto manufacturers, mobile service providers)
- Negotiates contracts with 3rd party customers
- Ensures map data is installed appropriately on customers servers

Question to Ponder

i What are the economically significant risks?
ii Who assumes and controls economically significant risk for developing software platform and IP map data?
iii Who assumes and controls economically significant risk for exploiting IP in map data?

iv What should be the remuneration model for Company P?
v What should be the remuneration model for Company S1, S2, S3
vi Who should bear the risk for upside and downside of commercial opportunities created from sale of IP in map data?

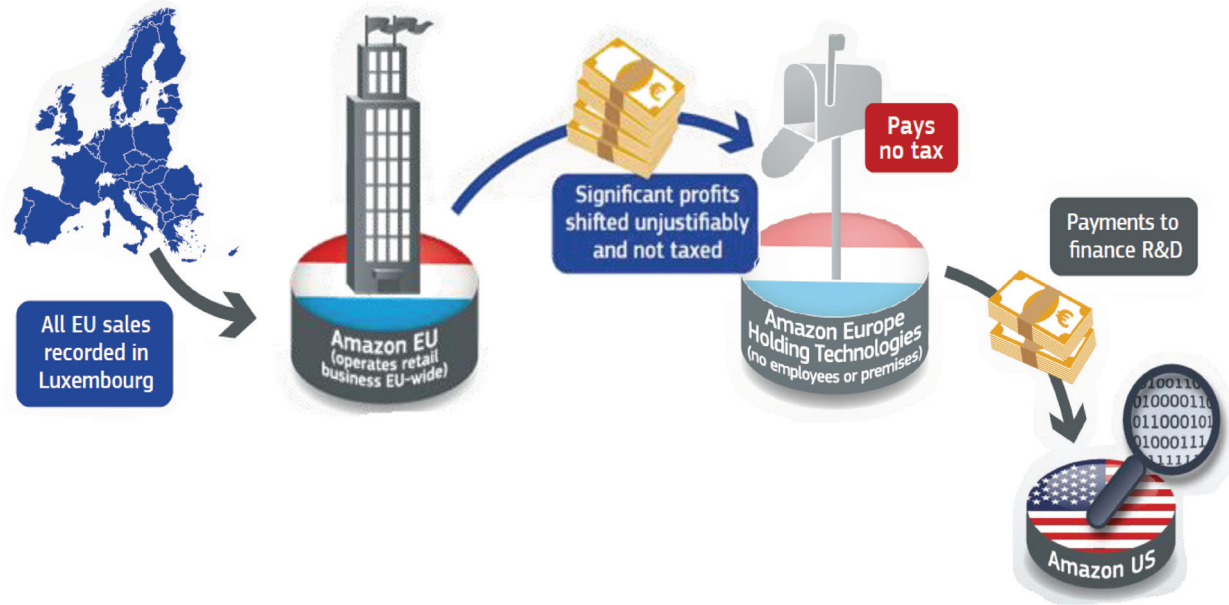
Conclusion

- Company P contractually assumes the economically significant risk of investment, production and sale of digital map data…
- Based on the conduct, Company X and Companies S1, S2, S3 have the control and the capability to assume the said risks

5. Digital Economy

The last topic of the panel discussion was profit distribution in the case of e-commerce arrangement based on value chain analysis. To examine the topic, Mr Petruzzi Raffaele presented a case study

Case Study 4:



Question to ponder

1. Does Amazon create value in the countries where customers are located?
2. Who are the significant people functions in the countries where customers are located?
3. What assets and risks can be attributed to Amazon in the countries where customers are located?
4. How much profits can be attributed to Amazon in the countries where customers are located?

6. Conclusion

The panel gave a precise 5 pointer approach to handle the emerging transfer pricing issues

i. Refresh the assessment of your TP risk profile

Examine your structure and model to identify where your greater areas of risk lie and devote your resources and focus accordingly

ii. Update your risk mitigation and compliance activities

Prepare robust and contemporaneous documentation in support of TP policies and strategies. Consider whether the substance within relevant points in your model needs to be modified to meet the new BEPS requirements

iii. Develop a comprehensive audit plan

Develop a plan, including knowing what data is available and can be produced, to respond to inquiries and audits. Consider using APAs and other agreements with tax authorities where appropriate. Conceive a methodology for consistently answering queries from various tax authorities

	Technology development	Inbound logistics	Manufacture/ Operations	Outbound logistics	Marketing/ Sales	Service
Functions in general	➢ R&D ➢ Production engineering ➢ Product and process design etc.	➢ Quality control ➢ Receiving ➢ Storing goods in warehouses etc.	➢ Payment system 24 hours ➢ Production ➢ Maintenance ➢ Control etc.	➢ Dispatch ➢ Delivery ➢ Invoicing	Marketing	Admin-n of returns/ warranties
Value 1. Individualized production	Software for analysing Data demands to create personalised valuable offer	-	-	➢ Standard shipping/ ➢ Prime delivery	➢ Personal discounts ➢ Vouchers ➢ Analysing personal demand and making offers	-
Value 2. Complementarities	Software for analysing Data on purchases	-	➢ Integration of many sellers ➢ Variety of production	-	Analysing of demand for complement-s	-
Value 3. Lock-in	➢ One-click payments ➢ Personal cabinet ➢ Data storing	-	Production of own goods and quality control	-	➢ Discounts ➢ Recommendations	Admin-n of returns/ warranties
Value 4. End-to-end digital integration	Development and update of the platform	-	-	-	➢ 24-hours access ➢ Social networks coop-n	-

iv. Revisit TP policies

Re-examine inter-company arrangements at the most potential risk in light of the new BEPS standards, such as those involving buy-sell distributors, IP transactions and inter-company loans

v. Realign your TP and IT systems

Evaluate the available tools for aligning TP and IT and reporting systems.

Develop the automation needed to monitor TP results as close to real time as possible to reduce errors and unusual results, which attract the attention of tax authorities

PERMANENT ESTABLISHMENT THROUGH DIGITAL PRESENCE – WILL IT WORK

Himanshu Parekh

Presentation by **Himanshu Parekh,** India

Panelists: Wasoudeo Balloo, Mauritius - N Meyyappan, India

The digital transformation in today's age is occurring at a rapid pace and is changing the way people interact with each other and society more generally, raising a number of pressing issues in the areas of jobs and skills, privacy and security, education, health as well as in many other areas.

Digitalisation is an important source of entrepreneurship, lowering barriers to entry and more broadly affecting the business environment by bringing down transaction costs, increasing price transparency and improving productivity. It is now easier for businesses to communicate with suppliers, customers, and employees using Internet based tools, and developments in Information and Communication Technology (ICT) are also leading to the emergence of new and transformed business models.

The OECD/G20 Base Erosion and Profit Shifting (BEPS) 2015 Action Plan 1 Report recognised that digitalisation and some of the business models that it facilitates present important challenges for international taxation. The report also acknowledged that it would be difficult, if not impossible, to 'ring-fence' the digital economy from the rest of the economy for tax purposes because of the increasingly pervasive nature of digitalisation.

The Action Plan 1 report identified a number of key features of digitalisation that are potentially relevant from a tax perspective. These include mobility, reliance on data, network effects, the spread of multi-sided business models, a tendency towards monopoly or oligopoly, and volatility. There was recognition that digitalisation has also accelerated and changed the spread of global value chains in which Multinational Enterprises (MNEs) integrate their worldwide operations. More specifically, the report observed new phenomena such as the collection and exploitation of data, network effects and the emergence of new business models, such as multi-sided platforms, as exacerbating the challenges to the existing tax rules.

The Action Plan 1 Report also identified a number of broader tax challenges raised by digitalisation, notably in relation to nexus, data and characterisation. These challenges go beyond BEPS and chiefly relate to the question of how taxing rights on

income generated from cross-border activities in the digital age should be allocated among countries.

To tackle the broader direct tax issues raised by digitalisation, the Action Plan 1 report analysed three options, namely (i) a new nexus rule in the form of a 'significant economic presence' (SEP) test, (ii) a withholding tax which could be applied to certain types of digital transactions, and (iii) an 'Equalisation Levy', intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient "economic presence" in the jurisdiction.

The G20 gave a mandate to the Task Force on the Digital Economy (TFDE) in March 2017, to deliver an interim report in 2018. The TFDE, inter alia, worked on areas like monitoring of developments in digital technology and business models, the individual measures taken by countries to address the broader tax challenges raised by digitalisation, the extent of implementation and impact of the relevant actions from the BEPS package and released an interim report in March 2018.

The interim report dealt with how digitalisation has impacted value creation in business models. In the interim report, OECD classified all processes of value creation, from the more traditional to the most highly digitalised, into three groups: value chains, value networks and value shops.

OECD also performed an analysis of various value creation processes while applying it to several digitalised business models. A reseller of tangible goods as an example of a value chain, two multi-sided platforms: a ride-for-hire company and a social network as examples of value networks, and finally, a cloud computing company as an example of a value shop. The interim report also discussed the common features of highly digitalised business models, i.e. scale without mass, heavy reliance on intangible assets, and the role of data and user participation, including network effects.

As indicated in the BEPS Action Plan 1 report and as reiterated by OECD in the interim report, the key rules on the basis of which the taxation of business profits from cross-border activities are measured are: a) the nexus rule to determine jurisdiction to tax a non-resident enterprise and b) the profit allocation rules, based on the arm's length principle.

The taxation of a non-resident enterprise depends on rules that are strongly rooted in physical presence requirements to determine nexus and allocate profits. The principal focus of the existing tax framework has been to align the distribution of taxing rights with the location of the economic activities undertaken by the enterprise, including the people and property that it employs in that activity. This conceptual approach was recently reinforced by the BEPS Project, which sought to realign the location where profits are taxed with the location where economic activities take place and value is created. However, the effectiveness of these rules may be challenged by the ongoing digitalisation of the economy to the extent that value creation is becoming less dependent on the physical presence of people or property.

At the time the Action Plan 1 Report was adopted, no agreement had been reached among countries participating in the BEPS Project on the actual scale and impact of these broader direct tax challenges. In particular, no common view emerged on whether changes going beyond the measures proposed in the BEPS package were warranted. The result was that none of the potential options discussed in the Action Plan 1 Report were adopted as agreed international standards. Nonetheless, it was acknowledged that countries could introduce any of these options in their domestic laws, provided that they respected existing tax treaties and other international obligations.

Since the release of the Action Plan 1 Report, the lack of consensus in relation to these options has seen many countries around the world explore alternative measures for the taxation of highly digitalised businesses, generally by adopting new tax measures or changing the way they interpret existing laws and tax measures. To date, these uncoordinated actions include a variety of measures usually implemented through domestic law changes seeking to protect and/or expand source taxation of online business activities (or more generally of activities of large MNEs), whether based on a measure of profit or some other equivalent factor.

India being one of the pioneers in the implementation of the suggestions of Action Plan 1 report, introduced the Equalisation Levy in 2016 which provides for a 6 per cent levy to be deducted from the consideration paid for the provision of online advertisement services by non-residents. This was followed by some more similar measures by other countries/jurisdictions viz. Italy (introduced a levy on digital transactions), and the recent proposal introduced by UK (Digital Service Tax proposed at the rate of 2 per cent on revenues of certain businesses with effect from April 2020).

Many countries have amended their domestic or Permanent Establishment (PE) threshold based on factors such as digital or online presence; the measures implemented and enforceable so far include the SEP test introduced in April 2016 by Israel, the expanded definition of a fixed place of business for certain digital platforms introduced in 2017 by the Slovak Republic and the new nexus rule based on the concept of SEP that has been introduced by India from 1 April 2018 (AY 2019-2020). A 'virtual service PE' has been officially endorsed in Saudi Arabia. While the measure in the Slovak Republic is targeted at specific activities carried out by online platforms (i.e., intermediation services for transportation and accommodation), the measures in Israel and India involve a more general broadening of their existing domestic nexus rules based on the concept of SEP.

With a view to cover emerging business models such as digitised businesses, which do not require physical presence of such businesses in India, amendments to domestic nexus rules (Section 9(1)(i) of the Income-tax Act, 1961) for income tax purposes have been introduced within the concept of 'business connection' under the Act. SEP of a non-resident enterprise shall constitute 'business connection' in India and income attributable to the SEP shall be deemed to accrue or arise in India. SEP covers certain distinct situations (Refer Annexure A below that discusses the SEP provisions).

The SEP provisions introduced in India are swamped with several issues which may lead to protracted litigation. For instance, the SEP provisions are so broadly worded that they may cover not only digital transactions but also transactions relating to physical goods, within their ambit. Some key terms have not been explicitly defined, for e.g. 'transaction', 'carried out by a non-resident in India', 'systematic and continuous soliciting of its business activities' etc. Currently, some of the payments with respect to digital transactions are liable to withholding tax (WHT) provisions under the provisions of the Act for e.g. software royalty. After implementation of SEP provisions, conflict may arise between such WHT provisions and SEP provisions. Once the SEP provisions are implemented, there could also be an overlap between the existing provisions dealing with the taxability of Royalty and Fees for Technical Services and the provisions of EL. Further, there is no clarity as to the attribution rules for such income i.e. determination of income attributable to SEP.

On the global front, immediately after the interim report was released by OECD, the European Union (EU) also proposed new rules for the taxation of digital business activities in the EU. EU proposed the following two legislative proposals to provide for fairer taxation of digital activities in the EU region:

- Reform corporate tax rules so that profits are taxed where businesses have significant interaction with users through digital channels (referred to as Significant Digital Presence [SDP]).
- Impose an interim tax that would cover the main digital activities that currently escape tax altogeth-

er in the EU (referred to as Digital Service Tax [DST]).

Under the first proposal, a digital platform would be deemed to have a taxable 'digital presence' or a virtual PE in an EU Member State if it satisfies one of the following criteria:

- The proportion of total revenues from supply of digital services in a EU Member State exceeds €7 million, or
- More than 100,000 users in a EU Member State in a tax year, or
- Over 3,000 business contracts for digital services entered into between the company and business users in a tax year.

As per the EU proposal, profit attribution to SDP would require ascertainment of economically significant activities (ESA) performed by the SDP and attribution of corresponding risks and economic ownership of assets to it. ESA is defined to include collection, storage, processing & sale of user data; collection, storage, processing and display of user generated content; sale of on-line advertising space; making available of third-party content on digital market place; and supply of digital services. The profit attribution would be based on profit split method where splitting factors may include expense on R&D and marketing and number of users & data collected in a particular jurisdiction.

The second proposal dealing with the proposed interim tax provides that activities that are currently not 'effectively taxed' would begin to generate immediate revenues for EU Member States. This system would apply only as an interim measure, until the comprehensive reform would be implemented.

The interim tax would apply at the rate of 3 per cent to revenues arising from certain activities such as revenues:

- from selling online advertising space;
- from digital intermediary activities that allow users to interact with other users and that can facilitate the sale of goods and services between them;
- from the sale of data generated from user-provided information.

Tax revenues would be collected by the EU Member States where the users are located, and would only apply to companies with total annual worldwide revenues of at least €750 million and EU revenues of at least €40 million.

With the EU proposing the DST for the taxation of digital business, the US has expressed grave concerns thereon. In a recent communication to the European Commission, the US has observed that the EU DST proposal has been designed to discriminate against US companies and undermines the international tax treaty system. It has been further observed that though the EU claims that the EU DST proposal is an interim measure, the proposal contains no end date and could conceivably last indefinitely. If the EU DST is approved as an interim measure, taxpayers and taxing authorities would be required to develop new, complex, and costly tax collection and compliance systems, which would be discarded once international consensus is reached. These burdens would be forced largely on US companies and the EU would erect another barrier to transatlantic trade.

Way forward

The OECD is slated to provide an update on the taxation of digital economy in 2019, along with working towards a consensus based solution by 2020. As of now, a global consensus seems challenging and only a strong political will could help to break through the deadlock. In the meanwhile, unilateral measures adopted by countries are likely to create uncertainty and potential double taxation.

Annexure A

- "SEP" shall mean

(a) **transaction in respect of any goods, services or property** carried out by a non-resident **in India** including **provision of download of data or software in India,** if the aggregate of payments for such transactions exceeds such amount as may be **prescribed;** or

(b) **systematic and continuous soliciting of *business activities*** or **engaging in interaction with such number of users** as may be **prescribed,** in India **through digital means**

- Transactions or activities shall constitute SEP in India, **whether or not,-**
  - the agreement for such transactions or activities is entered in India; or
  - the non-resident has a residence or place of business in India; or
  - the non-resident renders services in India.
- **Income as is attributable** to the transactions or activities referred to above shall be deemed to accrue or arise in India.

THE ROLE OF A TAX OMBUDSMAN IN THE CURRENT DOMESTIC AND INTERNATIONAL TAX ENVIRONMENT

Edson Uribe[1]

1 Current Tax Environment

It is no secret that the legal framework that has governed the taxation of international business transactions for more than a hundred years is currently under strict scrutiny. The rules have simply not kept pace with globalization and the rapid developments on how multinational entities conduct their business.

Global efforts are well underway to provide tax administrations with the necessary tools to curb international tax evasion and collect taxes from multinational enterprises that nowadays can create billions of dollars in revenues in a jurisdiction without having a physical presence therein. These new business strategies are challenging the traditional nexus and attribution of profits principles in which the international tax rules have relied on for decades.

All these efforts are praiseworthy. Governments need tax revenues from taxpayers to function, so any initiative to curb tax evasion and increase tax collection should be applauded. Unfortunately, these efforts sometimes end up in tax terrorism practices suffered by taxpayers. Tax terrorism should be understood as the misuse of power by tax authorities to collect tax revenues with no regard towards taxpayers' rights.

The rights of taxpayers are commonly overlooked in the fight against tax evasion. For example, out of the 15 Actions that integrate the base erosion and profit shifting project (BEPS) of the Organisation for Economic Cooperation and Development (OCDE), only Action 14 "Make Dispute Resolution Mechanisms More effective" considers, to a certain extent, taxpayer's rights. However, participation of the taxpayer in the Mutual Agreement Procedure (MAP) is still very limited and no mechanisms exist to keep the taxpayer informed of the status of his ongoing MAP.

1 Deputy Mexican Tax Ombudsman and member of the United Nations Subcommittee on the Mutual Agreement Procedure, Dispute Avoidance and Resolution.

All other BEPS Actions are aimed at preventing profit shifting, limiting interest deductions, limiting the application of tax treaties, imposing burdensome information requirements to taxpayers, curbing their business strategies, etc. Again, all these efforts are praiseworthy, but the rights of taxpayers need to be considered when implementing mechanism to fight tax evasion or increase tax collection. Otherwise, the relationship between tax authorities and taxpayers will most likely turn conflictive and positive results will be complicated to achieve.

The role of a Tax Ombudsman is precisely to serve as an amicable intermediary between tax authorities and taxpayers to enable the resolution of disputes by providing flexible non-judiciary methods.

2 The Role of a Tax Ombudsman

Experience has demonstrated that the most efficient way to protect taxpayer's rights is to insert empowered autonomous institutions between taxpayers and tax authorities.

For example, in 2011 the Mexican Congress created the Mexican Tax Ombudsman Agency ("Prodecon" for its Spanish Acronym of *Procuraduría de la Defensa del Contribuyente*). Since then, Prodecon has grown 8,709% in services rendered to taxpayers, it expanded from one office in Mexico City to having presence in all of the States of Mexico and increased its employees from 20 in the year 2011 to more than 700 in 2018. This significant growth is a result of the demand of taxpayers for an independent governmental institution to protect their rights and for flexible non-judiciary mechanisms to resolve tax disputes effectively.

One of the key features that has enable Prodecon to be successful in the protection of taxpayers' rights is the amicable relationship it has with the Mexican Tax Administration. The fact that Prodecon acts as a watchdog in the dealings between taxpayers and tax authorities to provide a level playing field to assure that everybody plays by the rules does not thwart that relationship, on the contrary, it enhances it.

Having a Tax Ombudsman as an autonomous observer of the controversies between tax authorities and taxpayers provides a trustworthy environment for all parties to achieve an amicable resolution to controversies.

3 What can a Tax Ombudsman do in the face of tax terrorism?

A Tax Ombudsman can intervene at various stages to prevent tax terrorism from taking place or to resolve conflicts created by tax terrorism. Below are three examples on how Prodecon has successfully intervene to prevent tax terrorism and to resolve disputes caused by it.

3.1 Unbalanced tax legislation:

Tax terrorism can happen at a very early stage, from the moment tax legislations or administrative rules are drafted. Unbalanced tax rules serve as the foundation for conducts of the tax authorities that can ultimately harm taxpayer rights.

Laws, regulations or administrative provisions granting excessive powers to revenue administrations can derive in the systematic violation of taxpayers' rights. This is quite delicate, since the abusive conduct of the authorities would be supported by the unbalanced law.

To prevent the creation of unchecked and unbalanced tax rules, a Tax Ombudsman can safeguard taxpayers' rights by serving as an intermediary during the rules drafting process to provide a voice to all stakeholders.

In this respect, Prodecon actively participated in the implementation of BEPS Action 13 in Mexico. It is worth mentioning that transfer pricing information disclosure is fundamental as an anti-abuse strategy, it eliminates the asymmetry of information between tax administrations and multinational entities, thereby curbing base erosion and profit shifting.

For the implementation of Action 13 the Mexican Congress enacted article 76-A of the Mexican Income Tax Law that established the legal obligation to file the Local File, Master File and the Country by Country Report if taxpayers met specific legal requirements. The information and documentation that the new transfer pricing returns had to include were incorporated in administrative regulations drafted by the Mexican Tax Administration.

In this sense, to provide an opportunity to taxpayers to express their opinion towards the draft regulations governing the new transfer pricing requirements pursuant to BEPS Action 13 Prodecon, with the support of the Mexican Tax Administration, issued a public consultation and held a public hearing for all stakeholders to express their opinions with respect to the content of the proposed tax rules.

The public consultation and hearing allowed the Mexican Tax Administration to consider the comments and input of taxpayers, academics, chambers of commerce and professional associations. Ultimately, the final version of the tax rules detailing the information and documentation to be included in the Local File, Master File and the Country by Country Report considered the information received from taxpayers.

Without the intervention of Prodecon in the drafting and approval process of the new tax rules, taxpayers would not have had an opportunity to express their discontent with the manner in which the rules were initially drafted and the issue would have probably ended up in tax litigation at some point. Prodecon's intervention prevented future tax controversies and provided a rare opportunity for stakeholders to be listened.

3.2 Un-authorized information disclosures:

Tax terrorism can also be caused by un-authorized disclosures of the information of taxpayers, or by the failure to provide the necessary safeguards to protect such information.

In this respect, the financial information collected and exchanged as a consequence of the domestic implementation of the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS) is very sensitive, and taxpayers living in countries where criminal activity is a major concern sometimes worry more about an illegal disclosure of their information than the tax implications that the collection of such information might have.

In Mexico, article 69 of the Mexican Federal Tax Code establishes the obligation to all tax officers to keep in absolute secrecy the information of taxpayers obtained in the exercise of their public functions, any illegal disclosure is punishable by law.

However, there are no mechanisms to provide certainty to the taxpayers that their information will be kept confidential. Additionally, there is no provision in the law allowing the taxpayer to be informed if his information has been shared with a foreign government pursuant to the exchange of information regulations.

The taxpayer can, however, file a Complaint procedure[2] with Prodecon if any of the scenarios described in the paragraph above takes place. The Complaint enables Prodecon to act as a true Tax Ombudsman. Prodecon analyzes the taxpayer's complaint and if it fulfills the formal and substantive requirements, it sends an official order to the tax authority requesting a report on the illegal conduct that the taxpayer claims from such authority. Once the order is received, the tax authority has 72 hours to provide a reasoned answer to the taxpayer's complaint.

If PRODECON considers the answer provided by the tax authority to be illegal or considers that its conduct harmed the taxpayer's rights, it can issue a public non-binding recommendation requesting the tax authority to remedy the violation of rights.

Even when Prodecon's recommendations are not binding, the fact that if they are ignored by the tax authority the recommendations are published in major newspapers of national distribution pressures the tax authority in remedying the violation of the taxpayer's rights. It is important to mention that the recommendations name the tax officer responsible for the illegal conduct, which increases the strength of Prodecon's recommendations.

It is worth mentioning that before a recommendation is issued, Prodecon first approaches the tax officer to resolve the controversy in an amicable manner. The primary and most important objective is to resolve the dispute, not to shame and name the tax authority through a recommendation.

3.3 Tax terrorism in tax audits:

Tax audits are the main channel through which tax authorities can subject taxpayers to tax terrorism.

What can a taxpayer do if the tax authority is supporting its findings during the tax audit on incorrect information? What if the authority's conduct during the tax audit is clearly illegal?

In many jurisdictions the only alternative for the taxpayer is to wait until a tax assessment is issued to challenge the conduct and/or findings of the tax authority during the audit. Unfortunately, taxpayers can spend years in litigation before resolving a tax dispute that could have been resolve during the audit.

Considering this, on 2014 as a result of a proposal made by Prodecon to the Mexican Congress,[3] several amendments to the Federal Tax Code took place to enable Prodecon to act as an impartial mediator between taxpayers and tax authorities whenever a controversy arises during a tax audit. The mediation procedure is known as a "Conclusive Agreement".

The procedure is the first Alternative Dispute Resolution Procedure (ADRP) in tax matters in Mexico and the mediation revolves around the tax treatment that the authority gives to the facts or omissions detected during an audit and can involve aspects related to the interpretation of the law, formal issues and/or assessment of evidence presented during the audit. The filing of the Conclusive agreement suspends the tax audit.

The Conclusive agreement can only be initiated during the audit, so once the tax authority issues its tax assessment, mediation ceases to be an alternative for the taxpayer to solve the controversy.

It is worth mentioning that it is mandatory for the authority to appear before the mediation procedure requested by the taxpayer; but as it is common in most ADRPs, it is optional for the tax authority to accept or refuse the taxpayer's proposal to reach an agreement that could terminate the controversy.

After the Conclusive Agreement is signed, the tax effects stipulated in the agreement apply immediately, i.e. no legal act or action is needed for the agreement to be legally binding for both parties. The parties cannot challenge the result of a Conclusive Agreement with the courts as it is the product of their own free will.

If no agreement is reached, the audit suspension is lifted and the tax authority is free to continue the audit. If a tax assessment is issued, the taxpayer will be able to file the available legal defense mechanisms before the courts.

4 Conclusion

The relationship between taxpayers and tax administrations is complicated by nature. Their opposing interests tend to create a conflictive environment instead of a productive alliance. At the end both parties are dependent on one another.

2 The Complaint procedure of Prodecon can be filed against any act of the tax administration that a taxpayer, individual or entity, considers it is harming its rights as a taxpayer.

3 The Organic Law of Prodecon grants the Agency the power to present amendment proposals to tax laws directly to Congress.

The creation of innovative mechanisms and/or institutions to pave the road for a productive and amicable relationship between tax authorities and taxpayers should be on the international agenda.

Just as the traditional international tax principles of nexus and attribution of profits are being scrutinize to develop new strategies to prevent and avoid tax evasion, the same development needs to occur with the protection of taxpayers' rights, and the creation of Tax Ombudsmen, empowered to safeguard such rights and provide flexible non-judiciary mechanisms has proven effective on that regard.

RECENT TAX TRENDS IN M&A LANDSCAPE

*Amrish Shah**

The current year has been momentous for M&A professionals as significant domestic and cross border corporate deals were witnessed, compared to the earlier year. Mounting globalization, unrestricted economies, key policy amendments and multiple facilitating schemes from the government are some of the key reasons for such an impetus in the Indian M&A landscape.

Any M&A transaction is incomplete sans compliance with relevant laws and regulations. One of the key Indian legislations amongst others has been the income-tax law. Repercussions of M&A transactions under income-tax law has always been an area of concern for its stakeholders, specifically in the backdrop of changing tax and regulatory environment. This article attempts to highlight some of the key tax and regulatory changes in M&A arena.

1 Changing tax environment

General Anti Avoidance Rules (GAAR) provisions have been introduced in the statute book from April 2017. These provisions under the income-tax law empower tax officers to re-characterize / disregard any transaction which lacks commercial substance and is predominantly undertaken to derive tax benefit. Understanding the nuances of diverse businesses and consequently applying these provisions to a particular transaction to examine its commercial expediency, might be a challenging task for revenue authorities, especially having regard to a dynamic and diverse business environment. The tussle between the taxpayers and revenue authorities regarding commercial substance driving a particular transaction seems inevitable.

While GAAR acts as a generic weapon against tax evasive practices, the revenue authorities have also been endowed with specific rules colloquially referred to as Specific Anti Avoidance Rules (SAAR), to counter aggressive tax planning. These specific regulations have been incorporated in the tax law over a period of time to protect revenue's interests. Citing increased abuse of tax provisions under the existing law, the government introduced these regulations to bring various transactions within the tax net, right from transfer of shares in a closely-held company, transfer of immovable property to receipt of identified assets (including shares of a company and immovable property amongst others) for less than fair consideration (as per prescribed rules).

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Further, amendments have been made to tax the issuance of shares to a resident taxpayer by a closely-held company at a premium, in the absence of adequate justification for such premium. Apart from these, many other specific provisions form part of the legislation.

Co-existence of GAAR and SAAR does create conflict at times because any particular transaction which escapes the rigors of SAAR may be caught by revenue authorities by invoking GAAR. Revenue authorities' approach towards such aspects would be interesting to observe in the times to come. It is therefore imperative to consider that any M&A transaction/restructuring undertaken especially within group companies will have to be backed by strong and justifiable commercial rationale and the same should be adequately documented.

Requirement of a transaction being justified by strong commercial rational is gaining popularity globally. Worldwide, the focus has been shifting from a legal form of the transaction to economic substance. Various steps in this direction have already been undertaken including BEPS (Base Erosion and Profit Shifting) Project and the signing of Multilateral Convention (MLI) to implement tax treaty related measures to prevent BEPS. India being an active member of G20 and OECD is committed towards implementation of the BEPS Project. Some of the BEPS Actions Plans such as Thin Capitalization, Country by Country Reporting and Equalization Levy have already been implemented unilaterally by India in the form of necessary amendments in its domestic tax law as SAAR.

Further, regulations with respect to Place of Effective Management (PoEM) has been brought in domestic tax law. In furtherance to the objectives listed in the BEPS Action Plan, India has also signed MLI and has particularly chosen to apply limitation of benefit rule which provides an objective determination to deny treaty benefits along with principal purpose test to counter treaty shopping. These developments indicate the intention of revenue authorities globally as well as in India, regarding the thrust on commercial rational and justification, motivating any actions on behalf of the taxpayer. Any transaction lacking commercial expediency may face action from revenue authorities, resulting in re-characterization of the entire arrangement and consequential tax and penal implications.

2 Changing regulatory environment

2.1 Indian Accounting Standards

It is often said that change is the only constant. Every change brings different perspective with which we evaluate a particular scenario. One such change has been brought in by the introduction of new accounting standards, Indian Accounting Standards (Ind-AS) for listed and unlisted companies having net worth of more than INR 500 Crores, from FY16-17 and listed companies having net worth of more than INR 250 Crores but less than INR 500 Crores, from FY17-18. For NBFC's having net worth of INR 500 Crores or more, Ind-AS is applicable from FY18-19 and for listed NBFC's having net worth less than INR 500 Crores or unlisted NBFC's having net worth of INR

250 Crores or more but less than INR 500 Crores, Ind-AS is applicable from FY19-20. Ind-AS predominantly focusses on the substance of a transaction rather than its form.

Newly introduced Ind-AS 103 governs accounting for Business Combinations. Technically, Ind-AS 103 not only deals with amalgamations but also with all such transactions which result in acquisition of control over the business of an entity by way of demerger, slump sale etc. Accounting norms prescribed in Ind-AS 103 may have far reaching implications while interpreting tax laws. One such instance amongst others is summarized below.

Ind-AS 103 mandates acquisition method of accounting in case of acquisition of business from an unrelated seller. This method of accounting mandates fair valuation of assets and liabilities acquired pursuant to an amalgamation or demerger in case of third party acquisitions. Hence, a transaction of demerger between two unrelated parties needs to be accounted for in the books of the acquirer at fair values.

Tax laws provide that assets and liabilities should be transferred at their respective book values as one of the pre-conditions for tax neutrality. Whether compliance with these mandatory accounting standards will have any adverse tax implications in the hands of companies and shareholders participating in the transaction, is a matter of concern for many stakeholders. While there are divergent views with respect to tax neutrality in such situation, litigation on these issues cannot be ruled out.

2.2 Insolvency and Bankruptcy Code (the Code)

Newly introduced insolvency and bankruptcy code has opened many closed doors in the M&A field. Certain amendments have also been carried out in income tax law to assist companies which are facing proceedings under the Code.

Taxability on account of write back of hair-cuts in the books of the borrowing company needs dual examination. One under normal income tax provisions, and the second under Minimum Alternate Tax (MAT) regulations. Implications under the normal provisions are governed by the intent for which the borrowings were obtained and utilized. If the loan was obtained for the purposes of capital expenditure, then it may be contended that the write back should not be subject to tax under normal provisions. However, if the borrowings were for working capital purposes, then such write back should be taxable under normal provisions.

On the other hand, intent and utilization of borrowings is not relevant as far as taxability under Minimum Alternate Tax (MAT) provisions are concerned. Write backs are generally routed through profit and loss account of the borrowing company and there is no adjustment proposed in the law to not offer such write back while computing book profits for the purposes of MAT. Considering this, a debt-ridden loss making company would be subject to tax on such write backs under MAT.

However, little respite has been provided in terms of allowance of aggregate of business loss and unabsorbed depreciation as per books as a deduction, while computing book profits as against lower of two in case of companies facing insolvency proceedings. Having said that, suitable amendments in tax laws to mitigate the adverse tax impact of these transactions having economic significance has been a humble request of India Inc.

3 Revenue authorities' attacks on M&A transactions

3.1 Schemes of Arrangements

Any scheme of arrangement undertaken by a company with its shareholders or creditors, requires compliance with applicable provisions of corporate law including obtaining approval from regulatory authorities such as income-tax department, registrar of companies, regional director, sectoral regulator, if any, jurisdictional National Company Law Tribunal (NCLT) and other parties such as shareholders and creditors.

Recently, while providing comments on the scheme of amalgamation of GABS Investments with Ajanta Pharma, revenue authorities invoked provisions of GAAR and concluded that the scheme has been floated to evade taxes and hence, the scheme should not be sanctioned. The objections raised by the revenue authorities are surprising as CBDT has already clarified that GAAR will not interplay with the right of taxpayer to select or choose method of implementing a transaction[1]. Much to the applicant's dismay, the Hon'ble Mumbai Bench of NCLT rejected the

[1] CBDT Circular No. 7 of 2017 dated 27th January 2017

scheme on the grounds raised by revenue authorities. Several similar schemes have been approved in the past without any objections and conditions.

A simple scheme of merger being rejected on the basis of objections raised by revenue in light of GAAR provisions is an eye opener for the M&A fraternity. Every scheme of arrangement needs to be carefully tested for probable implications under the GAAR provisions, to avoid a last minute knock-out.

Interestingly, a similar scheme has been recently approved by Hon'ble Delhi Bench of NCLT in case of amalgamation of promoter holding companies into the listed company[2]. Revenue authorities, on similar lines, objected to the scheme stating that it has been floated to evade taxes and there was no commercial reason for the scheme to be implemented. The applicant defended its case and provided justification for the scheme. Hon'ble Delhi Bench of NCLT in its detailed order evaluated various parameters to distinguish tax evasion from tax planning. Hon'ble Delhi Bench observed that taxpayers have a right to manage their affairs in a tax efficient manner and hence approved the scheme stating that the same was not a device for tax evasion.

It will be interesting to see how revenue authorities approach such schemes of arrangement in future and how tribunal analyzes such observations and consequently how the law evolves around this over a period of time.

3.2 Conversion of company into LLP

Various forms of organizations are adopted by people to carry out their business operations. Companies, Limited Liability Partnerships (LLP), partnership firms, proprietary concerns are few examples. Each one of them have their own pros and cons. Recently, LLPs have been increasingly adopted primarily due to ease in incorporation and reduced legal compliances. Various business houses are even considering converting corporate structures into LLPs which has drawn the attention of revenue authorities. Regulations governing LLPs provide for conversion of a private limited company into LLP. Following the procedure prescribed under law, an existing private limited company can be converted into a LLP on fulfilment of stipulated conditions.

The issue which invariably comes up for examination is whether conversion of a private limited company into a LLP attracts any tax implications. Historically, taxpayers have always contended that such conversion is in accordance with LLP regulations and there is no transfer of property executed in favor of the LLP. All the assets and liabilities of the private limited company statutorily vest in LLP and not consequent or incidental to any transfer, as transfer pre-supposes existence of two parties. On conversion, the erstwhile private limited company is remodeled into a LLP and hence there should not be any tax exposure on such conversion. This contention is also supported by an analogy drawn from a Bombay High Court ruling[3] which dealt with conversion of a partnership firm into a company as per provisions of erstwhile corporate laws.

Income tax law does provide for a specific exemption from taxability in the hands of the private limited company and its shareholders on such conversion, subject to satisfaction of certain conditions (although stringent). Some taxpayers have been adopting a view that per-se there is no transfer on such conversion and hence complying with the conditions for availing the said exemption is not necessary.

Further, there should be no exposure to shareholders, since the underlying interest remains the same. Simply the form in which such interest is held undergoes a change, i.e., shares of private limited company are replaced by partnership interest in LLP pursuant to conversion.

However, recently on this issue, Mumbai Tribunal in case of Celerity Power LLP after considering various aspects of LLP regulations and income tax law, held that conversion of private limited company into LLP as per provisions of LLP Act would constitute a transfer as per income tax law. Mumbai Tribunal further observed that the entire undertaking of erstwhile company got vested into LLP at book values and no separate cost other than book values was attributable to the individual assets and liabilities. Tribunal also observed that full value of consideration for such transfer cannot be construed as market value of the asset on the date of transfer. Therefore, since assets and liabilities have been vested in LLP at book values, the same will have to be considered as full value

[2] Merger of PIPL Business Advisors and Investment Private Limited and GSPL Advisory Services and Investment Private Limited with NIIT Technologies Limited

[3] Texspin Engg. & Mfg. Works

of consideration for the purpose of computation of capital gains tax, resulting in nil capital gains.

Above mentioned Mumbai Tribunal rulings has challenged the principles followed as regards taxability of conversion of private limited company into LLP. CBDT may consider bringing in clarity around these aspects to avoid litigation in future.

4 Conclusion

Considering the changing tax and regulatory landscape and increasing thrust on commercial justification of transactions and also the approach of revenue authorities, it is important that M&A transactions stand the rigors of anti-avoidance rules and increased scrutiny by revenue authorities. Any M&A transaction should have a justifiable commercial rationale as its driver and meticulous documentation of these commercial rationale over the lifecycle of the transaction should be of utmost importance going forward.

Further, there are umpteen number of tax concerns for stakeholders in M&A transactions. Clear guidelines and rules related to GAAR, more sophisticated approach by revenue authorities, consistency across all applicable legislations and necessary amendments keeping pace with changing business environment, should be the way to address any potential litigation and hereby enhance the case of ease of doing M&A deals.

A REVIEW OF TAXPAYER S' CHARTERS AND TAXPAYERS' PROTECTION

*Ian Young**

Ian Young from the Institute of Chartered Accountants in England & Wales (ICAEW) used his experience as chair of the UK Taxpayer Charter Oversight Body and his work in this area for various international organisations to shed light on what individual countries need to do if they are to uphold the rights of taxpayers and create a more efficient and effective tax system.

Ian Young noted that the recent report of the Indian Tax Administration Reform Commission under the chairmanship of Dr Partho Shome recommended:

"There is an urgent need to revisit the present [indian] citizen's charter to make it more meaningful and customer focused. The citizen's charter should be renamed the taxpayer's charter to focus on all categories of taxpayer."

Ian Young noted that while all taxpayer charters had similar objectives and all charters use similar language with similar objectives nevertheless they also needed to respect the specific characteristics of the country for which they are the charter. So the OECD in setting out its practice note on Taxpayer Rights and Obligations nearly 20 years ago stated:

"In drawing up a taxpayers' charter a country must properly reflect their own policy and legislative environment and their administrative practices and culture."

The great strength of a Taxpayer Charter is that it is not a complicated legal document which is difficult to understand but it is a clear statement of intent, by the tax administration, as to how they are going to run and administer the tax system and how they are going to be focusing on good outcomes for the taxpayer as well as helping to create a more effective and efficient tax system.

OECD has captured this vital essence of a Taxpayer Charter in its statement:

"The taxpayers' charter is an attempt to summarise and explain in plain language a taxpayers' rights and obligations in relation to their tax affairs, making such information much more widely accessible and understandable."

Ian Young explained the work of the many international organisations that have been promoting the introduction of taxpayers charters over the past 30 years from

* *ICAEW*

the European Commission, the United Nations, the International Chamber of Commerce, CFE Tax Advisers Europe and IBFD, one of the sponsors of the Mumbai Conference.

The OECD model charter of taxpayer rights and obligations, most recently published in its biennial publication, Tax Administration 2017, gets to the heart of what charters need to "say".

Right	Obligation
To be informed, assisted and heard	To be honest
Of appeal	To be co-operative
To pay no more than the correct amount of tax	To provide accurate information and documents on time
Certainty	To keep records
Privacy	To pay taxes on time
Confidentiality and secrecy	

But the really difficult task is to make a Taxpayer Charter work in practice. Mere words do not deliver the desired result.

So Ian Young set out some of the issues that any country, including India, needs to consider if it is trying to improve the environment for taxpayers and make the existing tax system more efficient.

The Taxpayer Charter may need to be included in Statute to make sure that it is taken seriously and that it can be relied on by taxpayers particularly when they feel that they are not being treated in accordance with the terms of the Charter.

There needs to be an oversight body, sufficiently independent from the tax administration, to monitor and review what is going on and hold the tax administration to account, in a meaningful way, if the tax administration is not adhering to its obligations under the Taxpayer Charter.

There need to be surveys of what is happening in practice so that there is more objective information about the working of the Taxpayer Charter. A survey needs to be undertaken each year to determine trends and whether the system is improving or where there are continuing problems.

There also needs to be transparency and public reporting, to Parliament or other appropriate body, so that the oversight body can share its views and conclusions with the government and other societal bodies interested in creating a better tax system.

There is already a very ambitious Vision in the current Indian Citizen's Charter:

"A nation building process through a progressive tax policy – an efficient and effective administration and improved voluntary compliance/"

There is also a more detailed Mission statement:

- To formulate progressive tax policies
- To make compliance easy
- To be accountable and transparent & act with honesty, in a fair and judicious manner
- To deliver quality service
- To continuously upgrade skills and build a professional and motivated workforce

There is clearly a great deal of government ambition for the tax system in India and Ian Young suggested that the introduction of a Taxpayer Charter and the necessary back-up mechanisms could help to translate this ambition into reality.

LIKELY IMPLICATIONS OF THE NEW TECHNOLOGIES ON FUTURE TAX POLICY AND ADMINISTRATION

Craig West

Sub-issues: Impact on (i) Tax Systems, (ii) Tax Administrations, and (iii) Tax Policies of the Future

Session Chairman: Mr Clive Baxter

Special Speaker: Prof. Jeffrey Owens

Panel Leader: Prof. Craig West

Panellists: Ms Monica Bhatia, Ms Shikha Mehra, Dr Neil Pennington, Mr Sam Sim, Mr Jon West

After a brief introduction to the topic and the panellists, Mr Baxter invited Prof. Owens to deliver his special presentation.

Prof. Owens, in a brief presentation firstly outlined diagrammatically the volume of transactions, downloads and other activity taking place through the internet in a 60 second period. This diagram illustrates the volume of economic activity that, to some extent, is untracked.

The first question posed by Prof. Owens was "how did we get here, and what is the current state? With respect to this question, Prof. Owens challenged the audience to consider a series of interconnected themes. In no particular order, these are: (i) instant globalisation (Digital breaks down barriers to entry and growth, enabling companies instantly to access and monetize global consumers, reshaping markets and supply chains, and creating new business opportunities and risks); (ii) significant global shift in digital policy (Governments are demanding greater transparency and introducing new rules and regulations for the digital economy. Others are adapting existing tax and legal concepts for the new world – creating further uncertainty); (iii) converging industries (Industries are blurring and integrating elements of the technology sector into aspects of legacy business processes at an accelerating rate. Existing enterprises now risk disruption from all sides. New, forward-looking alliances are also changing the landscape) (iv) the digital revolution (Emerging production and consumer models, as well as new technologies – all enabled by the proliferation of the connected economy – are affecting all companies in every industry). All of these interconnecting themes have resulted in the obvious conclusion that digital transfor-

mation has and will lead to further tax implications. These new tax implications (on policy, systems and administrations) will offer opportunities as well as significant risks).

After this scene setting analysis, Prof. Owens continued by providing the audience with an overview of a digital tax administration. He demonstrated the impact that new technologies may have on the compliance cycle, including utilisation of "live" data from companies (for example) matched with sophisticated systems facilitating e-verification of the data and utilising data analytic platforms to assess the data. Such techniques may significantly shorten the compliance cycle and collection of taxes.

The use of such new technologies has been predicated on a number of global themes and trends. These, Prof. Owens identified, are:

(i) Creating a web of valuable taxpayer information
(ii) Moving compliance "upstream"
(iii) Moving to real- or near real-time
(iv) "Layering" of new requirements
(v) Data analytics and data matching techniques
(vi) Significant collaboration among different tax authorities
(vii) Not all tax approaches necessarily being enshrined in law
(viii) The movement to digital tax administration being not necessarily linear.

The test case for such digital application seems to have first appeared in the VAT space. A trend was identified with respect to digital supplies being taxable in the country of consumption. The digital VAT trends were instrumental in the move towards tax authorities going digital.

Taking the topic further, Prof. Owens outlined new tax policy opportunities that were opening up. He included in his presentation the following:

- Potential new tax bases (Robots, AI, Data)
- New ways of applying old taxes (e.g. Opportunities to reassess the effectiveness of taxes on capital to reduce inequalities)
- Using technology to improve tax competitiveness
- The potential demise of the CIT
- The integration of tax and benefit systems
- Big data and fact-based tax reforms

- The start of a move towards a cashless economy
- More effective measure to counter Illicit Financial Flows
- New technologies as trade facilitator.

(a) New tax bases – taxing robots (universal benefits? – expensive) – unknown impact of robots (disruption first then long term benefit (new jobs)). Counter views that disruption remains, and greater inequality the result.

(b) New ways to apply old taxes: "Data is the new oil" – The Economist – Issues arise – who owns the data; who can sell the data etc.

(c) Use of new technologies to improve tax competitiveness (as one area of its use). Provide opportunity to reduce inequality; difficulty in past to gain the information in revenue authorities (but barrier being removed). Technology provides opportunity to track data and assets (for wealth taxes etc).

(d) Income taxes – lifetime perspective (perhaps – making adjustments) – payroll and personal income tax changes – pre-population tax returns as first step (but goes further)

(e) Govts restricted in incentives (by WTO etc), but providing improved tax environment (not so constrained).

(f) Do we need CIT? – Measure the incidence of corporate tax – but lead to no corporate tax in favour of new individual tax

(g) Fact based tax reform (based on data analysis) – also tests efficiency of the incentive schemes and other reforms.

(h) Cashless, IFF, trade facilitation – cashless can kill black money; removes other issues; trade facilitation -

Finally Prof. Owens challenged the audience to consider the possible winners and losers with respect to the new technologies and the potential impacts for tax systems, tax administrations and tax policy. He identifies the risk that application of new technologies may have on developed versus developing countries, the differing impacts for business and governments, the future role of tax advisors (in the light of tax authorities accessing "live" data, amongst other concerns) and, finally, society as a whole.

Prof. West highlighted that the topic had caused the panel to consider two clear aspects with respect to the likely implication of new technologies, namely the immediate / short-term future and the longer-term future. Before the longer-term theme could be examined, it was first necessary for the panel to consider the immediate and short-term future. The panellists, consisting of an international organisation representative, industry tax experts as well as technology experts, were then asked by Prof. West to look at the new technologies in terms of the classic SWOT analysis (Strengths, Weakness, Opportunities and Threats) and the impact that such new technologies will / may have on tax policies, tax systems and tax administrations in the not-so-distant future.

Prof. West indicated that an overarching consideration for the SWOT analysis would be, what do we want to get out of these new technologies: Simplicity, Certainty, Accuracy, Completeness, Cost effectiveness, Speed (both in terms of compliance and collection), Elimination of unnecessary dispute resolution, privacy and confidentiality (of taxpayer and third party data), global transparency (access to data by authorities), ensuring a "fair share" globally (both for authorities and taxpayers) alike. He asked the panellists whether these were likely / possible going forward?

Ms Bhatia began the discussions from an international organisation and revenue authority perspective. She pointed to the increase in the flow of data between revenue authorities in terms of the various instruments now available. The more immediate access to data was seen as an advantage. However, the increase in data flows was also creating challenges for developing countries in managing the data flows and dealing with the various and rapid changes. Certainly immediate advantages could be seen in the VAT space in terms of compliance and collection. She emphasized the need for global solutions to global problems.

Outlining various advantages that new technologies may bring to tax systems, administrations and policy were Dr Pennington and Mr West as technology experts. Dr Pennington firstly addressed the advantages of the new technologies in restoring or rebuilding trust in communities and the inter connectivity of people. Drawing from a lack of trust in traditional institutions the interaction in virtual communities with technologies such as blockchain would serve to recreate levels of trust. Blockchain could not only facilitate speed in processing and reporting, but equally created the advantage of not being slowed by traditional banking systems. In the medical space, blockchain could be utilised to monetize medical data for re-

search purposes. Blockchain also has huge potential to transform access to energy and help mitigate the impact of climate change through the Energy Web Foundation; in particular the ability for individuals in communities to both be consumers and generators of energy; such a changing business model will have implications for tax.

Mr West then asked how we could use digital currency technology to achieve a state where a business never needs to calculate, collect, remit, or file transaction taxes… could it all be real-time and automated…and what might that future look like?

He addressed the potential for blockchain and digital currency to influence the future of tax. The possibility was explored of a world where business would not need to worry about determining, collecting, and remitting indirect (transaction) tax… and tax authorities would not need to worry about tax administration costs, tax evasion, fraud, etc. Nor would either side need to worry about data privacy in the sense of relying on someone else to protect your data. It was recognised that such a world was idealistic, blockchain and digital currency were allowing taxpayers and tax authorities to take the first steps towards such a future. He emphasized that digital currency was providing new business models and economic transactions that aren't possible with current fiat currency (government recognised legal tender) technology. New technologies could be used to greatly improve the tax collection for both fiat and digital currency transactions. Of course, he emphasized the need for there to be trustworthiness of the data underlying the technologies.

He referred to the old adage that from crisis generally comes opportunity and that the disruption being caused by the new technologies was providing the necessary opportunities. He provided examples of new opportunities being created for various industry players and the value of data. Specifically he highlighted that value in data would lie in the analysis of that data. As an example, Artificial intelligence with its requirement for properly curated and standardized, machine readable data, will mean bring more and more of the world's unstructured data into a form that will be more useful.

Ms Mehra then addressed how blockchain based solutions could address the problem of taxing data in the digital economy. With real time information and being able to track the user base could provide an answer for the consumer based tax proposals currently being mooted. Mr Mehra further commented on the nature of work changing, particularly to part time flexible work or contract work. This is creating value increasingly at the fringes. She posed the question as to what this means for taxation and how relevant is blockchain (network centric architectures & currencies) in assessing and collecting tax in such scenarios. It was pointed out further that, currently, 90% of data in digital economy being captured by 9 global companies (mainly US and China). This has enormous value and implications for tax systems, policies and administrations. Ms Bhatia then interjected that, at least from a revenue authority perspective, data and access to data has great potential to provide greater opportunity arising from the analysis of that data as well as the potential of improving taxpayer services.

The panel was then challenged by Prof. West to consider the downside of the new technologies and the risks that the technology poses. This is also critical to understand.

Ms Bhatia started the discussion from the revenue authority perspective. New technologies were providing several tools to the authorities including the ability to do better risk assessment to get better global picture of a taxpayers affairs and ability of tax authorities to share bulk information with other countries. Many of the existing concerns around exchange of information (particularly on an automatic basis) were equally applicable to the new technologies. In terms of challenges these include the issue of revenue authority capacity; lack of understanding of the new technology, the difficulty in keeping ahead of the new technology. Ms Bhatia stated that revenue authorities would need to gear up with more skills in this area very quickly as the rapid change was, for many revenue authorities, particularly in the developing world, may be too much to manage.

Dr Pennington then spoke to the technologies themselves. He suggested that one key issue is the lack of understanding of the uses of the technology for fundamental transformation of traditional business models and that more effort should be made to disseminate information as to the use of the new technology. Change management with respect to its implementation was critical to the success of its use. He pointed out further the current issue of scalability. Currently, there are many small scale pilots across multiple applications, from finance to real estate, healthcare, energy and supply chains; there are also multiple protocols in use from open "permissionless"

chains to private, permissioned. Issues of scalability will be solved through the interoperability of different chains, through developments such as polka dot. From a tax perspective this will raise issues of complexity as tokens from different protocols will be created, retired, exchanged and converted – as such tokens are likely to have different values, and there will be an even greater need for tax authorities to have a technological understanding.

Mr West then highlighted an issue around micro payments (facilitated by cryptocurrency). While micro payments offered a great opportunity to widen the tax base (facilitating access to user supply of data to feed algorithms, this technology would generate an enormous volume of data that may limit the ability of the revenue authorities to process. He further highlighted the risk of security of the data. The new technologies, he pointed out, was essentially a written code, which may expose the data to hackers.

Mr Sim then referred to the trend of moving administrative functions for tax collection to industry, whether by way of Indirect tax regimes or implementing reporting via intermediaries. Further there was a potential change in the asymmetry of data issue, which was assumed by the BEPS project as being in favour of the taxpayers, but going forward is flipping to an asymmetry in favour of the tax authorities. This is because the average tax department does not have the budget nor the ability to summon resources anywhere close to that which national authorities can marshal – witness for instance, China's Golden tax system. He further indicated that effective use of the data required extensive government budgets to invest in the new technologies in order to facilitate its use. The increasing demands of automation and digitalisation means that tax administrations may have the upper hand over the relatively resource-deficient industry going forward.

Mr Sim also pointed to the future risk of the greater digital divide between those countries able and those not able to apply the new technology to tax digital transactions. Further a divide may arise between small taxpayers and large taxpayers, the latter being better equipped to deal with the challenges of complying with digitalization. Finally, tax being an instrument for redistribution means that the above imbalances could mean a risk of greater inequality being created by the new technology.

Prof. Owens interjected with the point that ethical and privacy concerns for both taxpayers and tax administrations would still have to be discussed and resolved. He further pointed to the increasing possibility of the use of robotics in tax planning.

Ms. Mehra then addressed the risk that, assuming the systems based on the new technologies were considered trustworthy, the issue remained of "rubbish in, rubbish out". This was the risk that irrespective of the system used, the initial data inputted into the system would require verification to allow for the outcome of the system to be trustworthy. It was unclear how this was to be applied in a new compliance system where traditionally, the outcome was audited and verified rather than the inputs. She reemphasised Dr Pennington's point on the scalability of the new technology.

Prof. West then noted the completion of the SWOT analysis highlighting both positive and negative aspects. He asked whether the risks were likely to slow the technological pace or the implementation. He suggested that we were already in the age of big data and asked what should be happening now, whether pilot studies were or should be underway and whether there was the chance that governments, industries and administrations could try to get ahead of the new technologies as they unfold. He asked whether successful implementation would hinge on a single solution and political buy-in from all governments. He pointed to developing countries stating that they do not want to be left behind. Prof. West highlighted the comment from the Head of ATAF and Nigerian revenue authority leader Tunde Fowler that it is important that a digital tax solution be developed that works for both developed and developing countries as well as the business community. Prof. West pointed to this comment being equally applicable to the application of new technologies.

Prof. West then asked the panel whether the time was ripe to rethink and redesign the tax system, administration and policies to be proactive and innovative rather than reactive and delayed.

To illustrate some of the above, Prof. West asked some of the panellists to speak to current pilot studies in the application of blockchain. Mr West was invited to speak first with respect to a pilot study in an indirect tax context.

Mr West, from Thomson Reuters, indicated that they have been working with solutions for both fiat and crypto currency types. Thomson Reuters had partnered closely with a start-up, Summitto, to provide a blockchain-based solution for existing tax sys-

tems (or for fiat currency transactions). A pilot was planned for the Netherlands. In terms of this pilot, companies would register their invoices to a blockchain network. This network would record proof of the invoice (it can be trusted at any later date) and tracks companies' VAT balances. The planned result would be that companies would no longer need to file a VAT return (instead they are simply assessed by the tax authority), they would not need to share detailed data with the Tax Authority (the company could maintain 100% privacy of its invoice data), and this application had the potential to identify traders not in compliance (as the other invoice party would have filed. This may help to address the some $50 billion per year VAT fraud in the EU. This pilot may assist to roll out blockchain technology in a way that would significantly improve the existing VAT system.

Mr. West further indicated that Thomson Reuters was engaged with digital currency transactions where they had created prototypes to accomplish split payment. For digital currency, split payment is relatively simple to accomplish as compared to fiat currency. Digital currency has properties such as:

- Immediate settlement
- Low cost
- Borderless
- Financial inclusion
- Programmable money
- Micro payments allows new functions not previously possible
- IOT
- Brave browser
- Can better align financial incentive of buy and seller

Fiat currency will likely not accomplish this features because these features are inherent in the blockchain technology. Fiat can accomplish such features by becoming a digital currency, currently being considered by at least a dozen countries and recently discussed by the IMF. Digital currency had the potential to greatly assist with tax regardless of whether a central bank for digital currency or private digital currency was created. He stressed that the time for tax authorities to plan and execute pilots was now because there is currently no risk. With currently very few digital currency transactions it is easier and less risky to execute pilots and get out ahead of the technology. Tax authorities should not wait because the problem will be much more difficult to solve when there are millions, billions, or trillions of digital currency transactions if they have no infrastructure to manage the data. He pointed out that existing tax policy and systems could be a hindrance to the innovation and economic growth that is possible with digital currency.

Ms Mehra (after providing the audience with a brief video clip) proceeded to discuss a VAT pilot in the GCC area using blockchain. The region was launching, in terms of the pilot, a VAT cryptocurrency (or VAT coin). However, this "VAT coin" was only redeemable with Government in respect of the VAT obligations. The pilot involved the use of a digital invoice custom exchange (DICE) and would satisfy the companies' VAT obligations.

With two pilot studies underway, Prof. West asked some of the panellists for comment on these pilots or other aspects.

Mr Sim made a number of comments. His comments were:

Since the 2008 financial crisis, the pendulum has already swung in favour of regulations and regulators in general. The area of taxation is no exception. It increasingly favours tax administrations over taxpayers - starting with personal taxation (FATCA, CRS, etc) and then corporate income taxation with BEPS. Digitalization portends a further swing of the pendulum in favour of governments with the consequence that the asymmetry of information that tax administrations may have suffered in the past could turn into asymmetry against taxpayers in a number of respects:

(i) First, Access. Digitalization will bring forth a hyper-transparent world. BEPS Action 13 already reveals information with CbC reporting and Masterfile reporting (value chain, IP ownership etc) beyond the traditional entity-level data revealed by tax returns. The exchange of information and intelligence via the formal regimes such as MCAA/treaties and through other channels such as OECD and regional meetings, peer reviews, capacity building will be facilitated by technology and digitalization. Where there were once dusty accounting records and archives hidden away in Iron Mountain, in the future, all transactions will leave an electronic trail and in great migration to the Cloud, will become located in highly concentrated data centres, no more than a few hundred across the world. Blockchain if it becomes widely adopted, will be-

come an immutable goldmine of distributed ledgers that the tax administration can tap from any node in the network as each possesses the complete ledger. In short, once the data is in the Cloud, it is there for the taking. And the Executive arm has the power to access the data.

(ii) Second, clean, standardized Data will greatly facilitate audits. AI demands curated, clean datasets before machine learning can take place. The same clean datasets then become much easier to interpret and process compared to unstructured data with varying formats. The avoidance of Rubbish in Rubbish Out also means the auditor need not pick through rubbish ! The same goes for Robotics Process Automation where the same clearly defined steps and clean golden sources of data mean that whilst the taxpayer reduces manhours and errors, such processes also become much more transparent, easier to interrogate and reconstruct or retrace the steps of the automated process. Here the local country tax manager, if not familiar with data structure or trained in data analysis, may be hard-pressed to mount an effective audit defence.

(iii) Third, asymmetry of resources. Technology is an enabler. Computing power is getting cheaper by the day and big data analytical tools are already adopted by various tax administrations in spotting patterns, in comparing with other taxpayers in analogous situations (Australia's "nearest neighbour" concept) and spotting inconsistencies that escape the human eye or the ability of humans to discern in a sea of data. Tax administrations have a natural upper hand in technology adoption. The crux of the matter is that tax is a support function within MNEs whereas the revenue agency if properly funded, can do things at scale, access to national or international datasets and the computing resources of other government agencies - witness China's Golden tax system for VAT or the certain tax authorities building specialist economist teams to analyse financial transactions or credit card data. Digitalisation tilts the balance of power in favour of tax administrations from the old world where the IRS speaks of taxpayers with greater resources "out-lawyering" the IRS to the new world where the average tax department (even the largest MNEs only have a few hundred people) have little resources to automate, digitalize, much less perform the analytics that a properly funded national revenue agency can. Even if an MNE can digitalize its tax functions, it will not have access to the data of the rest of its industry or country as a revenue agency does.

(iv) Next, there is asymmetry of speed. If digitalization results in real time data reporting and revenue collection, there is no time to exercise judgment on the part of the taxpayer. For instance, does a transaction fall under one or another category, thus warranting a different VAT or withholding rate? The speed may be such that the taxpayer has no choice but to program broad categorizations into automated systems instead of reviewing the transactions against the tax rules. It can be difficult to claim refunds if taxes are conservatively overpaid. On the other hand, once the tax is collected, the tax administrators are under considerably less time pressure to raise the audit.

(v) Asymmetry of Rights. The old adage of no taxation without representation Taxpayers' rights only applies within the sovereign borders. The changes in international digital taxation have transcended protecting the tax base and notions such as digital nexus, overseas supplier registration and user participation rapidly become unilaterally extra-territorial if not tempered by bilateral or multilateral allocation of taxing rights under the traditional DTA framework or the MLI. The sovereign will exercise its rights to enact extra-territorial rules but the offshore taxpayer who has to register, file a PE return, submit information or is subject to withholding, does not enjoy any of the taxpayer protections as a citizen. Tax treaties have yet to develop investor/taxpayer protections or investor-state recourse mechanism as those in Foreign Investment Protection treaties.

(vi) Further, there is the issue of asymmetry in the pace of development of digitalization and the development of ethical safeguards. What if an AI program behaves in a completely logical but unethical way. For example, if the

underlying data used to train the algorithms in audit target selection ends up profiling taxpayers with certain characteristics? Once information is available and fed into the system, will the taxpayer's privacy be respected? Will his data be anonymised before it is processed? Digitalization of tax collection seems poised to outpace updating protection of taxpayers' rights in this regard.

"To reap the societal benefits of AI systems, we will first need to trust it. The right level of trust will be earned through repeated experience, in the same way we learn to trust that an ATM will register a deposit, or that an automobile will stop when the brake is applied. Put simply, we trust things that behave as we expect them to. But trust will also require a system of best practices that can help guide the safe and ethical management of AI systems including alignment with social norms and values; algorithmic responsibility; compliance with existing legislation and policy; assurance of the integrity of the data, algorithms and systems; and protection of privacy and personal information." (per Dr. Guruduth Banavar Chief Science Officer, Cognitive Computing Vice President, IBM Research - *https://www.alain-bensoussan.com/wp-content/uploads/2017/06/34348524.pdf*)

(vii) Finally, asymmetry between the digital haves and have nots. Will we see a digital divide between large taxpayers with the resources to cope with digitalization vs small taxpayer without the resources? Similarly, will jurisdictions that have the resources and skills to digest large datasets and track transactions down to each electron in the information superhighway have an edge in asserting taxing rights over others for whom the next best revenue-raising measure is a sugar tax rather than tracking online user participation?

He indicated that the above points could be worth considering in setting global tax policies.

Mr Sim echoed Dr Shome's earlier remarks that revenue authorities could do well to assess good taxpayers differently from the "bad" ones. The new technology may provide revenue authorities the opportunity to certify the taxpayers for which they would trust the input going into the trusted system. Tax audits could become audits of systems, rather than audits of data and individual book entries. He thought that the new technologies could be a case of "no pain; no gain". As the profile of Tax us raised from an obscure area pre-BEPS issue to a board level risk, companies and authorities then become compelled to invest heavily in upskilling personnel and systems to successfully implement to cope with the deluge of data. In the long run, the use the new technologies and cleaning up with old databases and practices will benefit revenue authorities and taxpayers alike.

Dr Pennington indicated that the pilots were crucial, but ultimately a common solution may be required to match the global business model and facilitate common use of data by revenue authorities.

Prof. Owens summarised this part by indicating that numerous opportunities exist with the application of new technologies, but that care must be exercised in the application.

Prof. West then indicated that such care should lead to ensuring Simplicity, Certainty, Accuracy, Completeness, Cost effectiveness, Speed (both in terms of compliance and collection), Elimination of unnecessary dispute resolution, privacy and confidentiality (of taxpayer and third party data), global transparency (access to data by authorities), and ensuring a "fair share" globally (both for authorities and taxpayers alike).

The panel then turned to their third theme, a discussion of application of new technologies further into the future. Prof. West introduced the discussion with a few comments. He indicated that the panel had initial appeared to be advocating a new proactive type of revenue authority, but that another area to which governments need to be looking is Space. He highlighted that: (1) Despite the 1967 UN Outer Space Treaty providing that: "Outer space, including the Moon and other celestial bodies is not subject to national appropriation by claim of sovereignty, by means of use or occupation, or by other means", such utopian thinking seems to be struggling. This was an area that seemed, like the earlier discussions, to be an issue in need of a global solution. While space exploration used to be the providence of governments, it is rapidly privatising. Private companies are seeking legal certainty with respect to their rights, but an unanswered issue is the tax implication of such exploration and exploitation of space resources.

According to literature, the United States, Luxembourg and the United Arab Emirates have all made

some resolutions with respect to space resource mining: the United States with its unilateral law that its citizens may own the resources retrieved from various celestial bodies. Similarly, Luxembourg aim to protect the rights of private mining companies (presumably resident in Luxembourg) with respect to the resources they extract. The Canadian Space Agency is also aware of the value to be derived from asteroid mining and a mining executive in Canada is even referring to an aspect of tax law to secure funding for such a venture.

With estimations that a 30-meter wide asteroid may yield USD 50 billion in minerals renders space mining a reasonable proposition. But what about the tax consequences. Clear global guidance, apart from tax, is needed spanning multiple aspects. Are these unilateral laws currently being enacted a new tax haven or race to the bottom already with respect to taxes on resources retrieved from space?

Prof. West challenged the panel to consider the essential questions of:

1. Who to tax
2. How to tax
3. What to tax
4. Where to tax

Prof. Owens initially pointed to work done at the OECD, but that such work had been discarded some time back.

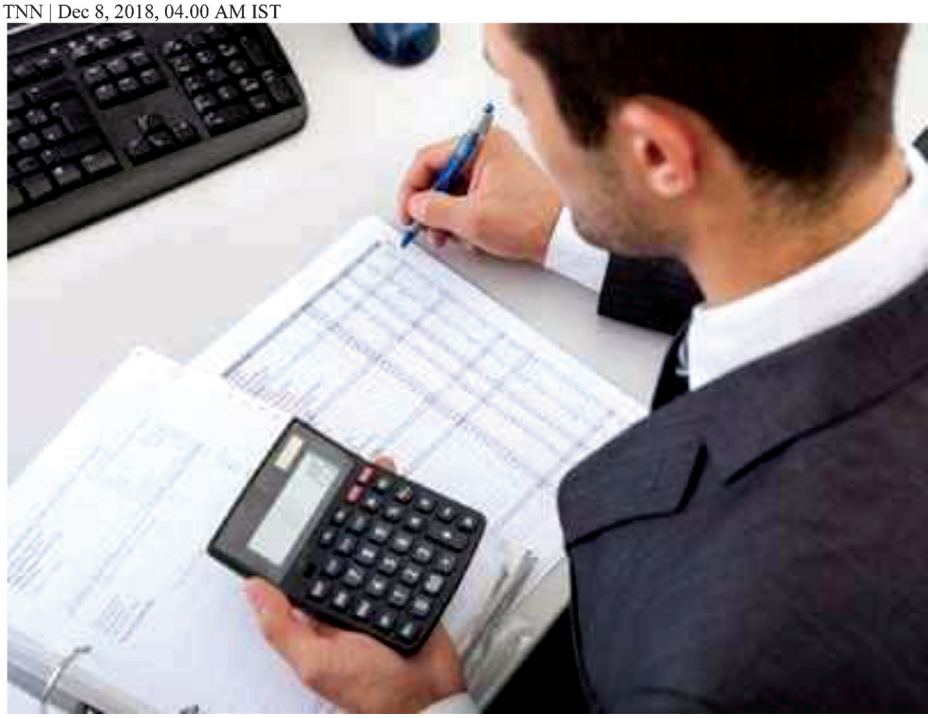
After some panel discussion, Prof. West invited Ms Bhatia to take the panel comments back to the OECD to perhaps reopen this topic before it got ahead of governments, tax policy, tax systems and tax administration.

Prof. West then handed the reins back to Mr Baxter who concluded and thanked the panel concluding the discussions timeously.

CBDT MAY SCAN COMPANIES' OUTBOUND INVESTMENTS

Akhilesh Ranjan

TNN | Dec 8, 2018, 04.00 AM IST



MUMBAI: Indian companies setting up operations overseas and, in the process, resorting to aggressive tax planning via investment structures to mitigate their tax liability could find themselves in the harsh spotlight of the taxman.

"We now need to think of preserving and augmenting our tax base. We have to look at the Indian industry, which is launching globally. We haven't yet paid much attention to this part of tax compliance (relating to outbound investments). We have been more focused on inbound investments," said Akhilesh Ranjan, member (legislation), Central Board of Direct Taxes (CBDT).

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* *Author of this article is Lubna Kably. This article is originally published in "The Times of India". https://timesofindia.indiatimes.com/business/india-business/cbdt-may-scan-cos-outbound-investments/articleshow/66994559.cms*

Ranjan is also convener of the task force for drafting a new direct tax code (DTC). "It is now time to look at what mechanism Indian industry is employing to reduce its tax liabilities. If there are loopholes in the law, we need to take measures to safeguard against that," he added.

Speaking at a tax conference organised by the Foundation for International Taxation (India) jointly with The International Bureau of Fiscal Documentation, Ranjan provided a broad road map of the possible future developments in the tax arena, especially in international tax. Overseas investments by India Inc are quite significant. According to the RBI's statistics, outward foreign direct investment (comprising equity, loans and guarantees) stood at $1,757 million in October this year as compared to $1,962 million in October 2017.

Speaking to TOI on the sidelines of this conference, Ranjan elaborated that aggressive tax planning, which results in parking of funds — such as by way of royalty payment to related entities in tax-favourable jurisdictions — is one of the issues that could be examined. He pointed out the measures taken by the US as part of its tax reforms to curb revenue leakage and garner its share of tax through BEAT.

While no tax proposal will be rushed into, the process of examination and deliberations on steps that can be taken to prevent revenue leakage appears to have begun. In order to curb forex outflows, plans to curb excessive royalty payments to related parties overseas by prescribing limits is already on the agenda of the government.

Referring to the current hot topic in the tax arena — the challenges of taxation in a digital economy — the

TAX DEVELOPMENTS OVERSEAS

BEAT Tax In The US:

- US imposes a minimum 10% tax on 'adjusted taxable profits' for payments made to all foreign-related parties
- Only payments made for purchase of goods by a US entity is out of the BEAT ambit
- Others like royalty attract this tax, which is payable by the US entity
- BEAT applies to large US entities having at least $500m annual gross receipts over a 3-yr averaging period & where deductible payments exceed certain thresholds

Tax In Digital Economy:

- Digital tax deadlock in EU continues as no consensus is reached
- France plans to forge ahead in 2019 with a 3% tax on ad sales of digital giants like Facebook, Google if no consensus is reached
- UK's budget proposed in October to impose 2% digital service tax on tech giants

India has introduced equalisation levy, but is exploring a tax levy based on 'significant economic presence'

CBDT member said, "You cannot ring-fence a digital economy. Business itself has become digital."

India has in place an equalisation levy, which is imposed at 6% on B2B advertisements, where payments made by the Indian entity to a foreign company exceeds Rs 1 lakh in a year. Ranjan referred to this as an interim measure and pointed out the importance of the concept of 'significant economic presence' for determining tax incidence.

Under new digital business models, a non-resident company can carry on a business and interact with customers in another country without having a physical presence in that country. India's long-standing position in international tax discussions is that the value of digital business is also created by the purchasing power of the market where the goods and services are consumed.

It may be recalled that on July 13, CBDT invited comments and suggestions on 'significant economic presence', which would trigger a tax liability for the foreign entity. India had introduced this concept under section 4 of the Finance Act 2018. CBDT has sought feedback on the revenue threshold of transactions that would denote significant economic presence and the threshold for number of users. "We are currently examining this and hope to come up with a viable business model. In addition, we continue our dialogue with the international community," Ranjan said.

TACKLING BLACK MONEY: 86 GOVTS SHARE FIN INFO

Monika Bhatia

Exchange of financial information 'automatically' among tax authorities is in the spotlight as countries prepare to crack down on unaccounted money held offshore. The OECD's 'Global Forum on transparency and exchange of information' — with the backing of the G20 nations — has facilitated commitments from participating countries. The process to 'automatically exchange financial information' was implemented in stages by different countries, across 2017 and 2018. After a long stint with India's finance ministry, Monica Bhatia took on her new role as head of this Global Forum in 2012. She has been recently recognised by an international tax publication as one of the top 10 influencers in the tax domain. Bhatia, who was in Mumbai to participate in a conference organised by the Foundation for International Taxation (India) jointly with the International Bureau of Fiscal Documentation, says, "The landscape of international tax co-operation has changed completely. So much has happened in such a short period of time." Excerpts from an interview (along with explanatory notes):

On automatic exchange and its statistics…

Bhatia: During 2018, 86 countries exchanged financial information automatically. These countries completed around 4,500 bilateral exchanges. Each exchange contained detailed information on the financial accounts held in the country sending such information, by tax residents of the country with whom the information was being shared. Recently, in the first ever exchange of information under the automatic exchange framework, Switzerland sent information on around 2 million financial accounts to over 30 countries. Four years ago, not many would have believed it would happen. What has happened has surprised me as well. Automatic information exchanges by 86 countries — that's big!

And it will only get bigger. For instance, Switzerland is expected to share information with many more countries in the coming year. Overall, 2019 will see more action — as bulk data and more complex data gets shared. Of the 154 member countries of the Global Forum, 107 are currently working together for automatic exchange of crucial information to usher in tax transparency. While 86 countries have so far exchanged

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information, the Global Forum is working closely with the remaining few to ensure commitments are delivered — these countries are lagging as they need to have domestic legislation or technical solutions in place.

(TOI's notes: The Global Forum is a multilateral framework, within which work in the area of transparency and exchange of information is carried out by countries. To enable exchange of standardised information on assets and accounts held by banks, investment entities (such as trusts or funds) overseas of tax residents of another country, a standard for Automatic Exchange Of (financial account) Information — or the AEOI standard — has been developed. A common transmission system exists via which information flows bilaterally — it is encrypted, safeguarded and managed by the Global Forum).

On 'golden passports' …

Bhatia: One area we are working on is mitigating risk to the integrity of the common reporting standard (CRS). We understand that many taxpayers would want to circumvent the CRS, find ways to avoid being reported. To illustrate: If an Indian national declares himself to be a tax resident of Vanuatu, information of his offshore bank accounts would not be shared with Indian tax authorities.

Golden passport schemes enable individuals to obtain tax residence and/or citizenship through local investments or against a flat fee. These schemes can be misused to misrepresent an individual's country of tax residence. OECD has an 'International Co-operation Division' — we analysed over a 100 schemes available in the market and the risks that they posed. Not every scheme offering residence or citizenship against investment is 'high risk'. For instance, if it requires a longer presence in that country, it is not typically attractive.

High-risk schemes are those that give access to a low personal income tax rate and do not require an individual to spend time (or a significant amount of time) in the country offering such a scheme. UAE's Residence by Investment scheme, or that offered by Cyprus, falls in this category.

Several such schemes have been identified as high risk. Note, this is not a black list of countries. The objective is to ensure that banks and financial insti-

tutions make additional checks, undertake further due diligence to ensure that the residency which an individual is claiming is actual. We also remove countries from this list when they agree to spontaneous exchange of information, which means informing the concerned country as and when an individual opts for their scheme.

(TOI's notes: Currently, certain golden passport schemes offered by Antigua & Barbuda, Bahamas, Bahrain, Barbados, Cyprus, Dominica, Grenada, Malaysia, Malta, Qatar, St Kitts & Nevis, St Lucia, Seychelles, Turks & Caicos Islands, UAE and Vanuatu have been identified as high risk)

What's next on the agenda?

Bhatia: While we have a robust peer review mechanism of countries for covering exchange of information on requests, we don't yet have one for checking the effectiveness of automatic exchange of information. The Global Forum will develop such a review process to enable vetting of whether governments have got what they ought to have got. The unknown (unshared data) should not remain unknown.

Further, countries need to be equipped to deal with the large influx of data, to connect the dots, detect tax evasion and obtain tax revenue. OECD's assistance will be focused here. We are looking at peer-to-peer learning among countries and providing a tool kit on best practices.

At the Global Forum, we are also looking at other products — such as crypto assets, e-money — to examine whether these are covered under exchange of information, or whether clarifications are required.

On exchange of information on request…

Here, all 154 member countries of the Global Forum are participating and a second round of peer reviews is ongoing. Nearly 40 reports have been issued. Under peer review, 14 countries were found fully compliant with the standards set, 21 (including India) were largely compliant and three partially compliant.

The focus in the second round of peer review is on beneficial ownership, which still remains a weak spot in many countries. One of the core requirements is for countries to ensure that they have information of the beneficial owners of all legal entities — be it companies, partnerships or trusts — and exchange such information when requested.

Both automatic exchange of information and exchange of information under request will co-exist. In the former, countries get bulk data. While this in itself is a major deterrent for tax payers, countries may have to follow up with requests for more information.

JUDICIAL TAX PERCEPTIONS OF THE PERMANENT ESTABLISHMENT

Jairaj Purandare

Session Chairman: Mr. Vijay Mathur

Panel Leader: Mr. Jairaj Purandare

Panellists: Ms Ola Ostaszewska, Mr Kamlesh Varshney, Mr Radhakishan Rawal, Mr PVSS Prasad, Mr Simachal Mohanty, Mr Akshay Kenkre, and Mr Kuntal Dave

A key takeaway from the session on Permanent Establishments was an acknowledgement by the panel that the revenue authorities have made an effort towards 'appreciation of facts' with an intent to not go astray from the facts of the case while deciding on a matter of Permanent Establishment. Therefore, it was indicated that the Functions (performed), Assets (utilised) and Risks (assumed) [FAR] analysis profile of the taxpayer needs to be strongly built throughout its genesis in order to reduce the fact-finding exercise in front of Courts and build a strong documentation. The overall theme of the session surrounded the discussion of recent key decisions on the establishment of PE in India and the need for a mechanism/manual for taxpayer and tax authorities to better interpret the attribution of profits of PE in the eyes of the court.

Mr Jairaj Purandare, the leader of the panel, lost no time in beginning the session with a discussion on recent cases witnessed in the courtroom on various forms of PE. Before engaging in a high-level dialogue, the tone of the session was cast with the mention of the evolving definition of fixed place PE (including the post era in BEPS) based on the key drivers of PE being enduring and permanency tests that are prevalent in the international tax systems(for example; OECD Model Convention suggests a 6 month period threshold in practice). Further, it can be said that to create a PE, one has to pass three tests of: a fixed place, disposal and permanency. Emphasis was made on the recurring activities being a reason to be covered in the definition of PE and its interplay when such activities are performed in combination with other activities and number of times the place is used to perform such activity.

Following case decisions were mentioned early in the session by the panel leader, which were also discussed at length during a presentation and the panel discussion. These are:

(i) **Formula One World Championship Limited** PE case [Decision at Supreme Court (SC) level] – Use of business control test, disposal test and duration test

to determine the fixed place PE in India for the Formula One event held in the Buddh International Circuit for conduct of a race for 3 days in a year. The Hon'ble SC held that the taxpayer created a PE in India and it was termed as a place not for temporary use.

(ii) **ABB FZ LLC** PE case [Decision by Income-tax Appellate Tribunal, Bangalore] – Determination of Service PE in India without the physical presence of employees of foreign company in the source state.

(iii) **MasterCard Asia Pacific Pte. Ltd.** PE case [Decision by Authority for Advance Rulings, New Delhi] – Setting up subsidiary in India without attributing profits. Mr Jairaj Purandare emphasised on the requirement of a critical FAR analysis and establish the value added by the Indian subsidiary of the applicant.

Apart from the important case decisions mentioned above, emphasis was also placed on the modifications to the definition of PE in the OECD Model Convention in relation to Agency PE situations. The modification states that where a person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. Additional weight was given to the concept of business connection through the introduction of Significant Economic Presence test in the Indian Income-tax Act 1961, by Finance Act 2018.

Mr Jairaj Purandare pointed out the recently issued Reserve Bank of India (RBI) directions requiring entire data relating to payment systems operations in India to be stored on a system/server located in India alone. A possible PE exposure was highlighted by the speaker in this aspect.

Mr Vijay Mathur, the chairman of the session, in his opening remarks, briefed the audience on the rising landscape of litigation due to PE and the broadening scope of PE through virtual business models. There are functional and factual issues arising due to which the taxpayer may be exposed to PE. Reliance was made upon the concept of virtual projection as noted in the landmark judgement of Vishakhapatnam Port Trust. Accordingly, few characteristics of a fixed place PE were noted from an analysis of the concept of virtual projection, namely: stability, productivity

and dependence tests. A question was raised whether a certain degree of permanence or timeframe is required for PE.

After the introductory remarks by the panel leader and Chairman, Mr Radhakishan Rawal gave a presentation on the topic with an elaborate analysis of the recent key judgements on PE. Few stalwarts in the panel also contributed to the analysis post the presentation in their opening remarks and in panel discussions.

Analysis of the Formula One PE case:

Important considerations deliberated were –

(i) Whether Buddh International Circuit was put at the disposal of the taxpayer. A wholesome reading of agreements was made by the Hon'ble SC to look through the manner in which commercial rights were held and exploited by Formula One UK (foreign party) and its affiliates and observe whether real and dominant control lied with the foreign party. This brought out the real substance of transaction between the foreign party and its affiliates.

(ii) The SC disregarded the foreign party's argument that the racing event did not constitute a PE because the duration of the event was only three days. The SC held that the HC had rightly concluded that having regard to the duration of the event, even though it was for limited days, the foreign party had full and exclusive access through its personnel to the circuit for the entire duration of the event; thus, number of days for which the access was available would not make any difference, in coming to the conclusion that foreign party had the circuit to its disposal and thus forms a PE in India.

(iii) Permanence test – Permanence in fixed place could be relative having regard to nature of business. In the present case, the SC disregarded the foreign party's argument that the racing event did not constitute a PE because the duration of the event was only three days. The SC held that the HC had rightly concluded that having regard to the duration of the event, even though it was for limited days, the foreign party had full and exclusive access through its personnel to the circuit for the entire duration of the event; thus, number of days for which the access was available would not make any difference, in coming to the conclusion that Formula One UK had the circuit to its disposal.

(iv) The SC placed reliance on the virtual projection test laid out in the Vishakhapatnam Port Trust judgement by Andhra Pradesh High Court.

Analysis of the Virtual Projection:

(i) **Vishakhapatnam Port Trust (1983)**: The Andhra Pradesh High Court, states that permanent establishment postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that would amount to virtual projection of foreign enterprise of one country into the soil of another country.

(ii) **Nokia Networks OY (2018) Ruling**: The judgement involved a majority and minority view on the matter of Nokia India Pvt. Ltd. (NIPL) constituting PE of Nokia Networks OY (taxpayer) in India on account of having a virtual projection of the foreign enterprise in India.

a. **Majority View**: As per this view, no fixed place PE or dependent agent PE was established. On the matter of virtual projection, the revenue authorities observed that entire identity of the taxpayer and NIPL got blurred, and that NIPL was practically a 'virtual projection' of taxpayer in India on the grounds that (1) NIPL carried out installation activities for the contract of supply entered by the taxpayer and (2) NIPL carried out marketing and technical support services for the equipment's installed by the taxpayer.

The Delhi Tribunal noted that no income from installation activities has been earned by the taxpayer in India or can be attributed either directly or indirectly through NIPL. Insofar as other activities like marketing and technical support services are concerned, the same has been transacted at arm's length in absence of any adverse finding recorded by the Assessing Officer (AO). Further, ITAT remarked that if on facts there is no establishment of fixed place and disposal test is not satisfied, then virtual projection itself cannot be held to be a factor for creation of a PE. Thus, the concept of virtual

projection brought in by the AO did not lead to any kind of establishment of PE Thus, the ITAT concluded that there was no PE within the terms of Article 5 of DTAA. The ITAT noted that once it has held that nothing is taxable on account of signing, network planning and negotiation of offshore supply contracts, therefore, there is no question of any attribution of income on account of these activities which are purely related to supply contracts.

b. **Minority (Dissenting) View**: Refers to the concept of alter ego. When a subsidiary company is merely an alter ego, or virtual projection of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a PE of the parent company in India.

Thus, Alter Ego subsidiaries which do not have any significant independent activity on its own could indirectly become PEs. It is not necessary that the disposal test needs to be satisfied to test an indirect PE through such alter ego subsidiary. An interesting point noted was the possible interplay of an alter ego subsidiary PE between Article 5(5) and Article 5(1) in connection with Article 5(7) dealing exceptions of PE.

Analysis of the MasterCard Asia Pacific Pte. Ltd. PE case (Authority for Advance Rulings or AAR):

Mr Radhakishan Rawal in his presentation brought out a detailed analysis of the AAR which was decided against the applicant. The discussion revolved around the topic of 'difficulty of facts' since the right attribution of profits and PE trigger requires a high level fact-finding exercise. Mr Kamlesh Varshney stated that the MasterCard ruling was a fact-oriented ruling by the AAR as it gave a ruling based on all the facts of the applicant submitted without going astray from any fact submitted.

The discussion on the MasterCard ruling between the panelists, involved both sides of the argument i.e. from the revenue and the taxpayer viewpoint where the PE was established through multiple factors including system and network. The applicant was MasterCard Asia Pacific Pte. Ltd. Singapore, the regional headquarter for Asia-Pacific region which applied for an advance ruling. The main business of the applicant consists of authorization, clearance and settlement of transactions between its customers for which it charges a fee.

The applicant entered into Master License Agreements (MLA) with various customers in the Asia-Pacific region, including India. These customers were mainly banks and other financial institutions (customer banks). The process involves settlement activities which is essentially the movement of funds between the issuer bank and the acquirer bank. Such customer banks transact with merchants and customers (consumers).

Following areas of the ruling have been highlighted clarifying the PE issue:

(i) Fixed Place PE through MasterCard Interface Processors (MIPs)

a. MIPs being automatic equipment placed at the site of customer banks in India were termed to constitute a fixed place PE since there is no condition of fixed place to be attached to ground. Further, permanency test was also satisfied as the equipment were placed throughout the year and the MIP activities were not preparatory in nature as it was a significant activity.

b. The legal ownership of MIPs were with the Indian subsidiary of the applicant and were controlled by the applicant through an agreement with the customer banks. It was noted that there was no agreement between the Indian subsidiary and the customer banks.

c. All risk mitigation functions were performed by the applicant and all decision with respect to MIPs were taken by it (for instance repairs, upgradation). Software inside MIPs is also admitted to be owned by the applicant which is upgraded by third parties on behalf of the applicant.

Thus, the AAR held that the Applicant is carrying out its business of facilitation of authorization of transaction through fixed place, i.e. MIPs, since MIPs are situated in India at its disposal. Hence, MIPs create a PE of the Applicant in India.

(ii) Fixed Place PE through MasterCard Network

MasterCard Network, which is in India as well as outside India, consists of:

a. MIP (owned by MISPL),

b. Transmission tower, leased lines, fiber optic cable, nodes and internet (owned by third party service provider); and

c. Application software - Master Connect and Master Card File express (owned by the Applicant)

Analysis on the findings of AAR

a. MasterCard Network passes disposal test as one of the MasterCard US entity is responsible for maintenance of worldwide network remotely from the USA.

b. Application software are owned by the Applicant and controlled by them and are therefore at the disposal of the Applicant.

c. Part of network provided by third party service provider in India is also at the disposal of the applicant. It was admitted that the network in India is secured by MasterCard to prevent fraud and to enhance security.

d. AAR stated that it would be relevant to observe that MIP being involved only in the authorization part of the transaction, still it constituted a PE of the Applicant in India.

The discussion on the findings of the AAR extended to the comparison of Applicant's case with the case of Amadeus Global Travel Distribution SA[1] and Galileo International Inc.[2] where it was observed that the activities performed in India are significantly more than what were performed in India in the cases of Amadeus Global and Galileo International.

Hence, the AAR noted that in order to decide existence of PE, like MIP, the MasterCard Network should also pass the tests of fixed place, disposal and permanence. It was observed from the Transfer Pricing (TP) report of the Indian subsidiary of the applicant, the MasterCard US entity is responsible for management and maintenance of MasterCard Worldwide Network remotely from the USA.

Thus, the AAR held that the MasterCard Network is at the disposal of the Applicant and creates a PE in India of the Applicant.

India's observations on the OECD Commentary in specific PE situations

Amid discussions on the fixed place PE situation through MIPs and MasterCard Network, Mr. Radhakishan Rawal highlighted important aspects of India's position on the OECD Commentary, namely:

(i) Para 38 of OECD Commentary 2017 (International roaming facility of telecom networks) – Roaming call is a composite process requiring composite use of various pieces of equipment located in the source and resident country. Hence, Para 38 does not intend to create a PE.

(ii) Para 36 of OECD Commentary 2017 (Leasing of ICS equipment) – Tangible or intangible property could result in PE situation

(iii) Para 124 of OECD Commentary 2017 (Website and server) – Depending on facts, opening the website on any equipment including downloading of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with the enterprise could be the deciding factor for PE to be constituted on any equipment.

(iii) Fixed Place PE through Bank of India premises

a. It was observed by the AAR that the applicant's important business activity of settlement is carried on at the premises of Bank of India (BoI) where the dedicated team of BoI employees perform the settlement activity and the responsibility for any errors is taken by the applicant.

b. Employees of BoI are found to be in control and supervision of the applicant and the space occupied by them in BoI is at the disposal of the applicant.

c. Accordingly, the AAR termed BoI as the agent of the Applicant under its instruction and supervision, and has a space at its disposal. However, BoI was not a dependent agent.

[1] Amadeus Global Travel Distribution SA vs DCIT [2008] 113 TTJ (ITAT Delhi) 767

[2] Galileo International Inc. vs. DCIT [2008] 19 SOT 257 (Delhi)

d. AAR held that for constituting a PE, the space may not be exclusively used by the non-resident enterprise. Further, amount of remuneration paid to BoI cannot determine the significant of the work.

Thus, the AAR held that BOI premise constitutes fixed place PE of the Applicant.

(iv) Service PE through Transaction Processing activity

a. Employee activities like interaction with clients, taking feedback from them, informing them about new products are an integral, monitoring operation efficiency, part of applicant's services rendered to clients and are not steward activities.

b. The AAR relies on the threshold of 90 days as per Article 5(6) of the DTAA which is satisfied in the applicant's case.

c. The AAR observed that the facts are different, in the present case, as compared to Morgan Stanley[3], wherein the Indian subsidiary was providing services to foreign parent and the employees of foreign parent were visiting India to check if such services are meeting the requirements that it had set. It was in that context; the activities were called stewardship activities by the Hon'ble Supreme Court.

d. In the applicant's case, it is not a case where visiting employees are checking the service provided by the Indian subsidiary of the applicant to see if it meets their requirement or not. In fact, they are meeting clients in India to whom they are rendering services and talking about the possibility of improving and adding services. The said services are not stewardship activity as held by Morgan Stanley (). This is part of the main function that is to be performed by any organization for rendering service to its clients.

Thus, the AAR held that the employees of the Applicant visiting India are providing services to the Indian clients and hence, once they cross the threshold of 90 days in a year, a service PE is created.

Noted panelists such as Mr. Kamlesh Varshney, Mr. PVSS Prasad and Mr. Kuntal Dave in their opening remarks, mentioned that the functions performed and risks assumed relating to transaction processing was not shown in the FAR analysis profile of the Indian subsidiary of the applicant which led to the judicial authorities to attribute profits to the PE for the function not mentioned. If the FAR adequately covers all the activities carried out by the Indian subsidiary, then only one can say that there cannot be any further attribution.

(v) Agency PE through activities of the Indian subsidiary

a. There was no habitual conclusion of contracts by the Indian subsidiary on behalf of the applicant.

b. It was clearly established that, orders or agreements are routed through the Indian subsidiary, though the finalization of the contract is by the applicant in Singapore.

c. AAR observed that the requirement of 'concluding contract' is not satisfied but the requirement of 'securing order' is clearly satisfied.

The AAR further stated that, if the above process is followed in all the new agreements, even though only two or three new contracts are entered into in a year, the requirement of 'habitually' would be satisfied. Thus, the AAR held that, the Indian subsidiary of the applicant constitutes a dependent agent PE under Article 5(8) of the DTAA, on account of habitually securing orders wholly for the applicant.

Additionally, the presentation opened the floor of discussion on the right profit attribution and PE trigger relying on recent judgements of MasterCard and Nokia Networks

Approach of Indian Judicial Authorities for Profit Attribution

Mr. Kamlesh Varshney in his opening remarks mentioned the trend of 'appreciation of facts' by judicial authorities to deal with identifying PEs, in the light of MasterCard ruling. Mr. Akshay Kenkre in his opening remarks specified the importance of FAR profile and remarked that it is not only important for attribution but also determination of PE trigger itself. Few panelists suggested that a right profit attribution mechanism or guidance may be the need of the hour.

[3] DIT(IT) vs. Morgan Stanley & Co. Inc (292 ITR 416)

In his presentation, Mr. Radhakishan Rawal explained the approach by judicial authorities in the Morgan Stanley case which was reiterated in E-Funds IT Solutions Inc. and Honda Motor Co. Ltd. case. The excerpt of the same was referred below.

"It holds that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE. The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to PE for those functions/risks that have not been considered."[4]

Thus, focus on proper transfer pricing analysis capturing all the functions, assets and risks of the enterprise is essential so that there are no further functions which are attributable.

Further, relying on the wording in MasterCard ruling, it was held that in the case of dependent agent PE, the FAR profile of the applicant is different from the FAR of the dependent agent (Indian subsidiary of applicant). It is only when the two FAR are same that one can say that there cannot be any further attribution.

Noted panelists such as Mr. Kamlesh Varshney, Mr. PVSS Prasad and Mr. Kuntal Dave discussed the right profit attribution and PE trigger with respect to transaction processing activities which were not reflected in the FAR of the Indian subsidiary due to which, the Indian subsidiary created a PE of the Singapore headquarter applicant in India. As analyzed above, the facility, service, personnel and premise of the Indian subsidiary were found to be at the disposal of the applicant.

In the discussion on the judicial authorities' approach in the Nokia Networks case, the trigger was the entire marketing and administrative support work performed by the taxpayer in India through the Indian subsidiary without adequate arm's length consideration at a fixed place in India. This was termed as carrying on the business of the taxpayer in India through a fixed place of business.

PANEL DISCUSSION VIEWS

The latter half of the session involved an engaging panel discussion among the members.

From an evolution standpoint, Ms Ola Ostaszewska gave the audience a pragmatic view of PE in a global scenario. This was followed by a brief practical analysis of a recent case of an Irish HQ entity forming a PE in France subsidiary as the authorities found that the French subsidiary engaged in activities that were not mentioned in its FAR profile. Further during the panel discussion, Ms. Ola also provided a brief overview of interpretation levels in different countries which led the audience to believe that Ireland has adopted a restricted definition of PE among other smaller yet rising economies such as Hungary and Belgium.

Mr Kamlesh Varshney proceeded to contribute to the audience with a legal perspective from the view of a tax authority. A very important point raised here was the evolution of the concept of PE with the time of law. Thus, with the changing times and technology, it is no wonder the concept of PE has also resulted in more than one interpretation. The battle of the courts are no longer with physical presence along, but virtual presence as well. With this perspective, the recent case of South Dakota vs. Wayfair (US Supreme Court) on sales tax was mentioned in the backdrop of extensive virtual presence. An example of a company with a website accessible in South Dakota leaving cookies saved to the user in South Dakota was discussed as a situation leading to physical presence.

In an impactful statement resonating the current emphasis of tax authorities and courts in India was the 'appreciation of facts' presented by the taxpayer. However, there yet remains uncertainty in terms of attribution of profits as there is no hard and fast rule of determining profit attribution. Thus, an adequate guidance mechanism from the Central Board of Direct Taxes would be required to be called for in future to resolve the uncertainty and mitigate tax risk.

Mr PVSS Prasad enlightened the audience with a succinct analysis of agency PE situations. A careful reading of the new PE definition in the OECD Model Convention in relation to Dependent Agency PE (DAPE) situations was called for. The modification states that subject to Article 5(6) of OECD MC, an enterprise shall be deemed to have a PE in the that

[4] SC in DIT v. Morgan Stanley [2007] 292 ITR 416 (SC) as reiterated in ADIT v. E-Funds IT Solution Inc. [2017] 399 ITR 34 (SC) and Honda Motor Co. Ltd. v. ADIT [2018] 301 CTR 601 (SC)

state where a person acting on behalf of an enterprise, habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. In connection to the DAPE, Mr Prasad discussed the case of Daikin Industries Ltd., Gurgaon (taxpayer) which was decided by Delhi ITAT against the taxpayer. Accordingly, Daikin Air-conditioning India Private Limited (DAIPL) was treated as DAPE of the taxpayer. As per the judgement, the taxpayer had stated that the role of DAIPL was limited to the marketing support services under a Commission agreement. However, the taxpayer failed to appropriately authenticate this claim and the Court held that DAIPL's activities went beyond marketing and played a role in direct sales.

Further, a discussion on the Additional Guidance on the Attribution of Profits to Permanent Establishments[5] provided by the OECD in March 2018 ensued which provided an overview of four examples from the guidance. The examples briefly mentioned were relating to potential PE situations in (i) Warehousing, Delivery, Merchandising and Information Collection Activities; (ii) Commissionaire structure (related intermediary); (iii) Sale of advertising on a website (related intermediary); and (iv) Procurement of goods (related intermediary).

Expanding on the additional guidance, the analysis also included the concept of 'significant people functions' for attributing risk assumption and economic ownership of assets to a PE. Mr Prasad also mentioned an interesting interplay between Article 9 and Article 7 of the Model Tax Convention where the intermediary and the non-resident enterprise are associated enterprises.

Mr Simachal Mohanty provided an industry perspective on the pragmatic points to be considered while dealing with a PE situation. De-risking PE in anticipated inbound structures would go a long way in avoiding unnecessary litigation. Mr Mohanty also emphasised the use of Country-by-country reports by tax authorities in the future to capture the data of any PEs and their FAR profile.

Mr Kuntal Dave spoke on the concept of Service PEs and virtual Service PEs with an overview of OECD developments, rulings and key Indian developments. Highlighting the importance of Section 9 of the Indian Income-tax Act 1961, and reminding the audience about the language used for fees for technical services in the domestic tax law to attract source based taxation and recent amendment on business presence through the concept of Significant Economic Presence. The recent amendment clarifies that significant economic presence of a non-resident in India shall constitute business connection in India drawing inference from the definition in OECD BEPS Action Plan 1. An argument was raised whether existing scope of business connection is robust enough to capture situations where there is no significant economic presence. If there is an element of continuity then significant economic presence test may not be required. Additionally, whether physical presence rules could be applied to virtual presence rules as well.

Mr Akshay Kenkre spoke about the Transfer Pricing aspects relating to a fixed place PE. From a judicial viewpoint a high focus was on the need for tax authorities to not jump the gun by fixing an arbitrary rate of attribution of profits to the PE before complete appreciation of facts or under-appreciation of facts. Rather the focus in the primary stage should be to fully satisfy whether the enterprise is PE or not a PE and proceed to follow suit on the attribution of profits to a Permanent Establishment. Highlighting the importance of FAR, it is not only important for attribution but also determination of PE itself. FAR is the single document that proves substance over form.

Q and A

Mr Jairaj Purandare posed a series of questions during the panel discussions to keep the audience engaged. With reference to the Formula One case, the panellists' views were sought on the position taken by the judiciary regarding fixed place PE. To this, Mr Akshay Kenkre responded that with India becoming a source country jurisdiction, the period thresholds do not necessarily require to be quantified. There can be a 3-day period of event continually happening every year and yet result in a PE due to the continuity factor. Hence, interpretation of facts is necessary rather than quantifying thresholds for PE which is more often than not dependent on several other factors as well. Mr Kamlesh Varshney stated that the Formula One judgement is in line with the OECD guidelines.

With regard to concept of virtual PE gaining traction in tax rulings, a question was raised before the panel whether there was a decline in physical requirement

[5] http://www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm

of employees in a taxable territory due to advent of technology and whether judicial authorities have been taking an extreme view with regard to virtual service PEs. In this regard, Mr Kuntal Dave observed that commercial exploitation of data outside India can trigger tax. Mr Radhakishan Rawal observed that business models change over time and hence such requirements may vary over time. Thus, if a corporate wants to deploy human resources they need to consider tax as an important element of business and follow the rules of the land rather than create structures to avoid tax

On the amendments in Indian tax law relating to DAPE, Mr PVSS Prasad responded to the question on interpretation of the term 'habitually plays the principal role leading to the conclusion of contracts' through the interpretation of the Daikin judgement. Regarding significant economic presence test, Mr Kuntal Dave explained the test which involves the purchase and sale of goods dealt by non-resident directly in India; and transacting through digital means using proxy of non-resident through systematic and continuous soliciting of business activities with users in India (for example; users who buy goods from the internet). To avoid the significant economic presence test enterprises may disguise their transaction of purchase and sale of goods in a manner to avoid the distribution tax that ought to be taxed.

In Honda Motor Co. Ltd case the Supreme Court has observed that once arm's length principle has been satisfied, there can be no further profit attributable to a person even if it has a PE in India. Thus, focus on proper transfer pricing analysis capturing all the functions, assets and risks of the enterprise is essential so that there are no further functions which are attributable. If a particular element of FAR is not captured, then the profit attribution increases on the enterprise having PE. This is a major distinction from the Supreme Court judgement in Formula One and the Advance ruling in the case of MasterCard (). The panel further discussed possible instances and deliberated on DAPE especially where online sales are made through sales force agents who convince users in India.

A debate emerged on the definition of fixed place PE, its interpretation by the Courts and taxpayer and how it brings business certainty. In this regard the corporate has to be clear that they are doing business in India. While many corporates want to avoid PE, the objective is to prove that they are not doing business in India. Such corporates need to consider tax as an important element and follow the rules. With the revenue authorities keen to gain a business understanding, corporates can use this to their advantage. Mr Akshay Kenkre stressed that data is an integral part of tax that could bring certainty to both tax authorities and taxpayers.

While discussing the global nuances of PE situations that may trigger tax, Ms Ola Ostaszewska explained the presence of server being the decisive element in the case of an Italian PE. Accordingly, the enterprise had a PE in Italy subsidiary as it had placed a server in Italy to process orders more efficiently. Additionally, Mr Simachal Mohanty highlighted the use of country-by-country report to show reallocation functions which could be used by authorities as a tool with respect to attribution.

On the question of key controversies in relation to attribution of profits to a PE, Mr Akshay Kenkre responded with the possibility of manipulations to FAR i.e. minimising functions and showing no risk when in reality the enterprise may assume significant risk. Mr PVSS Prasad while placing his observations on DAPE, added that taxpayer view PE attribution as an additional compliance burden. Therefore, as given in the OECD guidance, depending on facts and circumstances of a given case, the net amount of profits attributable to the PE may be either positive, nil or negative (i.e. loss).

CONCLUSION

The Chairman concluded the panel discussion with his closing remarks which included the Formula One judgement wherein the permanence and disposal test was considered as a key factor for PE coming back to the same place year after year, even if the duration was for a shorter period of time. Further, with the evolving definition of agency PE, even habitually securing orders can lead to a PE. Earlier, the definition only included habitual contracts which was subjective. This requires different variables and questions to be asked by enterprises to themselves, namely whether substantive activities are being carried out and what is the substance/subject matter of the contractual arrangements. In today's BEPS era where the agreements are always signed may not always be important. Such enterprises have to examine their standard operating procedures, pricing negotiations and delivery schedules to establish substantive activity.

Concluding on a high note, the Chairman appreciated the changing social trends and anticipated judicial authorities to adopt technology and extensive means to appreciate facts presented by taxpayers.

TREATY SHOPPING DISPUTES

Prof. Dr. Robert Danon[1]

1. Historical considerations on treaty shopping

It is undisputed that the purpose of bilateral tax treaties patterned upon the OECD or UN model tax conventions (MC) is to eliminate international double taxation in order to promote the international exchange of goods and services[2]. Yet as noted for example by the United States delegation back in 1961, it is recognized that this objective has: "*as a counterpart the prevention of tax avoidance and evasion, especially avoidance and evasion through the abuse of treaty provisions (…)".*[3] This policy then formed the basis of the commentaries to the 1977 OECD MC relating to the improper use of tax treaties: *"The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; they should not, however, help tax avoidance or evasion"*[4]. At the time, it was already quite clear that the use of « artificial legal constructions » would represent an improper use of tax treaties[5]. The 1977 commentaries also described very clearly the most common form of treaty shopping, namely the case in which *"a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly".*[6]

The means to put the foregoing policy into effect however developed gradually. Leaving aside mechanical limitations on benefits provisions (LOBs) rooted in US policy, the initial response came with the introduction of the beneficial ownership limitation in the dividends, interest and royalties articles of the 1977 OECD MC. While the 1977 commentaries merely indicated that the beneficial ownership limitation would entail the denial of tax treaty benefits to "*an intermediary, such as an agent or nominee"*[7], these commentaries made it clear that this requirement was intended to deal, at least to some extent, with the problem of improper use of tax treaties[8]. In 1986, the Conduit Report prepared by the OECD and the findings of which were included in the 2003 update of the OECD Commentary[9] further clarified that the beneficial ownership limitation also applied to deny treaty benefits to a conduit company which *"(…) can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company)".*[10] At the end of the 1990s, case law dealing with beneficial ownership also started to

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emerge with a majority jurisdictions construing this requirement on the basis of a substance over form approach[11].

Meanwhile the idea that tax treaties patterned upon the OECD MC are subject to a general and implied prohibition of abuse founded on art. 26 and/or 31 of the Vienna Convention on the Law of Treaties gained acceptance both in scholarly writing[12] and in case law[13]. This approach was expressly endorsed by the OECD Commentary in 2003: "*These States, however, then consider that a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 of the Vienna Convention on the Law of Treaties)*".[14] More concretely, this policy also led to the introduction in the commentaries of a so-called *"guiding principle": "A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions"*.[15]

This being said, is treaty shopping really bad from a policy perspective? Can it not be argued that treaty shopping may, in certain instances, contribute to foreign direct investment? In India, this question was answered as follows in the famous *Azadi Bachao Andolan* case: « *Many developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues. Moreover, several of them allow the use of their treaty network to attract foreign enterprises and offshore activities. Some of them favour treaty shopping for outbound investment to reduce the foreign taxes of their tax residents but dislike their own loss of tax revenues on inbound investment or trade of non-residents. In developing countries, treaty shopping is often regarded as a tax incentive to attract scarce foreign capital or technology. They are able to grant tax concessions exclusively to foreign investors over and above the domestic tax law provisions. In this respect, it does not differ much from other similar tax incentives given by them, such as tax holidays, grants, etc.* »[16]. In our opinion, this policy is difficult to reconcile with the principles and objectives underlying the OECD and UN model tax conventions. The purposes of avoidance of double taxation and prevention of tax evasion have their roots in the earliest tax treaties and were further developed by different committees of the League of Nations and the OECD[17]. It con-

sequently follows from that history that the position taken by the OECD Committee on Fiscal Affairs as to improper use of tax treaties should be given considerable weight. Therefore, where the two contracting states model their tax treaty after the OECD or UN Model Convention, the fundamental expectations and policy objectives of these states should be consistent with the principles adopted by the OECD or UN its commentaries[18]. From this perspective, therefore, the findings of the French *Conseil d'Etat* in the *Verdannet* case represent in our opinion a fairer expression of the general policy objectives underlying the OECD MC: "*The States that are parties to the Franco-Luxembourg tax treaty cannot be regarded as admitting, in the distribution of the power of taxation, the application of its provisions to situations arising from artificial transactions devoid of any economic substance"*[19]. In the same vein, the reporting judge Crépey considered that: "*the primary function of these treaties, beyond this immediate purpose, is to facilitate international economic exchanges (…). It is, therefore, part of their very logic that they be read as not intending to apply to taxpayers who artificially create the conditions of foreignness allowing them to claim, according to a literal interpretation, the benefit of their clauses."* [20] In fact, the limits of the reasoning followed in *Azadi Bachao Andolan* become fairly obvious if this reasoning is applied in so-called « round-tripping » cases. In these instances, the state of source is indeed in a worse position: the revenue losses borne by this state are not compensated by a corresponding increase of foreign direct investment. Presumably for this reason the Indian Supreme Court ruled that: *"if a structure is used for circular trading or round tripping then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity*".[21]

2. Treaty shopping in the post-BEPS world: the new preamble to the OECD MC and the Principal Purposes Test (PPT rule)

The fundamental policy problem posed by treaty shopping, which is essentially rooted in the residence versus source architecture of the international tax system, remains unchanged in the post-BEPS world. BEPS Action 6 aims however at reinforcing the ability of states to deal more effectively with treaty shopping[22]. The main outcomes of this work are two minimum standards, namely the introduction in bilateral tax treaties – in particular through the Multilateral Instrument (MLI)[23] - of a new preamble alluding expressly to treaty shopping, on the one hand and a Principal Purposes Test (PPT)[24], on the other hand. The PPT is in essence meant to codify into the OECD MC the *"guiding principle"* introduced in the commentaries in 2003. The new policy also confirms that states may rely on their domestic general anti-avoidance rules (GAARs) to deny treaty benefits,[25] provided, however, that these GAARs are in conformity with the PPT.[26]

As a result of these minimum standards, the new preamble to the OECD MC [27] states that tax treaties are: *"intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)".* The new commentaries clarify that since: *"the title and preamble form part of the context of the Convention1 and constitute a general statement of the object and purpose of the Convention, they should play an important role in the interpretation of the provisions of the Convention"*[28]. In our opinion, the new preamble confirms the limits of the reasoning followed in *Azadi Bachao Andolan*.

The PPT is included in article 29(9) of the OECD Model dealing with entitlement to benefits and provides that: *"Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 this Convention*".

The PPT is applicable *"in respect of an item of income or capital"*. It therefore requires an item-by-item of income analysis. In other words, where an entity derives different kinds of income, the PPT could lead to the denial of treaty benefits for certain income streams, but not for others. Finally, the scope of the PPT extends to both conduits and abusive restructurings.[29]

The PPT incorporates a subjective and an objective element. Accordingly, a denial of tax treaty benefits by the source state may come into play where *"one of the principal purposes"* of the arrangement or transaction was to obtain these benefits. While subjective in nature, this criterion, as is often the case with GAARs,

is objectified by a *"reasonableness"* test. If this condition is satisfied, the taxpayer may then establish that granting the treaty benefit at stake *"would be in accordance with the object and purpose of the relevant provisions of this Convention"*. Under the OECD Commentary, however, the object and purpose of the treaty itself is rather referred to in order to determine whether treaty benefits ought to be granted. Hence, to deny treaty benefits, it is generally contended that *"it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement"*,[30] and in cases in which the PPT does not apply, the fact that "*the general objective of tax conventions is to encourage cross-border investment"* is put forward.[31, 32]

This being said, one of the most important practical questions in this context will be the role of *"substance"* in the residence state when considering the application of the PPT. There are numerous references in the OECD Commentary suggesting that the analysis governing the PPT is substance oriented.[33] To begin with, the Commentary on Article 29 notes that *"where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit"*.[34] In our view, it follows from the new commentaries that substance and value creation in the state of residence are important elements to evidence that that one of the principal purposes of an arrangement (i.e. particularly the creation and maintenance of an entity in the state of residence, respectively to transfer to such entity of rights giving rise to income) is not to obtain the benefits of the treaty concluded by the state of residence with the state of source. In the area of IP income, we have for example argued that transfer pricing principles flowing from BEPS Actions 8-10[35] may serve as guidance. The same holds true as regards the modified nexus approach applying to patent box regimes (BEPS Action 5)[36] which implements the concepts of value creation and substantial activities in an even stricter fashion.

Finally, where the PPT is applicable, the issue of the recharacterization of the fact pattern under review arises. In this respect, we have argued that when the PPT is applicable, a jurisdiction should not be prevented from granting treaty benefits on the basis of a recharacterized fact pattern even if such jurisdiction has not expressly opted for the discretionary relief mechanism suggested by the OECD Commentary.[37]

3. Conclusions and challenges ahead

The PPT will undoubtedly play an important role in future treaty shopping disputes. At the same time, it is also quite clear that the PPT may also lead to a certain degree of uncertainty. Therefore, multinational enterprises will be well advised to ensure in advance and especially in the initial implementation phase that the scope that will be given to the PPT rule by the jurisdictions in which they operate coincides indeed with the OECD interpretation. Fortunately, the OECD is aware of this problem. The IMF/OECD Report on Tax Certainty released in July 2018 notes indeed: "*The implementation of PPT rules in bilateral treaties, while effective in reducing aggressive tax planning, is perceived as potentially increasing tax uncertainty. Various stakeholders have in fact expressed concerns on the implementation of the PPT. These concerns are expressed notwithstanding the extensive work already carried on by the OECD on tax conventions and related questions on the development on Commentary on the application of the PPT (…) To increase tax certainty in the application of the PPT, the OECD has formed an informal group of interested delegates that would explore various areas where more tax certainty could be provided in the PPT, including best practices in the area of the general anti-avoidance rules and would report back with recommendations".*

In our opinion, the areas which require additional attention are in particular the following:

- Enhancement of the *"nexus safe harbour"* (OECD Commentary para. N 181 ad art. 29). Further clarifications would in particular be welcome for IP, group finance and holding companies;
- Clarification in cases involving absence of increase of tax treaty benefits;
- Clarification regarding interaction between PPT and specific anti-avoidance rules (SAARs), including beneficial ownership and BEPS SAARs;
- Clarification regarding the possibility to grant alternative tax treaty benefits even in the absence of a clause corresponding to art. 7(4) MLI (OECD Commentary para. N 184 ad art. 29).

As already mentioned, the most important issue is to obtain clarity on the degree of *"nexus"* or *"substance"* required in the state of residence to claim tax treaty benefits. Given the holistic nature of the BEPS initiative, it would, as we have argued, be natural to turn other BEPS Actions dealing with substance, such as in particular BEPS Actions 8-10 in the field of transfer pricing.

This being said, at the time at which we conclude this short note there seems to be a growing concern that, despite the changes introduced by BEPS Actions 8-10 (in particular the so-called DEMPE functions requirement with respect to IP income), profit shifting to low tax jurisdictions remains possible. Therefore, in the framework of the ongoing debate on the digital economy, some jurisdictions argue in favor of a minimum taxation. From the perspective of the state of source, such regime would operate to deny tax treaty benefits (or a deduction) with respect to payments made to a low tax jurisdiction. In the same vein, the state of residence of a parent company could pick up income which is insufficiently taxed in another state. In a policy note of 23 January 2019, the OECD confirmed that reviewing these aspects would form the basis of a *"second pillar"* designed to address some perceived remaining BEPS challenges: "Under the second pillar, the Inclusive Framework agreed to explore on a "without prejudice" basis taxing rights that would strengthen the ability of jurisdictions to tax profits where the other jurisdiction with taxing rights applies a low effective rate of tax to those profits. These proposals recognise that in part the tax challenges of the digitalisation of the economy form part of the larger landscape relating to remaining BEPS challenges and further reflect more recent developments such as US tax reform"[38] . Given the significance of the new proposals for the international tax system, the Inclusive Framework will issue a consultation document that describes these developments in more detail, and a public consultation will be held on 13 and 14 March 2019. Therefore, it remains to be seen how these latest developments will interfere with tax treaty rules.

Perhaps, the 13th IFA Asia Africa Regional Meeting to be held in Mauritius on 9-10 May will be an excellent opportunity to continue this conversation.

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2 See for example 1977 OECD Commentary ad Art. 1, para. 7.

3 Note by the United States Delegation On Tax Avoidance Through the Improper Use or Abuse of Tax Conventions, 14 November 1961

4 1977 OECD Commentary ad Art. 1, para. 7.

5 1977-1998 OECD Commentary ad Art. 1, para. 8.

6 1977-1998 OECD Commentary 1977-1998 ad Art. 1, para. 9.

7 1977 OECD Commentary ad Art. 10, para. 12; ad Art. 11, para. 8.

8 1977 OECD Commentary, para. 10 ad art. 1: *"Some of these situations are dealt with in the Convention, e.g. by the introduction of the concept of "beneficial owner" (in Articles 10, 11 and 12)"*. The same policy was kept and reaffirmed – although with a slightly different language – in the 2017 OECD commentaries: *"some forms of tax avoidance have already been expressly dealt with in the Convention, e.g. by the introduction of the concept of beneficial owner"* (2017 OECD Commentary ad Art. 1, para. 63).

9 2003 OECD Commentary ad Art. 10 para. 12.1.

10 OECD, *Double Taxation and the Use of Conduit Companies*, para. 14 (1986).

11 See for example in Switzerland : *Re V SA*, 4 ITLR 191 (2001) and later *Re Swiss Swaps Case I/A*, 18 ITLR 138 (2015) ; in the United-Kingdom : Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, 8 ITLR 653 (2006) ; in Spain : Real Madrid cases, AN, 18 July 2006, JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549, AN, 10 Nov. 2006, JUR\2006\284679, AN, 20 July 2006, JUR\2007\16526, AN, 13 Nov. 2006, JUR\2006\284618 and AN, 26 Mar. 2007, JUR\2007\101877 ; in France : Ministre de l'Economie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683 (2006). A formal interpretation of beneficial ownership was on the other hand adopted in Canada in Prévost Car Inc v R, 10 ITLR 736 (2006-2007) and in Velcro Canada Inc v R, par. 45, 14 ITLR 613, 633 (2011). For a critical discussion, see Arnold, *The Concept of Beneficial Ownership under Canadian Tax Treaties*, in: Lang/Pistone et Al. (ed.), *Beneficial Ownership: Recent Trends*, IBFD, p. 43 (2013).

12 Vogel, *Klaus Vogel on Double Tax Conventions*, III Ed., Introduction, MN 121 (1991) ; Ward, *Abuse of Tax Treaties*, 23 Intertax 4, p. 180 (1995) ; Prokisch, Art. 1, in: Vogel/Lehner (Ed.), *DBA Doppelbesteurungsabkommen. Kommentar* (5 Ed.), MN 117 (2008); Engelen, *On Values and Norms : the Principle of Good Faith in the Law of Treaties and the Law of Tax Treaties in Particular*, Kluwer, p. 36 (2006); De Broe, *International Tax Planning and Prevention of Abuse*, IBFD, pp. 374-375 (2008); Vogel/Rust, *Introduction*, in: Reimer/Rust (Ed.), *Klaus Vogel on Double Taxation Conventions*, N 57 (2015), Rust, *Art. 1*, in: Reimer/Rust (Ed.), *Klaus Vogel on Double Taxation Conventions*, Annex C (2015) ; Danon *Article 1*, in: Danon et al (Ed.), *Modèle de Convention fiscal OCDE concernant le revenue et la fortune*, Helbing Lichtenhahn, MN 144 – 158 (2013)

13 In Israel : Yanko-Weiss Holdings 1 Ltd v Holon Assessing Office, 10 ITLR 524 (2007) ; in Switzerland : A Holding ApS v Federal Tax Administration, 8 ITLR 536 (2005). Contra in Canada : MIL (Investments) SA v Canada, 9 ITLR 25 Tax Court of Canada and Federal Court of Appeal, 9 ITLR 1111 (2007).

[14] 2003 OECD Commentary ad Art. 1, para. 9.3.

[15] 2003 OECD Commentary ad Art. 1, para. 9.5. However, this policy had already begun to emerge in the 1992 OECD Commentary: "*"The main problem seems to be whether or not general principles such as "substance-over-form" are inherent in treaty provisions, i.e. whether they can be applied in any case, or only to the extent they are expressly mentioned in bilateral conventions. (...). However, it is the view of the wide majority that such rules, and the underlying principles, do not have to be confirmed in the text of the convention to be applicable"*. See 1992 OECD Commentary ad Art. 1, para. 24).

[16] Union of India v. Azadi Bachao Andolan (2003) ITR 6 233 279.

[17] Van Weeghel, *Improper Use of Tax Treaties, with Particular Reference to the Netherlands and the United States*, Kluwer Law International, p. 117 (1998).

[18] Ibid.

[19] France : Conseil d'État, *Verdannet*, 396954, 25 October 2017, 20 ITLR 867.

[20] France : Conseil d'État, *Verdannet*, 396954, 25 October 2017, 20 ITLR 872.

[21] Vodafone International Holdings BV v Union of India and another, par. 68, 14 ITLR 431, 451. As observed by Chawla, *Tax Treaty Disputes in India*, in: Baistrocchi, *A Global Analysis of Tax Treaty Disputes*, p. 1007 (2017): *"Unlike treaty shopping, round tripping (where money is routed back into the country by local investors through tax friendly jurisdictions like Mauritius and Cyprus) is not regarded to serve any economic purpose. It results in significant loss of revenue."*

[22] OECD (2015), Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris

[23] For a general overview of the functioning of the MLI, see in particular Danon R / Salome H., *The BEPS multilateral instrument: General overview and focus on treaty abuse*, IFF Forum für Steuerrecht 2017, Issue 3, p. 197 et seq.

[24] For an in depth analysis of the PPT rule and our positions thereupon see in particular Danon R, *Treaty Abuse in the Post-BEPS World : Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, in : Bulletin for International Taxation 2018, p. 31 et seq

[25] 2017 OECD Commentary ad Art. 29, para. 169.

[26] 2017 OECD Commentary ad Art. 1, para. 77.

[27] Preamble to the 2017 OECD Model Convention, see also 2017 OECD Commentary ad Art. 29, para. 1.

[28] OECD Model Convention 2017, Introduction, para. 16.2.

[29] For further details, *see* Danon, *supra* n. 24, at sec. 4.3.2. sec. 4.2.3 (2018).

[30] 2017 OECD Commentary ad Art. 29, para. 182, Example A.

[31] 2017 OECD Commentary ad Art. 29, para. 182, Example C.

[32] For further details, *see* Danon, *supra* n. 24, at sec. 4.3.2.

[33] For a recent detailed discussion of these examples, *see* V. Chand, *The Principal Purpose Test in the Multilateral Convention: An In-Depth Analysis*, 46 Intertax 1, p. 18 (2018).

[34] 2017 OECD Commentary ad Article 29, para. 181.

[35] OECD, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 2015

[36] OECD, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 2015

[37] *See* Danon, *supra* n. 24, sec. 4.7.2 and 4.7.3.

[38] OECD/G20 Base Erosion and Profit Shifting Project, Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note, 2019 available at : https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf

ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS UNDER ACTION 7

Rajesh Simhan

Session Chairman: Ms Shefali Goradia

Panel Leader: Rajesh Simhan, India

Panellists: Bijal Ajinkya, India - Daksha Baxi,India - Amar Mehta, Canada - Jeffrey Van Hove, OECD

The panel topics were comprised of two different but related topics:

- The first part was on the concept of dependent agent permanent establishment (DAPE) under the BEPS Action Plan
- The second part was on whether permanent establishment concept has a long term future in the context of tax treaties.

Dependent Agent PE

The session started off with the changes that have been proposed to the DAPE provisions under BEPS Action Plan 7. The summary of the changes to the DAPE provision were highlighted.

The first change is in respect of Article 5(5) of the Model Tax Convention (MTC) to provide for a more expansive scope on the deeming fiction of a DAPE as below.

Existing provision	Proposed change
A person, being a dependent agent, acting on behalf of a foreign enterprise is deemed to be a dependent agent PE *if it has and habitually exercises the authority to conclude contracts* in the *name of the foreign enterprise.*	Amend to also cover persons habitually playing the *principle role leading to routine conclusion of contracts* without *material modification by the foreign enterprise*, and the contracts are (i) in the name of the foreign enterprise, or (ii) for the transfer / license of property owned, or sublicense of property held under license by the foreign enterprise, or (iii) for the provision of services by the foreign enterprise.

The proposed changes expand the deeming DAPE fiction to provide that even where a person plays a principal role in the contract negotiation and the foreign enterprise does not make an material modifications to the contract, it could lead to creation of a PE. Further, the changes also expand the scope to clarify that that the nature of the contract i.e. whether of a transfer, license or provision of services would all be included in determination of whether a PE has been constituted.

The second change that was highlighted was in relation to narrowing the scope of who constitutes a dependent agent. The earlier provisions contemplated that a person acting on behalf of a foreign enterprise is an agent of independent status and acts in the ordinary course of business. The new provisions provide further colour around the nature of independence to state that if a person acts exclusively or almost exclusively for one or more foreign enterprise with whom it is closely related, it would not meet the test of an independent agent.

Existing provision	Proposed change
The deeming fiction in Article 5(5) shall not apply if the person acting on behalf of a foreign enterprise is an *agent of independent status and acts in the ordinary course of its business.*	Restrict the exclusion to provide that an agent should not be considered to have an independent *status if it acts exclusively or almost exclusively on behalf of one or more foreign enterprises to which it is closely related.* A person would be closely related to an enterprise, if based on all the relevant facts and circumstances, one has control of the other or both are under the common control of another enterprise.

From an Indian context, we have seen cases such as Varian India where the Tribunal has held that even where activities are provided to multiple associated foreign enterprises, the same should still qualify for the exclusion as an independent agent.

The last set of changes discussed were in respect of the specific activity exemptions under Article 5(4) of the MTC. The key change proposed is that in respect of the specific activity exemptions to provide that the activities have to qualify as preparatory and auxiliary

in the context of the business as a whole in order for it to qualify outside the PE tests. Further, it has also proposed anti-fragmentation rules to prevent artificial avoidance of PE by 'fragmenting' a cohesive business into small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities.

Existing provision	Proposed change
Maintaining stocks of goods for storage, display, delivery or processing, purchasing of goods or merchandise, collection of information **("Specific Activity Exemptions")** *should not be* regarded as constituting a PE.	Restrict Specific Activity Exemptions to *only those which are otherwise preparatory or auxiliary in nature in the context of the business as a whole.* Further, introduced new *Anti-Fragmentation Rule* to prevent avoidance of PE by fragmenting a cohesive operating business into several small operations in order to argue that each part is preparatory or auxiliary in nature.

The panel went on the discuss some of the key reservations that had been adopted by different countries in the context of the DAPE provisions. Some of the key reservations that were discussed included the following:

- Preparatory/ Auxiliary Services: India had made a reservation that scientific research would not qualify as preparatory or auxiliary activities in the list of examples of such activities. This is on the ground that scientific research may be itself qualify as a core activity and hence cannot form part of the exclusion.
- Authority to conclude contracts: India had made a reservation that the mere fact that a person has attended or participated in negotiations in a State between an enterprise and a client, can in certain circumstances, be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. This to a certain extent is not in consonance with the revised MTC which provides that the principal role test will still need to be satisfied for a risk of DAPE to be created. India is also of the view that a person, who is authorised to negotiate the essential elements of the contract, and not necessarily all the elements and details of the contract, on behalf of a foreign resident, can be said to exercise the authority to conclude contracts.
- Use of marketing representative: The reservation made by Malaysia on marketing representative was discussed. The reservation is that a marketing representative may constitute a permanent establishment particularly if the representative also negotiates the essential elements of the contract, and not necessarily all the elements and details of the contract, on behalf of a foreign resident. This is similar to the view that India had taken that essential elements is sufficient to meet the test of DAPE.
- Low Risk Distributor: India considers that distribution of goods owned by an enterprise by an associated enterprise or a closely connected enterprise, particularly in a case where the risks are not born by such enterprise, such as the so called "low risk distributor", may give rise to a permanent establishment of the enterprise, whose goods are being sold.

Case Law Analysis

The panel discussed some of the recent case law in the context of DAPE and discussed the new changes to the DAPE provision and its impact on those cases.

Google Ireland

The first of the cases was that of Google Ireland, where the French Courts had reviewed whether Google Ireland has a PE in France as a result of the actions of Google France. Google Ireland managed ad campaigns for French clients. The activities of Google Ireland was supported by Google France which had a service agreement for marketing and support services under which it was compensated on a cost plus 8% basis. The French tax authorities had claimed that notwithstanding that the employees of Google France had the authority to conclude contracts in the name of Google Ireland, there was a de facto power to conclude contracts.

The Court in this instance concluded that the test of DAPE as it stood was not fulfilled on the grounds that that the tax treaty required the authority to conclude contracts and not a mere de facto power. It made the finding that the adwords contract was signed by Google Ireland and the fact that no campaign had been

online prior to execution of contract by Google Ireland was sufficient to establish that Google France was not concluding contracts on behalf of Google Ireland.

It is important to note that the standards adopted under the revised MTC prescribe a lower threshold as compared to the test of 'concluding contracts' to provide that even activities of taking on the principal role leading to conclusion of contracts could give rise to a PE. In such circumstances, there is a possibility that under the revised MTC, the Court may have given a different view on the issue.

UAE Exchange

The next case that was taken up was the case of UAE Exchange (UE) where the Court was determining the scope of preparatory and auxiliary activities. In this instance UE provided remittance services for transfer of money from UAE to India. Under the contract with the remitter, UE accepted funds in the UAE and it was transmitted to beneficiaries in India by involving a liaison office in India who would download details of remittances and would draw cheques on banks in India and dispatch it to the beneficiaries in India. For the services performed UE charged a commission to the customers and the question was whether the activities of the liaison office in India would tantamount to a PE in India.

The High Court in this instance held that the activities of the liaison office would be of mere preparatory and auxiliary in nature and is not part of the core activities or functions. Therefore, it held that the provisions of DAPE or fixed place PE should not apply in respect of the activities of the liaison office. The question of course arises that in the context of the revision of the MTC to provide that the exemption has to be looked at in the context of the business as a whole would imply that the activities performed by the liaison office would be seen as a preparatory or auxiliary activity.

Amadeus Global

The Amadeus

Mastercard

The last case that the panel discussed was the Mastercard case, which was of recent vintage. The Mastercard case dealt with multiple different aspects of creation of a PE in India in respect of the payment facilitation services that were provided by MAP (Singapore) pursuant to a re-structuring of the Mastercard business in India. As part of any transaction processing, Master Card Singapore receives transaction processing fees, assessment fees for building and maintaining a processing network and it also has other miscellaneous streams of revenue.

While the case involved multiple different facets of PE creation such as fixed place PE, service PE etc. and classificiation of income as royalty, one of the relevant aspects was also in terms of how the Tribunal looked at the DAPE concept. The Tribunal went on to hold that MasterCard India habitually secured orders for the MasterCard Asia Pacific in India. Based on the narration of the MasterCard, the AAR observed that all agreements entered with Indian customers after the incorporation of MasterCard India were in fact routed through MasterCard India. In the Tribunal's view, this showed that MasterCard India was habitually securing orders for MasterCard Asia Pacific, thereby resulting in the constitution of a dependent agent PE of MasterCard Asia Pacific in India.

It was noted that post the adoption of the changes to the MTC, this risk may have actually increased since the threshold requirement for constitution of DAPE has been reduced.

TAX TRENDS IN MERGERS & ACQUISITIONS

Pranay Bhatia

Session Chairman: Gautam Doshi, India

Presentation by Girish Vanvari, India

Panel Leader: Pranay Bhatia, India

Panelists: Vivek Gupta, India - Bobby Parikh, India - Amrish Shah, India - Himanshu Sinha, India - Jeffrey Van Hove, OECD.

In the backdrop of opening remarks by Mr Gautam Doshi and presentation by Mr Girish Vanvari on M&A trends and what lies ahead, Mr Pranay Bhatia initiated the panel discussion.

On question whether the shift to substance over form is impacting even the legitimate tax planning, Mr. Vivek Gupta opined that fundamental change has happened across various laws such as adoption of Ind AS for accounting, Companies Act 2013, SEBI laws. which are far more substance-oriented. The fundamental transition is taking place from historical layer of rule-based law to injection of substance elements into these. Referring to instances from Mr Girish Vanvari presentation, he cited that while Ind AS requires merger to be accounted at fair value, the tax law has older rules-based requirement of book value for a tax neutral merger. The dichotomy of transition is causing the problem and trouble for M&A transactions. Mr Amrish Shah supplemented the view and added that dichotomy prevailed earlier as well, but it was balanced between laws having fiscal impact and not having fiscal impact. Now, the fiscal laws are creating the challenges and clients are questioning whether the commercial rationale will fly in GAAR regime. There are genuine transactions which will be questioned because we do not know how it will evolve.

Mr Amrish shah further commented that commercial rationale will be tested every time. Post BEPS and post GAAR, different solutions will come up in transactions. Citing recent newspaper reports on GSK and HUL, there is anxiety on GAAR, indirect transfer application. On point of BEPS adding to tax transparency, Mr Vivek Gupta answered in affirmative. However, BEPS will not provide certainty in respect of tax outcomes.

Mr Pranay Bhatia enquired the panellist about the areas that need to be kept in mind going ahead. Mr Vivek Gupta believed that globally jurisprudence had laid out how anti-avoidance laws should apply. In India, the principles from jurisprudence will find their way. He indicated that there could be over reporting and over examination by Indian tax authorities, however, in ultimate application of GAAR, we will find

balance in terms of situations where GAAR should apply and situations where it should not apply. Also, approving panel appointed under GAAR is independent and therefore, they will give fair and reasonable judgment. While analyzing transaction, one must ask himself that whether transaction is bonafide or is it only carried out to take benefit of tax rules. Taxpayers will have opportunity to present before the Panel, appeal against the order, therefore GAAR may not be as draconian as it is believed to be.

Adding to it, Mr. Himanshu Sinha clarified that permissible tax avoidance is still allowed. What is permissible would be understood on the touchstone of good faith, bonafide transaction, commercial rationale etc, but what comprises that is uncertain. He added that we are moving from aggressive tax planning to cautious tax planning. Explaining a case of startup, the issue of shares carrying rights as that of equity as well as preference shares, he mentioned that investor would go with the characterization as equity rather than facing the prospect of recharacterization by tax officer. He remarked that there is lot of caution because of GAAR and rightly so.

In relation to interplay of Principal Purpose Test (PPT) under MLI and GAAR, Mr. Himanshu Sinha explained that MLI is broader whereas GAAR is more specific. Treaty benefits can be availed if it is within the object and purpose of treaty. This aspect is highly litigative. He cited Azadi Bachao case wherein it was highlighted that objective of providing capital gains tax benefit was to attract investments from Mauritius and that needs to be respected. Such aspects will be looked into while interpreting MLI. On the other hand, under GAAR, commercial rationale needs to be proved, which is ambiguous. It cannot be encapsulated in language as to what can be contours of substance. Mr Amrish Shah listed the points that one can consider for commercial rationale referring to jurisprudence – how are you putting your capital, what is the political scenario or capital market where you are investing, etc. These will be important elements for PPT test i.e. proving non-tax objectives. Each situation would be tested for passing the muster under MLI or GAAR.

With reference to impact of BEPS Action Plan relating to hybrid mismatch, interest limitation, harmful tax practice on deal financing or IP structuring aspect of M&A, Mr. Bobby Parikh believed that these factors could impact all the re-organisation structures carried out. Supplementing the views of other panelists, he noted that bottom line is that whether you have good commercial rationale for the structure that you are using. He opined that Action Plans which are

incorporated in law create real constraints to taxpayers and one needs to find structure that works as per the provision or one has to accept that there would be higher cost to the business. Interest limitation rules introduced in Income-tax Act, which is similar to BEPS Action Plan 4, has affected how one structures the transaction.

While explaining the importance of debt in fund raising, Mr Bobby Parikh illustrated a case of a structure that includes both debt and equity for relatively temporary business need and permanent need respectively. Further, companies do not borrow funds from financial institution initially, the parent entity will infuse the funds in entity. In such scenario, if interest cost is disallowed, then it might impact the cost of the project. Earlier funds were introduced through NCDs. This has been affected due to change in RBI regulations and introduction of interest limitation rules. Further, he explained that if one cannot find risk mitigated measure then it will relatively increase the cost of the project. He believed that there is a price created for uncertainty in taxation and uncertainty will get priced like cost of indemnities, insurance, adding to commercial impact of tax in future.

The panel took up for discussion the Mumbai National Company Law Tribunal (NCLT) judgement in the case of Ajanta Pharma. The M&A scheme was rejected on the basis of observations of tax authorities that the transaction is for the purpose of tax benefit. In this relation, Mr Pranay Bhatia put up a question as to whether this case unveils the mindset of tax authorities on perceived tax avoidance? Would it sustain going forward as well? Mr. Bobby Parikh explained that rejection of merger on the basis of comments from tax officer is a worrying factor. He shared his experience by specifying that tax authorities' initial approach against any advance ruling application is to reject the same considering it as a tax avoidance. He mentioned that scheme of Ajanta Pharma has been rejected by a Judge as it is not in interest of public policy. However, what is called as a public policy requires senior judge to comment on it. He pointed out that merger of NIIT with similar facts as Ajanta Pharma has been approved by Delhi NCLT. Therefore, this is adding to the pool of uncertainty and path becomes more unstable. Mr. Himanshu Sinha opined that GAAR needs to be examined under the touchstone of income tax, however, Mumbai NCLT has overstepped its jurisdiction by examining scheme under touchstone of public interest. By public interest assumption, there is sort of erroneous assumption of jurisdiction by Mumbai NCLT. He further pointed out that Gujarat High Court in the case Essar (later upheld by the Supreme Court) specified that regulators are free to pursue against the company if they feel that scheme is against the public interest, but they should not hold up the scheme since many stakeholders might be impacted. Mumbai NCLT has given the judgment in contradiction to the principle laid down in Essar case. He believed that ruling of Mumbai NCLT should be corrected in further appeal proceedings.

Due-diligence is an important event before deal is agreed. The new tax transparency measures like exchange of CbCR reports will affect the availability and access of information and thus, tax professionals will be required to consider these reports at due diligence stage itself. The panel considered an aspect from advisors' perspective – if these developments would increase their scope of work, particularly to highlight the tax risks arising from structure or operating model of target? Mr. Amrish Shah remarked that what position was taken in past and how sustainable those positions are after tax amendments need to be looked out in due diligence. We have to exercise our judgments while doing due diligence and have to keep on evolving ourselves as we go ahead. If tax issues are not pointed in diligence, then it might back fire on advisors. Further, he explained that certain elements such as compliance of SAAR provisions, are margins within safe harbor law etc. would be looked upon in future diligence.

With reference to the impact of norms of 'fair value' while structuring deals involving listed or unlisted securities, Mr. Bobby Parikh mentioned that valuation of shares has become material component of the transaction. He cautioned that as we are moving from rule-based law to substance-based law, more interpretation, subjectivity would be involved, and commercial thinking needs to be developed i.e. how business and businessman operate. He also pointed out that approach of tax officer while doing scrutiny has to be commercial.

At the end of session, all panelists summaried important points from the session. Mr. Himanshu Sinha added that GAAR should not be approached in the same manner as transfer pricing i.e. you have different opinions, you wait for jurisprudence to come. Instead of this, more proactive approach should be adopted by Government. Government needs to come out with

clear cut rules on commercial substance, commercial rationale etc. Mr. Amrish Shah expressed that as the new law will settle down, we will figure out a way for M&A deal to move forward. Mr. Bobby Parikh commented that we should have more matured approach. At this time, regulations are unclear, you cannot approach regulators to get clarifications, but you need to find a path and if you get it wrong then you have to face penalties and prosecution. This situation need to be improved. Mr. Vivek Gupta said that true balance would be achieved when regulators and authorities are able to administer the laws with sophistication that these laws deserve. These laws have been drafted with certain level of sophistication, thus if they are applied and interpreted with that same level of sophistication, a balance can be attained. Mr. Gautam Doshi provided closing remarks to state that GAAR is an unknown element, we don't know how it is going to turn up. We need to document, prove and establish the commercial substance. This would be the major change going forward. There is a need for maturity in tax administration. There are clarifications required, we will get the same sooner or later.

GOODS AND SERVICES TAX

*Mr. Santosh Dalvi**

Implementation of the GST law in India marks one of the most significant transformation in the tax laws of the country. The country like ours which is focusing on a consistent economic growth by striving to boost business, the GST law has bought the industry in-line with the global practices, which has helped the corporates achieve their global agenda.

The GST law implemented in India is unique in its construct by having a dual levy of Central and State GST. Given the same, the entire framework of the GST law is complex to understand and difficult to implement.

Further, there are numerous and continuous updates to the GST law, which give businesses limited time to assess their systems for upgradations. The dependencies on the IT system for the success of GST have made digitalization inevitable. The quantum of data involved is ginormous which necessarily requires a secure and proficient IT environment with the Government as well as the Industry. The capability and stability of the IT systems is the most imperative aspect in determining the success of the GST law.

Given the present scenario, while the industry is saddling with continuous updates and upgradations, the Government recognizes the need for simplification and is focused on cutting complexities.

The simplification is also targeted to ensure higher tax base and propagating ease of doing business. From simplification of compliances, to issuance of clarifications on ambiguous matters, to adding further supplies into exemption list – all the efforts of the Government presently are towards working with the industry to in collaboration to achieve mutual objectives.

Compliances under the GST law are of prime importance and is also a measure of achievements and settlement of GST law in the country. The industry therefore needs to focus on achieving this purpose. The vision of transparent tax regime cannot be fulfilled unless there is a discipline in the compliances. The large corporates have raise acknowledged the need to build Center of operational Excellence with a view to achieve the objective of compliance. While the large corporates are capable of efficient planning, the smaller players should be bought to speed on this aspect. This is necessary not achieving revenue targets but also to ensure stability of the law.

Other than the elementary issue of ensuring appropriate compliances, the business should also turn their attention towards the technical developments under the GST law. The Advance Ruling Authorities was formed to assess, examine and respond

* *Partner and Deputy Head, Indirect Tax, KPMG India*

to the issues raised by the businesses under the GST law so that the matter attains prompt clarity. The Advance Ruling Authorities have being formed in the each State, which necessitates the business having multi-state presence to file multiple applications for the same issue, hence the same issue is examined by the multiple states and authorities, who may have divergent views on the same subject. This will trigger massive convolutions for the businesses. There needs to be uniformity within the same organization and even at the industry level to ensure rational competition. Therefore, there was a need for formation of a Central Advance Ruling Authority to achieve uniformity and consistency. The Government has recognized this requirement by proposing the same in the 31st GST Council meeting. While the manner in which this authority will operate is yet to be notified, the proposal has bought huge relief to the industry.

Separately, the industries have also been resorting to 'representations' for significant issues which have substantial impact. It is experienced that the Government is receptive to these representations and is forthcoming for resolving the same by issuing appropriate Circular / Notifications.

In Governments efforts towards simplification, significant changes and clarifications have been issued after the 31st GST Council meeting. The majority changes proposed are towards simplification and removing ambiguity, these inter alia include;

- Waiver of late fee / penalty for delay filing of monthly GSTR 1 and GSTR 3B for the months of July 2017 to September 2018, with rationale to ensure and streamline compliances;
- Extension of the time-limit for availing input tax credit for FY 2017-18 to 31 March 2019, to minimize the loss of credit;
- Relaxation in compliance is also provided by dispensing the requirement to sign or digitally sign an electronic invoice issued in-line with the Information Technology Act, , 2000 (21 of 2000).
- The due for filing the GST Annual Return and Audit Report for FY 2017-18 is further extended to 30th June 2019.
- Further, doubts were raised on whether amendments to the outward supplies can be made in the Annual return in Form GSTR-9 for any errors or omissions made during filing the monthly return; as per the amendments the same has been allowed. However, input tax credit can be availed / adjusted only in the monthly returns upto March 2019.

The amendments have got considerable comfort for the taxpayers who may now focus on qualitative review of FY 2017-18.

While the Government is continuously striving towards simplification, there exists stringent laws for ensuring minimum impact on the end customer. The GST law therefore formed an Anti-profiteering committee which focuses on assessing if the benefits availed by the businesses under the GST law have been appropriately passed on to the customer. The focused assessment by the anti-profiteering authorities have made the businesses vigilant and cautious while making commercial decisions. We have also experienced instances, were corporates have self-assessed and declared benefits not passed onto the customers and have then ensured the corrective measures. Hence, the formation of the Anti-profiteering authority is a creditable by the Government and its uniqueness has made it an integral part of the GST law.

It is evident that the concepts of the Indian GST law are inimitable from the world, which makes it challenging. Also, the Indian GST law is the law which is evolving through changes; to keep-up to the speed of change is the biggest issue for the industry. The issue of rigidity of the IT system is raised before the Government which needs to be consciously considered. Large business have a very sophisticated IT system which cannot undergo a updating at the speed of amendments, which is a crucial area for a dialogue with the Government.

The industries have welcomed the GST law and are working towards achieving the objective and vision of the Government for its implementation, however, the recognition of IT systems limitations should be of primary importance in crafting the GST law going forward.

GOODS AND SERVICES TAX

Session Chairman: Mr. Santosh Dalvi, India

Panelists: Mr. Prashant Bhatnagar - Prashant Deshpande - Ashish Jain - Uday Pimprikar - Amit Sarkar (all from India)

India witnessed a paradigm shift in the Indirect tax laws with implementation of GST. In the one and a half year of implementation of GST law, the economy of the country has beheld numerous fiscal, technical, procedural changes which ultimately have a potent impact on the manner in which the business is conducted.

The session on GST was focused on macro impact of GST on the economy post its implementation. The session was also focused on discussing certain key areas which the industry is presently saddled with.

Session on GST began with the Chairman, Mr. Santosh Dalvi giving a brief overview of the macro-impact of the GST on tax-base and also the GST revenue for the Government of India.

With introduction of GST, the Indirect tax payers have increased upto 50 percent as compared to the pre-GST Regime. Presently, approximately 1 crore tax-payers are registered under the GST law and the number is constantly increasing.

The compliance under the Indian GST law being of prime importance, the taxpayers are getting attuned to the same, which is evidenced by the consistent and steady increase in the compliances. The discipline in the compliance has grown from 50.1 lakh returns filed in October 2017 to 67.45 lakh returns in September 2018.

Further, the Government's budget for GST collection for FY 2018-19 is INR 13.5 lakh crores, of which approximately 50 percent , that is, INR 6.75 lakh crores has been collected till October 2018. The Government is expecting to cover this gap in coming months.

The revenue from GST from July 2018 to October 2018 has been in the range of INR 93,000 - INR 97,000 crores as against target of more than INR 1 lakh crores per month. Only the months of March 2018 and September 2018 have managed to cross the targeted revenue collection of INR 1 lakh crores.

While the large states of Maharashtra, Gujarat and Tamil Nadu have managed to achieve their targets, the North-Eastern states of Manipur, Mizoram and Arunachal Pradesh have collected more than their target revenues. However, states of Puducherry, Himachal Pradesh, Punjab, Karnataka and Jammu & Kashmir had significant shortfall. With these statistics there has been an overall 13 percent shortfall upto June 2018. The Government is therefore continuously striving to bridge the

gap from a revenue and collection standpoint.

Having summarized macro-impact of GST on the economy and its present position, Santosh Dalvi turned to the penal members to share their perspective on this one and a half years into the GST Regime.

Prashant Bhatnagar, being a key industry representative, expressed that, in his view and experience, although there were certain teething problems, overall the GST a very positive change for the economy from global recognition perspective. The uniformity in the tax regime, in terms uniform rate, seamless credits and uninterrupted movement of goods is important for a country which is targeting higher industrial growth. Furthermore, country seems to have overcome the fear of inflation and appears comfortable.

Separately, Prashant Deshpande believes that, with simplification of compliances, the tax-payers are settling with the GST law. However, parity is required at the State-level, given that CGST of states are not fungible. Further, he strongly believes that a re-structuring is required at the industry level with formation of Centre of Excellence for ensuring compliances.

Uday Primprikar concurred with view of Prashant Deshpande and said that 'digitalization' is now the manner in which the business should be conducted and tax objectives or compliances can be achieved. Digitalization of Government in construct of GST Network has given them access to humongous information and data-base, which therefore requires strong internal controls at the industrial front to keep us to the expectation of the Government. Automation therefore is a key for manner in which business in conducted.

Ashish Jain was completely aligned with the views Uday Pimprikar expressed that the industry is continuously striving to achieve its IT objectives in-line with the tax laws. The industry completely recognizes the need for digitalization and are updating and upgrading their systems continuously.

Separately, Amit Kumar Sarkar said that there is a need for rationalization of rate structure. While the Government have always recognized the need to have multiple rates for goods, however, the single 18 percent rate for services should be re-examined.

The session was also intended to discuss certain specific topics – Filing of GST Annual returns (GSTR 9) and Audit reports (GSTR C) was a pressing topic, hence, Santosh Dalvi initiated the discussion in this regard and requested Prasant Despande to provide insight. Prasant began by discussing the requisites and construct of these forms. It was discussed that, the

GST Annual returns and the Audit reports are to be filed at the State level and the turnover at the PAN-India level should be examined to determine eligibility to file GST Audit report. Content of the Audit report require or indicate maintenance of state-level trial balances, which is a very challenging for the industries, especially the service industry which had not experienced a de-centralized tax regime. Nonetheless the maintenance of State-level trial balances and P&L appears non-negotiable. This requirement may seem burdensome in the first year, but should settle in the years to come.

Annual return and audit report forms were discussed in great detail and it was recognized that preparing these forms need comprehensive data collation and system discipline. The contents for of the Audit report are cumbersome and require through examination and analysis. An example of this is, the Annual return requires GL code wise reporting of expenses, whether or not input tax credit has been claimed. This being a requirement which is additional from the monthly reporting, would require additional efforts to arrange.

There were also discussions on the role and scope of the auditor for certifying GST Audit report – whether an auditor should restrict itself to the reconciling GST annual return with financials or is the auditor required to comment on the technical correctness of the positions adopted by the taxpayers. To this the Panel members (especially the consultants) believe that the scope of the auditor extends to assessing and examining the technical positions adopted by the taxpayers. An auditor should comment and provide qualifications on any inconsistency or irregularity that they may come across during conducting the audit. It has been indicated by the authorities that the GST Audit report would be the basis for the department to initiate assessments, hence the qualitative comments from a technical standpoint is expected from the auditor.

The audience also expressed concerns about the granularity of data and information sought for in the annual returns and audit reports. Further, on the point of requirement of qualitative or technical review by the auditor, the audience suggested this aspect should be represented against, since having the tax positions vetted by the auditor will further create anomalies.

Taking the session forward, Santosh Dalvi highlighted that since GST law is evolving, the industry looks up to Advance Ruling for clarification on interpretation issues and unresolved matters. Presently, there are numerous Advance Rulings that are being issued, also there are divergent rulings issued on the same matter / issue. Given this scenario, it is important to determine what would be the reference value of these rulings – in this regard Amit Kumar Sarkar expressed his views, that the conflicting Advance rulings are extremely bewildering given the facts that certain Advance Ruling are also against the settled positions of the industry as a whole. Furthermore, the Advance Ruling authorities being formed at the state-level, in case of taxpayers having multi-state presence gets dissimilar ruling in different states, it will lead to a huge operational difficulty and disruption at the industry level. It is important for the Government to monitor and ensure that uniformity which is of utmost importance and is a key characteristic of the GST Regime. Although it is agreed that an Advance Ruling is applicable only to the applicant, however, in practice it does influence the manner in which a matter is assessed by the taxpayer as well as the department. The drawl of perspective from Advance Rulings cannot be denied.

Moreover, the panel members discussed that the manner in which an Advance Ruling is argued plays a critical role on achieving the desired outcome from the Advance Ruling. Also, the arguments need to be presented bearing in mind the impact of the argument form a holistic perspective – an argument taken should not adversely have an impact on aspect which is settled.

The panelists consistently agreed the Advance Ruling authority was formed so that the taxpayers get prompt clarity on the issues that they envisage, however this rationale has not appropriately being met. It was deliberated amongst the panel members for a need to have a Central Authority for Advance Ruling to ensure consistency and reliability. One of the panel members also suggested that the Advance Ruling Authority should also have a judicial member who is abreast of the technicalities of the law at an industry level.

Given the present scheme of things, a debate was initiated on whether it would be better option to opt for a representation route rather than an Advance Ruling, which may ensure uniformity. The panel members commented that a representation may be preferred by the taxpayers who have multi-state presence. In this case, if the representation is responded negatively,

the same will not impact consistency within an organization and also the industry at large. Iit has been experienced the authorities are receptive of the challenges faced by the industry and are forthcoming in resolving issues. Further, an integrated approach by the affected taxpayers are being carefully heard and resolved.

The Chairman of the session also touched upon a certain other key areas and aspects of the GST Regime, one of the key ones being 'anti-profiteering'. The provision in relation to the anti-profiteering were formulated with a rational to keep a check on inflation by monitoring the transfer of the benefit of the GST law to the end consumer. The anti-profiteering authorities are therefore examining various goods and services which are sold / provided directly to the end consumer. The orders of the Anti-profiteering authority has set the tone for the industry to re-assess and ensure passing of the benefits. It is experienced that large corporate are conscious about these provisions of anti-profiteering and its impact and therefore have evaluated or would be evaluation their overall positioning for assessing the benefit to be transferred.

Further, Santosh mentioned availability and fungibility of input tax credit should be ensured otherwise the entire rationale of the GST law will be defeated, the provisions with respect to loss of credit due to time-barring or non-reporting by the vendors should be re-visited. Further, the taxpayers should build strong internal processes to appropriately report and avail credits and also follow-up with vendors for reporting to ring-fence any denial of credit.

Considerable focus of the GST Regime is on compliance, hence there should be a consistent endeavor by businesses to meet there compliance related objectives. Even the smaller taxpayers should necessarily streamline there process for compliances which would help them to achieve their business targets. As Government's commitments to propagate compliance discipline, the simplified return process has been proposed and should be implemented after the first quarter of 2019.

Overall the session on GST was particularly insightful where the Chairman and the Panel members discussed and deliberated macro impact of GST and also gave their perspective on certain key aspect of the GST Regime and the present scenario. They also focused their discussion to the matters that need attention. GST Annual returns and Audit report being particularly important compliance, the Panel member discussed the reporting requirements with all its nitty gritty. Advance Ruling being another extremely critical aspect of the GST regime as it stands today, and was deliberated quite extensively, along with its practical implications.

The audience heard the views of the top industry players and the knowledgeable consultants on each of the topic to get an all-rounded perspective on aspects that require consideration.

The key take always from the session being the inevitability of digitalization and requirement of sophisticated focus on compliances. These areas are of primary importance and should be assessed immediately.

The experience of the Chairman and the Panel members bought more clarify and quality discussion on the crucial aspects of the GST regime as it stand today. The government and the industry have to work in collaboration for the success and settlement of the GST law in the country.

RECENT TAX REFORMS IN THE UNITED STATES (2017): THEIR CURRENT STATUS AND THEIR IMPACT ON OTHER MAJOR GLOBAL TAX SYSTEMS

Marc Levey

Session Chairman: Rodney Lawrence, United States

Panel Leader: Marc Levey, USA

Panelists: Hitesh D. Gajaria,India - Pragya Saksena, India - Robert Stack, USA - Christopher Xing,China - Lawrence Zlatkin, USA

The Panel broke down their presentation in seven distinct topics.

1. The US Tax Rate Reduction and its Impact on Outbound Behavior

The US tax rate was reduced to 21 percent (likely 25 percent given state and local taxation). This significant change in rate was based on the widely held view in the US business community and Republican sponsors of US tax reform that a reduction from the previous rate of 35 percent was needed to make the United States competitive in the global markets. This was generally a political concern, with early discussions mostly centered on a plus/minus rate of 25 percent. It is not clear how the 21 percent rate was arrived at. Interestingly, the average pre-tax reform effective rate of tax for US multinational corporations hovered at about 22 to 23 percent, although domestic US income was taxed at 35%+ . It is unclear whether, or to what extent, this made a difference for non US multinational companies investing in the United States.

One concern of the panelwas whether the 21 percent rate would survive the new Congress coming into 2019 or in the medium term, especially given the spiraling US deficit and the growing impact of progressive politics on the Democratic Party. Another concern was how this rate change reconciles with the provisions of Section 163(j) (the earning stripping rules) and the net operating loss limitations, among other things.

2. The US Territorial System and the Global Intangible Low Tax Income (GILTI) and Foreign Derived Intangible Tax (FDII) provisions.

GILTI and FDII are provisions which were enacted under the auspices of a new territorial tax system, although whether the system is in fact territorial can be debated. The new territorial regime was reserved for a non-US "normal" return of 10 percent on tangible assets, whereas extra territorial normal return would now be taxed at a reduced rate of at least 10.5%. In short, GILTI was to be the answer for the perceived deficiencies in the US Subpart F regime.

The calculation of GILTI is the excess of the taxpayer's net controlled foreign corporate tested income over its deemed tangible income return. A 10.5 percent tax is imposed on this excess income, after taking into account a limited amount of credits for foreign taxes. Despite the title of "low tax intangible income," GILTI taxes all income in excess of the deemed tangible income return, regardless of the rate at which it has been taxed and whether it is generated by intangibles. GILTI excludes Subpart F income and income effectively connected income with a US trade or business, both of which are taxed under the normal 21 percent regime. Essentially, the US now taxes all income earned through a foreign corporate entity or CFC in excess of a deemed return on tangible assets at a reduced tax rate, less allowable tax credits for foreign taxes, thereby ensuring that a "minimum tax" is imposed on foreign income. Hence, the GILTI is considered the "stick".

The "carrot" to the "stick" is "foreign derived intangible income" or FDII. Here, in short, there is a mirror system for non-US income earned by a US company in excess of the same 10% deemed return on tangible assets, whereby the excess is taxed at a lower and more beneficial tax rate. In total, FDII can potentially reduce the US Multinational's effective US tax rate on FDII to 13.125 percent.

Because FDII is highly dependent on exported products from the United States, some have considered whether the FDII is a prohibited export subsidy under the rules of the World Trade Organization or WTO. Others have questioned if FDII is akin to a non-compliant patent box outside the BEPS process. It is unclear if and how these issues may surface in the future. Indeed, one reaction is that GILTI/FDII regimes operate to tighten the prevailing US CFC structure to avoid zero taxed or double non-taxed income, as has been favored by some non US countries.

3. Is the new Base Erosion Anti-Abuse Tax (the "BEAT") a back stop to a minimum tax imposed on certain deductible flows to non US related persons?

The BEAT was put in place generally as a back stop to preclude non US Multinationals from eroding the US tax base of their US affiliates. Essentially, the BEAT is a minimum tax that applies to large Multinational companies (with gross receipts averaging at least $500 million over a three year period) with certain amounts of base erosion payments to related parties (3 percent for corporations; 2 percent for bank and securities dealers). The percentage tax is applied to the US entity's total deductible payments to related foreign persons, with certain deductions excluded such as net operating losses, FDII, the participation deduction for foreign dividends under Section 245A, GILTI and others. This tax rate is 5% in 2018, 10 percent beginning in 2019 and increasing to 12.5 percent after 2025.

BEAT is very broad. It applies to both US and non-US organized groups and to a wide array of payments that may not have been considered base erosion. This includes exchanges made in reorganizations, payments for the purchase of goods, payments made through a shared group purchasing or supply arrangement and to most payments for services within a group.

The BEAT was the alternative to the prior considered Border Adjustment Tax and some form of VAT that had been considered. The BEAT is applied regardless of US Tax Treaties, but excluded are reduced amounts that are subjected to US withholding taxes. Services are excluded from the BEAT if they fall under the Simplified Cost Method; however, if such services are marked up, only the mark up amount is taxed as opposed to the actual cost base. Expenses included in Cost of Goods Sold are also excluded from the BEAT.

4. What is the Future of Digital Economies?

While GILTI may indirectly address issues surrounding the digital economy because "stateless income" and zero taxation is no longer available for US technology companies, the OECD and certain non US companies have pursued other remedies.

One proposed remedy is to modify the definition of permanent establishment to encompass the digital economies, possibly by expanding the concept of a virtual permanent establishment to tax cross border digital income derived from local markets and local participants. Another is the "diverted profit tax" enacted by certain countries such as the United Kingdom and Australia. And, finally, some jurisdictions in the European Union, for example, have suggested a revenue based exercise tax, namely, 3 percent on gross revenue. India also has introduced a 6% "equalization tax" on certain digital items earned through local online transactions. This latter proposal seemingly may work well with service type digital economies which have significant margins, but can have the reverse impact on distribution type digital economies who typically have lesser margins.

5. What is the impact on US Behavior?

US tax reform has introduced a number of significant provisions that will cause US Multinationals to react. Whether major restructurings occur is doubtful in the short term as there is much to learn regarding the existing set of provisions and details may await a technical corrections bill. Further, as Congress has changed its composition effective January 1, 2019, some express concern that more changes may come down the line, particularly with respect to US tax rates.

Some practitioners suggest that more foreign affiliates of US Multinationals will be structured as limited risk distributors to minimize the bite of GILTI. Similarly, some US Multinationals may seek to "check the box" on these foreign affiliates to create US taxable income, or try to create Subpart F income to either reduce GILTI or create foreign tax credit efficiencies.

The new BEAT rules in particular will have an onerous impact on services businesses where payments are made to non-US related parties. In many instances, this impact is harsh and has limited policy rationale, such as shared billing and servicing arrangements when the US acts are Treasury Center or Billing coordinator and where there is no attempt to reduce the US tax base.

Much speculation has surrounded the question of whether US Multinational companies will migrate intangibles to the United States, in part to increase FDII benefits. However, many appear reluctant to disrupt their supply chains at this time for a benefit that may be at risk or where the restructuring cost could well exceed any potential benefit received.

There is also no current clarity on how US Multinationals would treat marketing intangibles or digital economies, with many taking a wait-and-see attitude. Finally, it remains to be seen how BEPS 2.0 will play

out and affect the established international tax world order.

6. What is the Impact of the US Tax Bill for Indian Multinational Companies?

The most important item to watch is the impact that BEAT may have on India continuing it's pole position as the leading services center of the world. It is anticipated that most payments for services that US Multinationals make to their captive Indian group companies – which provide valuable services to them – will get covered by the US BEAT provisions. Will India still continue to remain a preferred outsourcing destination, given the imminent phasing out of the existing Indian tax holiday provisions for such exporters of services and the relatively extremely high Indian corporate tax rate of approx. 34% is a question whose answer will only be clear as time goes by.

The BEAT provisions will also force a re-think on the current commercial contract structures that many Indian multinational service companies currently have, with a Front or Sales Office Entity being in the US, backed up by the formidable delivery engine entity in India.

By contrast only time will tell whether Indian companies would go forth and make US as their main exporting base, given the favorable FDII regime in the US.

Similarly, limitation on interest deduction under the US Tax reforms will force Indian companies, particularly acquisitive ones, to revisit the quantum of leverage that typically has until now been the cornerstone of most outbound acquisition structures.

7. What is the Impact of the US Tax Bill for Chinese Multinational Companies?

There are a couple of different dimensions to the China response to US tax reform, at the level of policy making, and at the level of outbound and inbound investment from China. At the policy level, the reaction amongst Chinese tax policymakers has generally been that the US tax reform brings the US more in line with the OECD average (and indeed with the Chinese 25% tax rate). As such, policymakers have not made calls for any immediate major overhaul of China income tax rules. Instead China's policy in the period since the passage of the US tax reform law has focused on further enhancing China's innovation tax incentives (e.g. capex expensing, improved super deduction for R&D expenses, and enhancement of VC tax regimes), improving its VAT rules (e.g. zero rating for export, VAT refunds), and lower tax burdens for SMEs and start-ups. China's introduction of the dividend reinvestment incentive had already been in planning well prior to US tax reform.

At the inbound investment level, US MNEs with Chinese affiliates are undertaking organizational reviews to understand how the new US tax law impacts them, and what organizational changes can be made (e.g. reorganizing their cross-border payments), if any, to mitigate any adverse tax impact of BEAT. Broader restructuring decisions may be held off until the full regulatory detail of US tax reform becomes available and is studied in detail, and until the medium term China-US trade picture becomes clearer.

At the China outbound (US inbound) level, the US rate reductions improve attractiveness of FDI into US, though the structuring of China's 'go out' investment in US may need to be reviewed in light of EBITDA and BEAT interest deduction limitations. Chinese regulatory limitations on outbound investment into certain sectors (e.g. real estate, entertainment) and US limitations on inbound investment in technology (e.g. CFIUS review changes) have seen a sizeable fall in Chinese investment into the US in the last year, so one will need to wait until this situation stabilizes before the impact of US tax reform on China investment in the US can be fully discerned.

MANDATORY DISPUTE RESOLUTION: AN ESSENTIAL PILLAR OF THE INTERNATIONAL TAX FRAMEWORK

*Jeffrey Owens**

Mandatory Dispute Resolution (MDS) is widely used outside of the tax area and has proved an effective way of resolving disputes between government and business in areas as diverse as investment, the environment and trade .Yet the tax community has been reluctant to embrace this approach. Recently some progress has been made with the move in the EU from an Arbitration Convention to an Arbitration Directive and with 26 jurisdictions signing up to the MLI arbitration provision .

Yet at a time of heighten global political and economic uncertainty and in a period when the international tax arrangements are being reassessed , MDS offers countries an effective way to reduce tax uncertainty and thereby facilitate the flow of investment, goods, services and people across frontiers , which in turn can promote the achievement of sustainable growth.

Currently over 90% of cross border tax disputes are between a very small group of OECD countries ,Indian and China .The vast majority of LDC have never had a MAP .But this is beginning to change as LDC become more familiar with international tax arrangements and build up capacity , particularly in the area of transfer pricing .So today we are seeing disputes arise between OECD countries and LDC, between the BRICs and LDCs and between LDC themselves. Nevertheless very few LDC have MDS provisions in their existing tax treaties and even where they do even fewer have used them .

Non OECD countries have expressed a number of political concerns over MDS, namely:

- it could reduced their fiscal sovereignty
- May be in conflict with their constitutions

These countries have also expressed concerns over the integrity of the process , it s lack of transparency and its costs .More generally there is a fear that OECD coun-

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tries would use MDS to enforce their interpretations of the key articles found in tax treaties , given the lack of expertise in many LDC.

Many of the OECD countries which are now the strongest supporters of MDS shared the political concerns expressed above and some of the procedural concerns. But as they engaged in the discussion of MDS launched by the OECD in the mid 2000's so they became convinced that the political concerns were unfounded since;

- Every time a country signs an international treaty it is giving away part of it fiscal sovereignty. Put another way, sovereignty is there to be used to trade for other benefits.
- Constitutional constraints can be overcome, as can be seen from the fact that the vast majority of countries have BIT which include arbitration clauses.

The procedural and practical concerns are more legitimate, since current MDS practices, whether in bilateral Tax treaties or the MLI, were established to meet the needs of OECD countries and developing countries may find the current institutional framework difficult to operate or inappropriate to their own circumstances.

This is why the UN Tax Committee launched in 2017 work on Dispute Resolution , including on MDS , with the intend of developing approaches that could work for LDC .

At the same time the global tax policy centre at the WU Institute of Austrian and international Tax Law launched a research program to explore how a new institutional framework could be developed for MAP , including mediation and MDS .(see Eva: can you put in reference)

That framework would involve:

1. A standing Dispute Resolution Panel operating under the auspices of the UN Tax Committee
2. The standing Panel would consist of pre selected experts who would have to meet a series of criteria to ensure their independence and knowledge of the circumstances of developed, developing and economies in transitions.
3. All UN countries would have access to the Panel but when a cross border dispute arose the countries concerned could not select their own country experts from the panel .The two or more experts selected would agree upon a chair .
4. Experts appointed to the panel would be require to take a young professional from an LDC and to provide them with a hands on training, there-

by over time building up the capacity to engaged in effective Dispute resolution mechanism by LDC.

5. There would be predetermined caps on the all aspects of the costs of MDS and low income countries would have access to a dedicate fund to assist them to meet part of these costs
6. Redacted versions of the outcomes from the panel discussion would be published thereby providing some guidance on the types of disputes that typically arise and the approach of the panel to resolving them.
7. Financing would be provided by a mix of funding from aid agencies and from MNE's, with the funds being paid into a UN Trust Fund.

Such a new framework would address many of the concerns of LDC and would perhaps help them to reconcile the need of provide tax certainty with the need to protect their revenue base (an LDC is much more likely to arrive at a successful outcome from a cross border dispute with a large OECD or NON OECD country under this framework than under a traditional bilateral MAP). Achieving this change would take time and its details would have to be worked out by the participating countries, but with political will it could become operational within the next 2-3 years and would go some way to reducing tax uncertainty and protecting the revenue base of developing countries.

BEPS AND BEYOND BEPS: A REPORT ON THE FIT-IBFD INTERNATIONAL TAXATION CONFERENCE, 2018

Sriram Govind[1]

1. Introduction

The Foundation for International Taxation (FIT) and the International Bureau for Fiscal Documentation (IBFD) co-hosted the 2018 edition of the annual International Taxation Conference in Mumbai, India on December 6-8, 2018. The theme of the conference this year was to analyze global developments in the area of international taxation in the aftermath of the Base Erosion and Profit Shifting (BEPS) project as well as the coming into force of the OECD Multilateral Instrument (MLI).

Academic discourse in international taxation over the past decade has largely focused on preventing tax avoidance and double non-taxation of income. Per the bidding of the G-20 countries, the OECD initiated the BEPS project, releasing its final reports in October, 2015 covering 15 distinct actions mostly dealing with the prevention of tax avoidance, harmful tax practices and aggressive tax planning. Building on this work, the OECD has also created the MLI, a multilateral treaty that seeks to modify the application of double taxation avoidance conventions (tax treaties) entered into between its signatories to the extent of the treaty related actions in the BEPS project. As of January, 2019, 85 jurisdictions have signed the MLI and following ratification, it has already come into force for 17 jurisdictions as regards their covered tax treaties.

In this context, several questions arise. How does the MLI function and what is its impact on the landscape of international tax law? Apart from the MLI, how are countries implementing the BEPS project in domestic law? Following the BEPS project, what importance should be given to factors such as economic and commercial substance in international tax structures? Has the BEPS project failed in dealing with more fundamental concerns in international taxation i.e. how taxing rights are divided between the source and residence countries? How do States address such concerns, particularly in relation to the digitalized economy where traditional rules may not be well suited?

All these questions and several more were answered in this extremely engaging conference which featured around 20 panels on the most controversial topics in the area

of international taxation at the moment ranging from the BEPS project and the MLI to the impact of the digitalized economy to the impact of the US tax reform on international taxation. This report provides a summary of the most significant issues discussed during the conference.

2. BEPS and the MLI

Since the BEPS Project and the MLI were the marquee topics of the conference, several panels discussed various issues surrounding them. First, an action by action analysis of the BEPS Project was presented, stressing on how value creation may be different from value consumption used in indirect taxes, although the expression is vaguely defined, with the conclusion that moving to taxation on the basis of digital presence may be key for tackling the digitalized economy based on value creation. Some critique was also offered as regards the BEPS project here as to how country by country reporting may lead to overreach by authorities creating a disproportionate burden even for compliant multinational enterprises and that the interests of taxpayers are thus, not adequately protected under the BEPS Project.

Some focus was also placed on digital disruption and the impact on international taxation in the post BEPS world. Various issues were discussed such as how the post-BEPS world is dealing with issues such as digital taxation and the US tax reform, moving the debate more from BEPS towards allocation of taxing rights blurring the lines between income tax and indirect taxes. The impact of the ongoing trade dispute between the US and China and the consequent moving of supply chains out of China on international taxation and transfer pricing was also discussed. Further, areas of possible convergences were also discussed such as the convergences between financial services and technology industries and the alignment of the US, China and India as key players in the global digital economy going forward. Finally, the predicted change in East-West power dynamics, with more Asian countries (such as China) becoming net capital exporters and the impact on international tax and transfer pricing was discussed.

The relationship between the BEPS Project and the US tax reform was also discussed where it was concluded that while the BEPS Project was heavily influenced by existing US tax law, the new tax reform

itself was influenced by the BEPS Project as well with several provisions achieving similar outcomes, with the same general flavour such as anti-abuse and prevention of double non-taxation. Further, there was also a discussion on how aggressive tax planning is different from tax avoidance in that the former includes anything that undermines the operation of tax laws irrespective of artificiality, making it more difficult to tackle. Judicial anti-avoidance doctrines and broad general anti-avoidance rules may be required to prevent such frustration of the operation of tax laws. In the international context, hybrid mismatch and multiple deduction outcome structures can only be defeated by a coordinated approach, aligning taxation with substance addressing harmful tax practices.

Further discussions in this area focused on tax certainty following the BEPS project and the MLI. In this context, the relevance of the new preamble in the MLI, stating essentially that a tax treaty seeks to avoid double taxation without allowing tax avoidance including through treaty shopping, in the interpretation of tax treaties was discussed. As opposed to several cases decided by national Courts on these issues that have held that treaty shopping and similar arrangements aimed to make investment more attractive is permitted under the treaty sans an anti-avoidance provision, it was concluded that the new preamble would now make it difficult to justify such arrangements. Similarly, the principal purpose test (PPT) would now make it possible for tax authorities to deny treaty benefits in such situations. However, some areas requiring clarifications such as the possibility of protection to arrangements involving core commercial activities, the relationship between the PPT and the specific anti-avoidance rules under the BEPS Project and otherwise (such as the beneficial ownership test) and the consequences of applying the PPT (whether treaties applicable to a re-characterized arrangement would be applicable or not) were pointed out.

The OECD pointed out that 2018 has been the year of implementation as regards the BEPS Project and the MLI, exchange of information and rulings and review of more than 100 harmful regimes by the forum on harmful tax practices. It was stated here that substance would now be a necessity for tax structures as well as taxation regimes established by States. It was also stated that although country by country reporting (CbCR) presents great opportunities, the challenge is in learning to use the information. The OECD stated that it would publish consolidated, anonymized data to give the public a better understanding of where profits are located and where taxes are paid by multinational enterprises.

Finally, there were several inputs on the impact of the BEPS Project and the MLI on India. From the Indian Government's side, it was commented that although existing inequities in source-residence allocation in tax treaties has not been fixed as yet, India enthusiastically supported the BEPS project and accordingly, the MLI (including by implementing almost all BEPS related provisions under the MLI) to ensure coordination in the tackling of tax avoidance and aggressive tax planning. It was also stated that India is presently in the process of ratifying the MLI with a view to it coming into force for covered Indian tax treaties soon. However, it was also stated that although the Indian Government has implemented country by country reporting measures (CbCR) as under the BEPS Project, it is still working towards how to effectively use such information for risk assessment. From the side of practice, several issues were also raised as regards BEPS and MLI implementation in India such as the process that would be involved in the ratification of the MLI in India, how India has chosen to apply the simplified limitation on benefits clause in addition to the PPT, but its impact has been limited since most of India's critical trade partners have not chosen similarly and how the Indian tax administration, that is perceived to be aggressive, would now use the anti-avoidance rules in the MLI in practice.

3. Taxation of the digitalized economy

Another topic in vogue at the moment, the taxation of the digitalized economy was also covered in several panels across the three days of the conference.

There was some focus on short term measures to tackle taxation of the digitalized economy that have been implemented in some countries and are being discussed in various fora such as the European Union (EU) at the moment. A presentation comparing the EU Digital Services Tax Proposal to the Indian equalization levy highlighted how they are essentially different: that the former deals with targeted services that focus on user monetization such as advertising, platform facilitated transactions and data sharing while the latter is broader in principle, but is presently restricted to advertising services. Moreover, the former grants taxing rights to the state of the user ac-

cessing such digital services while the latter retains taxing rights with India if the service recipient (and not the user) is located in India. It was also discussed that although such short term solutions are stated to fall outside the scope of tax treaties (since they are not income taxes), it is questionable whether such a view can be upheld since the scope of Article 2 (taxes covered) in tax treaties is broad and since intentionally avoiding tax treaty coverage may be considered "treaty dodging". Finally, it was also elucidated that although short term solutions may be effective in generating revenues from digital companies without much complexity, they may be too simplistic and that different rules interacting together (such as the proposed EU tax and the Indian levy) in a single fact situation can create multiple taxation of income, taking us back to the initial problem that tax treaties sought to resolve. In light of this, it was concluded that an effective long term solution is the need of the hour.

Long-term solutions were discussed by several speakers as well. The OECD shared key outcomes arising from the latest meeting of the Task Force on the Digital Economy in December, 2018. Broadly, it was mentioned that a fundamental discussion on allocation of taxing rights, revision of nexus rules and possibly, even the arm's length principle had arisen. Although the impact of this work is similar to the BEPS project, many speakers were of the view that it should be differentiated from BEPS since it focuses on more basic source versus residence issues – which were stated to not be considered in the BEPS project. It was stated that in essence, the solution being discussed is one with a broader approach to BEPS – in line with the US tax reform, specifically the Base Erosion Avoidance Tax (BEAT) i.e. a minimum tax, which may be applied on a coordinated basis, instead of continuing to rely on the arm's length principle. This would be in line with the common understanding that the problem is beyond just digital companies, but affects the entire system. However, several issues in respect of a minimum tax system were also discussed such as how to deal with losses in such situations, how tax treaty coverage may be affected etc.

Further, as regards allocation, it was stated that many countries are now considering transactional profit splits as a global solution as opposed to traditional arm's length approaches. In this regard, it was stated that the preferred approach going forward would focus on simplicity and would try and preserve a single level of tax instead of trying to preserve the arm's length method. Therefore, the aim would be to not move to formulary apportionment either, but to achieve an intermediate solution. It was also stated that factors such as user participation and contribution would be considered in the consensus solution. However, it was mentioned that business models where existing rules are functional may be carved out.

It was also pointed out that since consensus on such a long term solution would take time (as of now, till the end of 2020), many countries are being impatient and are implementing short term solutions. It was opined that instead of such short term solutions, extending indirect taxes such as the value added tax may be a better solution for now till the income tax system is fixed in a coordinated manner.

From the Indian perspective, the Government put out the view that the PE threshold was outdated and that India would want to move past it to a more equitable solution in tax treaties, especially since implementation of BEPS has not resulted in a great increase in tax base. Further, they challenged the arm's length solution and considered moving towards an approach similar to formulary apportionment in light of the US BEAT moving away from the arm's length principle as well. It was emphasized here that a minimum tax as discussed above would not solve nexus/allocation issues and that this has to be done on priority. India's introduction of "significant economic presence" conditions for nexus under domestic law may be seen as a precursor to what it would want in its tax treaties in future negotiations. However, it was mentioned that the Indian equalization levy would be retained till the time where the Indian Government feels that allocation inequities have been resolved globally.

As regards allocation, a panel on transfer pricing also discussed whether the new OECD guidance on the transactional profit split method will result in *de facto* formulary apportionment. Several case studies dealing with distributor models, licensed manufacturer models, risk and capital based structures, the digital economy, hard to value intangibles, cost contribution arrangements and low value adding intra group services were discussed to explain the mechanics of the new guidance.

4. Other issues

Apart from the above mentioned two key areas, other panels focused on more specific topics. The US tax reform was discussed in detail and the impact on US businesses i.e. whether more businesses would now move towards setting up base in the US, thereby mov-

ing income and intangibles to the US was considered. Here, it was discussed whether the US would now be considered an outsourcing hub as opposed to countries like India which have a much higher corporate tax rate. However, it was opined that moving businesses and intangibles to the US may not be easy, particularly since many European countries are introducing anti-avoidance rules pursuant to the Anti-Tax Avoidance Directive, such as an exit taxation for changing residence. Possible compatibility issues such as possible trade law issues arising from the intangible related provisions in the US tax reform were also discussed.

Dispute resolution was the focus of a very interesting panel which considered the role that judicial authorities will have in the resolution of international tax disputes. Judicial members of the panel were of the view that an activist judiciary, especially in the form of specialized tax tribunals, would serve the proper implementation of international tax law well. In the post-BEPS environment characterized by uncertainty, it is expected that disputes will increase and although Action 14 measures have resulted in some improvements to the Mutual Agreement Procedure (MAP), it was stated that the key lies in implementation of these measures. The merits of considering binding solutions such as arbitration or non-binding solutions such as mediation to supplement MAP so as to improve its efficiency were also discussed. From an Indian perspective, the Government reiterated its position that having a third party decide a treaty issue between India and another State would be in violation of its sovereignty and clarified that they expect no change in this position. However, some judicial and academic speakers mentioned that the issue of sovereignty is not a legal bar, but a policy concern since even-handedness is not assured in tax treaty arbitration and unless and until this is obtained, India may be better off not choosing arbitration in its tax treaties. Similarly, another panel discussed taxpayer rights in light of BEPS and the merits and demerits of having a taxpayer rights charter and other mechanisms that have been popular in other countries like an independent Tax Ombudsperson.

In a panel focused on the impact of recent international tax changes on mergers and acquisitions in India, it was discussed that since amalgamation schemes in India require approval by the National Company Law Tribunal, which in turn requires a clean chit from the Indian tax department, several big ticket mergers and acquisitions are being stalled owing to the indiscriminate application of the Indian GAAR by the tax department. It was concluded that genuine transactions should be shielded from anti-abuse provisions irrespective of the new tax environment.

Two panels also focused on how the permanent establishment (PE) concept has developed over the past few years in terms of the BEPS changes as well as judicial perceptions. Many recent decisions of Indian Courts and Tribunals such as the *Formula 1* decision, the *Mastercard* decision and the minority view in the *Nokia* decision have held that PEs are created where affiliated companies act as alter egos of each other and where lines between activities of each company are blurred, irrespective of the form of the contracts requiring a separate entity approach. In such cases, it was held that the Indian subsidiary may be considered a "virtual projection" of the foreign parent company, creating a PE, irrespective of the fact that the OECD Model Commentaries may have taken a different position on such question. Although such positions were considered justified by many speakers from a tax policy perspective i.e. how treaties are to be modified, it was discussed whether a judicial forum, evaluating an existing treaty based on the understanding at that point of time, would be the right place to make such determination. On the issue of artificial avoidance of PE status, after discussing the changes proposed by the BEPS project and implemented by the MLI and the non-member positions taken on these matters by India, several Indian cases dealing with dependent agent permanent establishments and preparatory and auxiliary services were discussed. There was also a discussion as to the role that the PE concept will continue to have in international tax policy going forward since tax policy seems to be moving away from that direction.

In a panel focused on the UN Model, various changes made to the UN Model in the 2017 update, largely related to BEPS, were discussed. It was concluded that the UN Tax Committee may have accepted many provisions from the BEPS project without deeper deliberation as to the possible impact on developing countries. General opinion in this panel was that the OECD continues to have mostly capital exporting countries as its members and irrespective of the inclusion of developing countries in the Inclusive Framework, the UN Model would still have a key role to play for developing tax treaty policy that is suitable to developing and the least developed countries. A panel focused on the newly introduced Indian Goods and Services Tax also considered major issues surrounding implementation of the new tax in India.

Finally, two panels dealt with new technologies and their impact on international taxation respectively. Here, speakers from a technology background explained the working of blockchain technology and how it could help in taxation, both from the side of the taxpayer and the tax administration. The panel on the impact on international taxation went one step further and introduced the idea of a digital tax administration and how technology could aid everything from compliance to dispute management.

5. Conclusion

In light of all that was discussed at the conference, it is clear that the post BEPS world is as uncertain or perhaps, even more uncertain than before. Not only does the implementation of the BEPS project in terms of domestic law changes, exchange of information requirements and treaty changes through the MLI present a trying challenge to States and taxpayers, but the looming giant - lack of consensus as regards allocation rules and taxation of the digitalized economy - also increases the complexity of the situation.

However, the conference provided a forum for international tax experts from all quarters including practitioners, Government representatives, judicial officers, academics and policy representatives to engage in an open discussion, challenging each other's' views on these issues. The outcomes from this conference will hopefully feed into the work that is being done at the OECD and the UN and it is clear that international tax policy will improve in general owing to such gatherings.

SPECIAL ADDRESS BY MURRAY CLAYSON*

Murray Clayson

Good morning everyone, and many greetings to all of you in Mumbai, from London.

Just as with last year, my friend Professor Roy Rohatgi asked me to provide a greeting message by video on behalf of the International Fiscal Association, along with a brief technical offering. As before, I'd love to be there with you in person, but I hope this format will provide a reasonable second best.

We are now some three months on from a fantastic IFA Congress in Seoul, South Korea. There we enjoyed an excellent scientific programme, and of course some superb social, cultural and culinary tastes of the country. I expect many of you will have been there. We were delighted that, in the end, around 1,600 delegates attended. That was a wonderful outcome, given that, this time last year, we were, to say the least, a little anxious about the security position. So whatever one makes of the unusual diplomatic initiatives in the springtime in that part of the world, at least we were able to enjoy a calm and peaceful week in Seoul in September.

Those of you that were in Seoul for IFA may have heard me comment upon what I described as the "globalisation" of international tax. This is most strikingly observed through the work of the BEPS project, and especially the rolling out of the programme across the Inclusive Framework, now numbering some 1231 country members. When one turns to the *transparency* agenda, the size of the club is even more impressive. The Global Forum on Transparency and Exchange of Information for Tax Purposes now lists 154 members. And the Common Reporting Standard has more than 3,200 bilateral exchange relationships.

IFA is itself these days an organisation with its own global outlook. We now number more than 13,000 members from 114 countries and 71 national branches.

This year was IFA's 80th birthday, so we had a nice party in the Association's 1938 birthplace in Rotterdam along with our twin sister IBFD. But despite IFA's European origins, the world is now a much larger place for us. We have enjoyed our 4th Asia-Pacific Regional Conference in Taipei in April this year and, also in the springtime, the Latin American Region met in Costa Rica. We are working on progress in Africa, and especially using as a focal point the 2022 Cape Town Congress.

And we are now in the advanced stages of preparation for the 2019 London IFA Congress which will take place at the Royal Festival Hall next September. I very

** This is Verbal Copy of Special Address by Murray Clayson. President, IFA Worldwide*

much hope that many of you will be able to join us then. More of that in a moment.

In my video presentation for you last year, I offered a few thoughts about the ever-growing importance of economic and commercial *substance* in international tax structures. Developments on that front continue apace, and I expect the topic may pop up in your programme more than once over the coming days. Of course, substance is at the heart of the BEPS project.

But from the perspective, at least, of my own practice, the biggest noise over the last year has been around reforms to the tax treatment of the *digitalised economy*. You will know that this found its place at the top of the BEPS billing, at Action 1. I see that it will be one of the key sessions in your conference, and I don't intend to trespass upon that.

Nonetheless, I thought you might be interested in a brief update on the UK's own proposals for a digital services tax. I think of India as having led the way on this front with its 2016 equalisation levy upon on-line advertising revenue; but it came as something of a surprise, to me at least, when last year's UK autumn Budget announced a consultation on the introduction of a revenue-based digital tax in the UK.

This initiative has now moved to the next stage with an expanded consultation2 published with the 2018 Budget last month. What is now contemplated, as we hear so often these days in pursuit of supposedly "fair" taxation, is a 2% tax on certain digital revenues, designed to capture that elusive "value created by user participation". This is projected to raise 1.5 billion pounds over the next 5 years.

The business activities in scope will be social media, search engines and on-line marketplaces, bringing to mind certain familiar household names. The tax is designed to attach to UK source revenues (though there may be interesting practical challenges in tracking and identifying these, both qualitatively and geographically). All third-party revenues from in-scope businesses, and linked to the participation of UK users will be taxable – whether from on-line advertising, subscription fees, sales of data or otherwise. The provision of payment services, the sale of own goods online and the provision of on-line content, will be out of scope.

The UK Government has said that the new tax will apply from April 2020, and businesses will be taxable if they generate more than 500 million pounds in global annual revenues from in-scope activities, to-

gether with more than 25 million pounds in annual revenues linked to the participation of UK users.

Small businesses and start-ups are intended to be protected by making the first 25 million pounds of UK taxable revenues exempt; and there will be an elective "safe harbour" permitting an alternative calculation of DST by reference to profit margin – intended to assist businesses with low margins and loss-makers. DST will be deductible in computing profits subject to corporation tax, but not creditable against corporation tax. Of course, that will only be of use to UK corporation tax paying companies. The potential for double taxation is significant, including double DST where there is overlap with another country's system.

Both in the UK, and in relation to the similar, but different, initiatives by the EU in the same area, much has been made of revenue-based digital services taxes being of an "interim" nature. This appears now to be gaining some traction in Europe, and the Government has said that the UK tax will include a provision requiring a review in 2025.

Many people hope, of course, that the OECD's work will lead to a broad international consensus around a new long-term model of taxing the *profits* of digitalised businesses, so that the rash of revenue or turnover taxes, now emerging across quite a few countries in an uncoordinated way, can indeed truly be viewed as temporary measures.

Let me turn to something a little different, but which still sits within the overall philosophy of the BEPS programme, and specifically the desire to capture more taxation on income derived from high value intangibles located in low tax territories.

This is another new UK initiative, and, like the DST, makes a connection with income derived from UK sales. So, once again, the focus of taxation is homing-in on earnings from consumer markets, rather than placing heavy reliance on traditional notions of tax residence.

Not satisfied with the modern UK diverted profits tax (DPT), and expanded royalty withholding tax rules applicable to non-UK IP owners, the UK's Finance Bill3 now proposes to extend the reach of income tax to catch so-called "offshore receipts"4 in respect of intangible property.

This will be a new direct income tax charge on persons located in a country where the UK does not have a double tax treaty containing a non-discrimination provision, and where so-called "UK-derived amounts" arise. That is to say, income is generated by intangible property which is referable to the sale of goods or services in the UK. Again, the charge is on the *gross* income that is so referable. There will be a 10 million pounds *de minimis* UK sales threshold.

A paradigm case might be that of a multinational IP-rich group (again, it's tempting to frame an illustration assuming a US parent), with high value intangibles located in a tax haven, perhaps somewhere sunny in the Caribbean. The IP is then licensed to a manufacturing hub (dare one imagine Ireland?) for the production of goods, perhaps electronic products. Those goods are then sold into consumer markets, including the UK, perhaps through limited risk distributors. As you will perceive, the *royalty* flow goes from the Irish manufacturer to the Caribbean IP holder which, at first sight, does not look like the sort of UK source income which we would typically be expected to attract UK withholding tax.

In fact, the proposal has moved away from attempting to impose a withholding, and instead asserts a directly assessable income tax liability against the IP holder, assuming that its tropical location does not have a comprehensive tax treaty with the UK. Substance features again – via an exemption when all, or substantially all, of the business activity in relation to the intangible property has always taken place in the territory of residence. Joint and several liability will enable collection of the debt from connected persons. And this new basis of charge is fairly imminent, commencing in April next year.

So here we have yet another example of the extension of territorial taxing rights beyond traditional concepts, and all consistent with: the war against stateless income; seeking to maximise tax on income derived from high value intangibles; and shifting taxing jurisdiction from reliance on residence to consumer market-based concepts.

I hope these two brief illustrations of what the UK is up to in the international tax field will have been of interest to you. Certainly these sorts of topics, and indeed the fast-moving revolution in digital taxation more generally, will feature significantly at the IFA London Congress next autumn.

So, with that, please allow me to conclude, but also once more to send my very best wishes from London,

both personally and on behalf of IFA. I have no doubt you will be enjoying an excellent few days of the highest level of tax debate and discussion in the amazing city of Mumbai. I look forward to seeing many of you in London next year.

Murray Clayson
President, International Fiscal Association

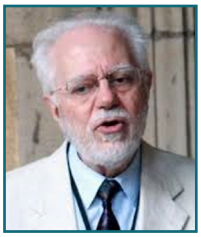
[1] Cape Verde joined the IF after the recording of this presentation to make124 members.

[2] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754975/Digital_Services_Tax_-_Consultation_Document_FINAL_PDF.pdf*

[3] Clause 15 of and Schedule 3 to the Finance (No.3) Bill 2017-19, published 6 November 2018, available at: *https://publications.parliament.uk/pa/bills/cbill/2017-2019/0282/18282.pdf*

[4] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752176/Offshore_receipts_in_respect_of_intangible_property__previously_Royalties_Withholding_Tax__-_Summary_of_Responses.pdf*

INTERNATIONAL TAX IMPLICATIONS OF DIGITALISATION OF THE ECONOMY



Sol Picciotto

Session Chairman: Mr. William Morris, USA

Panel Leader: Mr. Sol Picciotto, UK.

Panelists: Robert Danon, Switzerland - Sriram Govind, Vienna WU - Mindy Herzfeld, USA -Akhilesh Ranjan, India - Mike Williams, UK - Rasmi Ranjan Das, India - John Peterson, OECD Sam Sim, Singapore - Jeffrey Van Hove, OECD

The FIT conference was held at an opportune moment, overlapping slightly with a meeting in Paris of the Task Force on the Digital Economy (TFDE), which was due to report to a meeting of the Inclusive Framework on base erosion and profit shifting BEPS a month later.

Due to this overlap, the session on the first day aimed to take stock of the issue and discuss possible ways forward. On the second day we had the benefit of hearing the hour-long presentation from Pascal St-Amans of the OECD, a substantial part of which covered the work of the TFDE, especially the progress made at the meeting which had just finished.

Day One Session

The session began with a video presentation from William Morris, the deputy global tax policy leader at PwC, and chair, business at OECD (BIAC) Committee on Taxation and Fiscal Affairs. He recalled the extensive work done by the OECD over fifteen years ago on tax consequences of e-commerce, which at that time recommended that no changes were needed to international tax rules. Nevertheless, the Ottawa taxation framework principles remain important: neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility. The challenges today are more acute, but he urged all involved in the process to keep these principles in mind. Nishith Desai, the panel chair then introduced the session with wise words pointing out the importance of the issue and recalling India's efforts towards finding a solution. The session was facilitated by Sol Picciotto, emeritus professor at Lancaster University and senior fellow of the International Centre for Tax and Development.

The first part of the session examined short-term measures introduced or proposed. Sriram Govind, **currently a candidate in the** doctoral program in international business taxation at the Vienna University of Economics and Business (Wirtschaftsuniversität Wien), gave a presentation comparing the EU digital services tax proposal to the Indian equalization levy, highlighting how they are essentially different. While the former deals with targeted services that focus on user monetisation such as advertising, platform facilitated transactions and data sharing, the latter is broader in principle, but is presently restricted to advertising services. Moreover, the former grants taxing rights to the state of the user accessing such digital services while the latter retains taxing rights with India if the service recipient (and not the user) is located in India.

The next presenter, Prof. Robert Danone, of the University of Lausanne, argued that although such short term solutions are stated to fall outside the scope of tax treaties (since they are not income taxes), it is questionable whether such a view can be upheld since the scope of Article 2 (taxes covered) in tax treaties is broad, and since intentionally avoiding tax treaty coverage may be considered a breach of the principle of *pacta sunt servanda*. The panel also took the view that although short term solutions may be effective in generating revenues from digital companies without much complexity, they are blunt instruments, unrelated to actual profits, and their burden falls on consumers. Furthermore, different rules interacting together (such as the proposed EU tax and the Indian levy) can create double taxation of income, the initial problem that tax treaties sought to resolve. In light of this, it was concluded that an effective long-term solution is urgently required.

The second part of the session explored possibilities for a long-term solution. Mindy Herzfeld of the University of Florida presented an overview of the two main issues. The first is revision of the definition of taxable presence, for which India has proposed the concept of 'significant economic presence', based on a volume of transactions or the 'systematic and continuous soliciting of business activities' including interaction with users, while the European Commission's proposal suggests the 'supply of digital services

through a digital interface' with thresholds of 7m euros in revenues, or over 100,000 users, or 3,000 business contracts. These would probably require changes to tax treaties, although it may be possible to interpret the UN model's provision for a service PE to allow recognition of a taxable presence for such significant digitalised activities. The second is the criteria for allocation of income, for which the EU Commission has proposed ways of building on existing transfer pricing rules, by creating a presumption that the profit split method should be used, and designating specified factors to be considered as economically significant, such as DEMPE functions for intangibles, as well as data, user-generated content, sale of advertising space, making third party content available and supply of digital services.

Mike Williams, director of business and international tax of the UK Treasury, presented the rationale for the UK government's suggestion that the key factor in the digitalised economy is the participation and engagement of users, reflected for example through provision of content or contribution to intangibles such as a brand. Hence, the UK favours reform of allocation rules to take account of the value of user participation. Akilesh Ranjan the Principal Chief Commissioner of Income Tax, member of the CBDT and former Competent Authority of India, opined that focusing on users was too narrow, and overlooked the broader transformations wrought by digitalisation on all economic activities. Consequently, wider criteria for allocation should be adopted, including consideration of fractional apportionment. John Peterson for the OECD summarised the work done by the Task Force on the Digital Economy under BEPS Action 1, including its latest interim report of March 2018, and mentioned some of the issues on the agenda for its meeting that same day in Paris.

Day Two Session

This was immediately preceded by the keynote address by Pascal St Amans, which included an update on the latest discussion of the Task Force. He stressed the importance being given to this issue by political leaders especially in the G20, and expressed optimism that there could be a major announcement in 2019 which would open the way to agreement on a solution by 2020. He outlined the three main proposals that had been discussed by the Task Force, in two pillars. On the first, the allocation of income, it was agreed that measures were needed which would go

beyond dealing with base erosion and profit shifting, to reconsider the allocation of taxing rights. The two main proposals were the UK's analysis of the key role of user contributions, which however did not meet the concerns of other countries for a wider allocation of taxing rights where there are significant sales volumes not necessarily linked to user contributions. The US proposal, not limited to highly digitalised activities, would allocate greater rights to the market jurisdictions due to the value contributed by marketing intangibles, which is already recognised to some extent in the OECD Transfer Pricing Guidelines. The other pillar is a Franco-German proposal for a minimum tax, applying to both inbound and outbound investment, modelled on the provisions in the 2017 US tax reform for the Global Intangibles Low-Taxed Income (GILTI) and the Base Erosion Avoidance Tax (BEAT). In reply to a question, Mr St Amans confirmed that since this concept could be regarded as compatible with existing tax treaties, it could be adopted by a coalition of willing countries, and it would not require complete consensus. A report from the Task Force would be considered by the full Inclusive Framework for BEPS at its meeting in Paris in January.

This set the stage for the panel to debate these options. Mike Williams again argued for the distinctive feature in the digitalised economy of user contributions, and he counselled that the negotiators should not try to be over-ambitious and 'bite off more than we can chew'. Sam Sim, a Singapore practitioner (formerly with Microsoft) stressed that in view of the rapid changes in business models clear and sustainable long-term solutions were needed – we can't have the 'law of the jungle'. Rasmi Ranjan Das, Joint Secretary of the Central Board of Direct Taxes, said that a new definition of taxable presence was clearly needed; also, a new approach to allocation of income to rebalance the claims of residence and source jurisdictions, including as source the country where services are delivered. Such an approach could build on the profit split method, or even adopt fractional apportionment, which he pointed out was still permitted in the many tax treaties based on the UN model, or even the pre-2010 OECD model. Jeffrey van Hove, formerly of Amazon, who had recently joined the OECD as head of its Tax Treaty, Transfer Pricing and Financial Transactions Division, stressed the difficulties of resolving the challenging problems facing negotiators. He said that while it is easy to see the faults of existing rules on transfer pricing, it is harder to find an effective solution. He expressed some support for the UK arguments, saying that attribution of value to users would likely be part of any solution, and and suggested that even modest reforms would constitute some advance.

As regards the proposal for a minimum tax, Mike Williams pointed out that it may face obstacles under EU law in view of the Cadbury-Schweppes decision on controlled foreign corporations. Mr Das also indicated possible difficulties, notably in agreeing on a minimum effective tax rate, and pointed out that it would be complementary to proposals on criteria for allocation of income, which are anyway necessary.

Subsequent Developments

Reports of the meeting of the Inclusive Framework that took place on 23 January 2019 bore out the prediction of Pascal St Amans of a major announcement. In addition to the proposals that he had outlined, it seems that a paper was also tabled from the G24 group of developing countries, prepared by a working group consisting of Colombia, Ghana, and India. This paper reflected the suggestions that had been made by Mr Ranjan and Mr Das in the FIT conference sessions. The concepts in this paper were summarised, together with the others that had been discussed at the FIT conference, in a consultation document issued by the OECD on 13 February, inviting comments, which would be debated at a public event on 13 and 14 March. So FIT conference participants had been given privileged insights into the discussions on this key issue at a crucial moment in the debates.

BLOCKCHAIN TECHNOLOGY: THE ADVANTAGES AND ISSUES

Neil Pennington

In the digital age, now and increasingly in the future, who you are and who you trust … Matters. The world is becoming more digital; more connected; more decentralised and is changing the way we run our daily lives, from paying for things, transferring money across borders, exchanging messages with friends, travelling, and managing energy and supply chains, safely and securely … forever.

An often-quoted phrase is that "data is the new oil"; this phrase misses the point completely. In this new digital world data is not simply a "commodity" that "flows around the system", to be valued and traded in commodity terms; it is something much more fundamental than that.

With this increasingly digital transformation comes an exponential increase in the number and type of transactions to millions and billions per day; from person to person; from person to device (such as an autonomous vehicle or smart home controller); increasingly from device to device.

"The institutions and processes upon which we rely are rapidly becoming obsolete"

At the same time that this digital transformation is taking place, there is also a fundamental shift occurring in society; people's expectations are changing about their place in the world and how they are treated. This is exemplified by 3 factors:

There is a fundamental mistrust of anything established and "large" (government, big business): from the unfolding anger on both sides regarding how to make Brexit happen, to Donald Trump's use of twitter, expectations about the citizen's role in how decisions are made on their behalf has become polarised and changed forever.

Everything must work on a smart phone or not at all: this is not a "strategic choice" for business or government; it is a given.

User experience for services, things and content must be immediate: entertainment accessed anywhere, anytime, on any device from Netflix and Amazon; algorithms deployed by Facebook and Google to tailor content to the individual; Artificial Intelligence in everything to enable service and utility for all at an affordable level.

People are finding a way to bypass the established "way of doing things around here" to make the system and technology work for them. A shining example of this has been in Africa, where the rise of m-pesa saw the underbanked and those badly served by traditional banking and payment providers, transform the system through the use of mobile phones.

So, we have a "perfect storm:

- A fundamental shift to digital and decentralisation, involving the need to execute billions of global transactions on a daily basis, disrupting traditional business models forever, combined with
- A seismic shift in people's expectations of how they are governed and served.

Something different is needed.

"A new digital infrastructure is required, to empower the individual and remove the need for trust"

Until now, there has been one thing missing to enable the transformation; an underlying fabric that allows frictionless interactions between individuals and devices to occur, removing the barriers created by a lack of trust, out of date processes and closed systems that exist today … ***in short, the phenomenon widely known as the Blockchain***.

It is the emergence of the decentralised "internet of value", represented by blockchain and distributed ledger technology, that is providing the platform for true disruption of business models and empowerment of the individual across the globe.

"The key enablers: Distributed Ledgers (Blockchain), and Digital Identity"

Although widely known as "the Blockchain", the technology enabling the complete restructuring of everything from payments, healthcare, retail, criminal justice, energy & utilities, banking, real estate, government, to the homes in which we live, consists of three pillars.

Distributed Ledger: a secure way of making and recording transactions, agreements and contracts. Rather than being kept in one place like the more traditional ledger book, the database is shared across a network of computers. The use of complex algorithmic governance and a decentralised node-based network enables the distributed ledger to provide an immutable record of the truth of a transaction, changes everything. A blockchain database consists of blocks and transactions. Blocks contain batches of transactions that are "hashed" and encoded. Each block con-

tains the hash of the block before it, which links the two and forms the chain. This process validates each block, all the way back to the original, and is integral to the database's security.

There are three types of Distributed Ledger models in existence:

- *Public Blockchain*: a distributed ledger that uses a native digital currency to incentivise the operation of a network without the need for trust, for example Bitcoin, Ethereum.
- *Enterprise (Private) Blockchain*: a distributed ledger that relies on consensus achieved via a network of trusted nodes, for example Hyperledger, R3, Ripple.
- *Hybrid Model*: the future for use cases, such as energy and health, where frictionless access to the public is required but rules and regulations are needed in the network - built on public blockchain infrastructure but with some form of permissioned node governance in place to provide regulatory governance and privacy for secret transactions.

In all cases, decentralisation and immutability is the benefit provided – inherently more secure than centralised databases and significantly resistant to error and fraud.

Secure Digital Identity: Unless we have absolute confidence that the individual or device we are transacting with a) has a recognised set of credentials and b) is authenticated and authorised on a persistent ongoing basis, then a trust-less decentralised network will breakdown. A "reputation layer" on top of the blockchain with the appropriate Level of Assurance (LoA) will be required; at the highest level this will involve private keys and 3 factor authentication (something you have, something you are, something you know).

Strong cyber security: a new infrastructure based on a provable, immutable system of record, combined with secure digital identity needs to be underpinned by strong cybersecurity. This requires strong key management, use of trusted execution to enforce protected execution of authenticated code, confidentiality, authenticity, privacy, system integrity and data access rights, and encryption of the transport layer for data in transit.

So, what are the types of use cases that can be supported and what do we need to look out for as legal and tax professionals?

"The uses of blockchain are many and increasing"

The number and scope of use cases for blockchain are many, increasing and cover a range of industry sectors:

Automotive

- Track truthful, full history of vehicle from pre-production to sale
- Supply chain parts management

Banking, Financial, Fintech

- Streamline payments processing with high efficiency, fast and secure transactions
- Empower global transactions, tearing down national currency borders
- Minimize auditing complexity for any financial ledger

Charity

- Tracking donation allocation, accountability, integrity
- Reduce overhead and complexity of donation payment processing

Commercial Vehicles and Transportation

- Tracking journey stops; paired with IoT to create an immutable ledger of trip data

Credit History

- Make credit reports more accurate, transparent, and accessible

Donations

- Provide auditable trail for donations to prevent fraud
- Ensure crowdfunded campaigns receive donations and contributors are compensated

Education

- Digitizing, verifying academic credentials
- Federated repository of academic information specific to class, professor, and student

Energy

- Certification of renewables from generation to supply
- Grid decentralisation and enablement of smart grids
- Peer to peer energy trading
- Community energy

- Fractional financing of assets
- Electric vehicle charging and payments
- Smart utility metering

Forecasting

- Combined with machine learning algorithms, blockchain can provide a decentralized forecasting tool

Government and Voting

- Reduce voter fraud, inefficiencies with verifiable audit trails
- Minimize government fraud, digitize most processes
- Increase accountability and compliance for government officials
- Identity validation; integrity of citizen registry data

Gun Safety

- Tracking gun ownership and possession related information
- Tracking criminal ID history and attempts to purchase

Human Resources

- Background checks: Verification of identity, employment history
- Payment and benefits process validation—smart contracts

Insurance

- Improve multi-party contracts
- Streamline risk contract efficiency
- Streamline claims adjudication
- Reduce disputes with transparency of shared data

IOT

- Ability for IoT applications to contribute transactional data to blockchains
- Implications across industries (energy, trucking/transportation, supply chain integrity, etc.)

Law enforcement

- Integrity of evidence, resistance to falsification of case data
- Documentation of time-stamped, chronological chain of facts

Legal

- Smart contracts with defined rules, expiration, and accessibility for relevant parties.

Marketing

- Bypass intermediaries, providing more cost-effective advertising

Media

- Control of ownership rights
- Anti-piracy / copyright infringement
- Use of smart contracts for artist compensation/legal proceedings
- Payments processing—cryptographic, secure, and anti-3rd party

Medical / Healthcare

- Drug Supply Chain Integrity
- Patient Databases/Indexes on blockchain
- Claims Adjudication
- Medical Supply Chain Management
- Transparency and Automation within the patient-to-hospital or patient-to-doctor transactions, including telehealth
- Clinical trial provenance—integrity with an auditable trail of data exchange
- Efficiency, privacy, and ownership of patient health data

Real Estate

- Transparency within agreements
- Verify property information, update and decentralize records
- Reduce paperwork, digitize transactional processes
- Record, track, transfer land titles

Travel

- Passenger Identification, boarding, passport, payment, and other documentation digitized and verified
- Loyalty programs digitization and tracking

Wills and Inheritances

- Smart contracts to determine validity of will and allocation of inheritances

Tax is one area, often overlooked, for which blockchain and digital assets will have far-reaching consequences.

One example of a tax-based use case being developed is being driven by Thomson Reuters who have partnered with a small tech company to provide a blockchain-based solution for existing tax systems, with a pilot planned for the Netherlands. In the pilot, companies will register their invoices to a blockchain network, which will record proof of the invoice (it can be trusted at any later date) and track companies' VAT balances. The existence of a shared and immutable record of all transactions means companies would no longer need to file a VAT return (instead they are simply assessed by the tax authority), they would not need to share unnecessary detailed data with the Tax Authority (enhancing privacy in the VAT system). One potential consequence of this type of application is the potential to identify traders not in compliance (a problem that currently stands at some $50 billion per year VAT fraud in the EU).

Such a use of the "fractionalisation" possible with blockchain technology opens up significant opportunities for the collection of tax, at source.

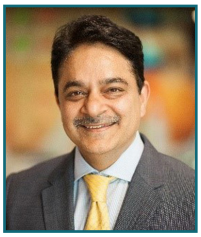
Currently, there are many use-cases in operation across multiple applications, from finance to real estate, healthcare, energy and supply chains; there are also multiple protocols in use from open permissionless chains to private, permissioned, and the ground-breaking chains that combine aspects of the two such as the Energy Web Foundation.

In the near future issues of scalability will be solved through the interoperability of different chains, through developments such as polkadot.

From a tax perspective this will raise issues of complexity as tokens from different chains will be created, retired, exchanged and converted to enable interoperability. Such tokens are likely to have different values, and there will be an even greater need for tax authorities to have a technological understanding.

We have seen that it is the smart contract that defines the conditions that must be satisfied for complex digital transactions to be executed on the blockchain; in actuality the smart contract is computer code; in reality it will represent the new legal framework; such a regime has a number of legal and practical issue that need to be considered.

THE HOLY GRAIL OF TAX CERTAINTY IN POST BEPS ERA



Mukesh Butani[1]

Surabhi Suri[2]

Tax Certainty is a vital element for the benefit of the taxpayers as well as the revenue authorities. In an event of uncertainty, taxpayers are left at the fate of codification of the tax laws, its interpretation thereof, and an inevitable transition period for tax trials to reach finality. With the advent of MLI, and its current rudimentary nature, the teething problems can be done away with, if we have predictable reflexes of the nations. Even though the impetus of the BEPS/ MLI initiative was to circumvent the tax uncertainty transpiring from unilateral actions, the BEPS initiative itself has led to uncertainties for MNEs. In this regard, the OECD and the IMF were requested to analyse the problem of tax uncertainty to aid the policy makers in September 2016 at the G20 Summit held at Hangzhou, China. A comprehensive report was submitted in March 2017, and an additional updated report has been submitted in July 2018. The comprehensive report of 2017 on tax certainty, commented that by ensuring the consistent adoption, interpretation and implementation of the minimum standards, it could increase certainty in the international tax system.

Additionally, the 2017 report noted the cause of uncertainty which is the tax law design and implementation issues; to curb this IMF supports its member countries with the design and drafting of anti-avoidance rules, including by reviewing its consistency with existing rules against international standards in the context of IMF surveillance. A good example is the Danish tax system, many of whose anti-avoidance rules have been incorporated in the BEPS recommendations and the EU's Anti-Tax Avoidance Directive (ATAD)[3]. The updated report discusses the developments which are important for tax certainty, however, they were not discussed in the 2017 report and analyses measures to prevent and resolve tax disputes. The author in this article attempts to analyse the interplay of tax certainty with the policy of abuse prevention under the MLI.

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[1] The essay has been reviewed by Mukesh Butani, Founder BMR Legal who was a panellist in the session, Treaties and Tax Certainty under MLI chaired by Prof. Robert Danon, Chair, Permanent Scientific Committee, International Fiscal Association.

[2] Surabhi Suri is an Advocate; an alumnus of Faculty of Law, University of Delhi & National University of Singapore. She is an Associate with BMR Legal Advocates.

[3] "2018 Article IV Consultation-Press release and staff report"; IMF Country report no. 18/177; IMF; 2018

Anti-avoidance rules

BEPS envisages two minimum standards included in the MLI relating to, 'Prevention of Treaty Abuse' and 'Improvement of Dispute Resolution'. Many jurisdictions have however bypassed the BEPS and legislated specific measures in their respective domestic laws, though in line with the principles of BEPS though taking away its basic essence by unilateral actions. OECD recognises that certain design features of these uncoordinated and unilateral actions are common and can be therefore grouped under four categories:

- Alternative applications of the PE threshold

  Several countries have responded with tweaks in its domestic laws to amend their PE definition, by including the new business models and structural changes of the MNEs. There is an eventual decline for the requirement of physical or permanent presence of place of business to establish its taxing rights, and therefore the emergence of new concepts such as 'agency PE', 'virtual PE', 'significant digital/ economic presence' are defining the new rules for nexus-based tax. Measures such as the Israel's 'significant digital presence' approach, Kuwait and Saudi Arabia's 'virtual service PE', Turkey's 'electronic place of business' and 'electronic taxpayer' and India's 'significant economic presence', are notable examples.

- Withholding taxes

  The idea behind such measures by the source jurisdiction is generally to assert taxing rights even on non-residents without any physical presence in the jurisdiction of consumer of services. DTAAs create a distributive rule regarding passive incomes such as dividends, interest, and royalties, allowing the source state to impose withholding taxes on a gross basis with residual rights to tax on the resident state. These source jurisdictions have started expanding the scope of 'royalties' embracing payments for data transmitted through information technology, payments for 'use' or 'right to use' software, among others; adopting withholding taxes for technical services, given that OECD now recognises that large number of services are supplied without any physical presence.

- Turnover taxes

  Measures to tax suppliers of goods and services, integrate them with the broader approach of nexus-based tax generally applicable to residents and non-residents. This ensures a level playing field between domestic and foreign suppliers as well as maintains tax neutrality. However, an underlying risk of such taxes is the eventual shift of burden from the taxpayer to the end-consumer. Measures to note are the India's 'equalization levy', Italy's 'Levy on Digital Transactions (LDT)' and Hungary's 'advertisement tax'.

- Specific regimes targeting large MNEs

  Measures such as United States' 'base erosion and anti-abuse tax (BEAT)' 'diverted profits tax (DPT)' of Australia and United Kingdom though not aimed at specific business models, however, generally target MNEs with large operations. The aim of these measures is to act like a deterrent for excessive use of base eroding payments by the large MNEs and sound more like anti-avoidance measures rather than revenue mobilization measures such as equalization levy of India.

Nonetheless, such unilateral measures were not an unanticipated response, though it enhances uncertainty; apparently the unilateral responses in line with the minimum standards and best practices were debated and envisaged by OECD in their interim reports, but largely represent lack of consensus on Action Point 1. Constructing the BEPS model sounds straightforward theoretically, while getting all the nations to a consensus to adopt a standardised model treaty, and eventual treaty amendments is strenuous. The anti-avoidance rules have acted as a blessing as short-term deliverables in line with the best practices. These have played a pivotal role as they appeal to the jurisdictions as a band-aid solution and due to their effortless collection.

On the other hand, the uncertainty surrounding such actions cannot be brushed away from the standpoint of MNEs. Measures such as equalisation levy, diverted profits tax, etc are protectionist policies of abuse prevention, which makes it harder to coordinate and align the policies by a solitary international organisation.

To ensure that the BEPS minimum standards are applied harmoniously, there is an ongoing peer-review monitoring system in place, which reports periodically regarding its application to various jurisdictions.

Judicial uncertainty

Another dimension of tax uncertainty is the arbitrariness of judicial orders whilst the dust settles on BEPS implementation. Nearer home, Indian judicial authorities are divergent on several issues; to pick one would be the contrasting opinions in differentiating the transfer of 'right to use' from mere 'use of technology'. ITAT in Yahoo India[4] and Pinstorm Technologies[5], upheld that the payment made by the resident taxpayer to non-resident for uploading and display of banner advertisement on non-resident's portal would not be liable for tax deduction at source, in absence of any PE of non-resident in India. However, the ITAT in Google India[6] held to the contrary that the payments made by the assessee to a non-resident for purchasing advertising space for resale to advertisers in India constituted as 'royalty'. Evidently, the income characterisation and contribution of a specific process in the value chain has been an interpretive challenge.

The OECD is working on a project to identify and study the most disputed articles of the OECD Model Tax Convention in courts and in the MAP (Mutual Agreement Procedure) cases, which will promote consistent tax treatment across jurisdictions.[7]

Improvement of dispute resolution has consistently been on the agenda for tax administrators and academicians, the same is recognised by the OECD; refining it has been an integral BEPS endeavour. Action Point 14 with implementation of minimum standards and best practices enhances the effectiveness of the MAP process. Some of the 'best practices' envisaged by the OECD are access to MAPs for taxpayer-initiated adjustments, bilateral advance pricing agreements, training for tax examiners, suspension of collection of tax disputed during pendency of MAP cases, among others.

Several countries are joining the bandwagon of mandatory binding arbitration in their respective bilateral agreements, which to a certain extent does away with the uncertainty surrounding judicial orders under domestic law. India, not surprisingly has reserved its position with regard to mandatory arbitration, which seems to be an extension of the line of thought that there is disparity in treatment at the arbitration stage between developed and developing economies, besides citing constitutional constraints. As this was a minimum standard, India has opted for bilateral notification or consultation process.

[4] Yahoo India Pvt. Ltd. v. DCIT; [2011] 46 SOT 105 (Mumbai)(URO)

[5] Pinstorm Technologies Pvt. Ltd. v. ITO; [2012] 54 SOT 78 (Mumbai)

[6] Google India Pvt. Ltd. v. ACIT; [2018] 194 TTJ 385 (Bangalore - Trib.)

[7] "IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors"; Update on Tax Certainty; OECD; July 2018

Conclusion

The OECD package is being tested by several jurisdictions, as the lawmakers want to ensure that their domestic law challenges are reflected in the final report of the OECD. It would not be progressive to assume that even these unilateral measures will get saturated and MNEs will eventually find a way. If there is uncertainty in the global tax paradigm, it is due to jurisdictions implementing unilateral measures. Can OECD figure out a way to curtail such domestic measures as part of inclusive framework is a point of debate.

TAXSUTRA'S SUMMARY OF CONFERENCE*

The Joint Conference between Foundation for International Taxation, India and International Bureau of Fiscal Documentation, Amsterdam kick started with special address by **IFA world-wide President Murray Clayson**. He made the thought provoking statements about the ever growing importance of economic and commercial substance in International tax structures. However, according to him the biggest noise over the last year has been around the reforms to the tax treatment of the digitalized economy.

Mr. Parthasarathi Shome (Chairman, International Tax Research and Analysis Foundation) extensively deliberated upon various articles of MLI. Mr. Shome at the outset posed the question whether there is Resilience or Decline of MLI. While deliberating on Action 8: Aligning Transfer Pricing Outcomes with Value Creation, Mr. Shome commented that "The idea is to ensure that a legal owner of intangibles will become less relevant while activities performed within the intangibles cycle of development, enhancement, maintenance, protection and exploitation will become more relevant." Mr. Shome highlighted importance of dealing with accountability and compliance costs between global tax authorities and MNEs alongwith sharing of revenue pie. Mr. Shome opined that "A heavy-handed reporting under Action Plan 13 as applicable to MNEs is detrimental to global productivity and growth. Otherwise Action 13 could be scaled back in future deliberations reflecting concerns over lagging global growth that were in any event the main motivator of G20's revival while BEPS and revenue increase were only its outcomes."

In the afternoon session, **Ms Monica Bhatia, Head of Global Secretariat, OECD** elaborated on the current status on exchange of information (EOI) covering automatic EOI, EOI on request, exchange of rulings, etc. She stated that in the year 2018, EOI has become reality and it will intensify in 2019. She also remarked that in future countries may enter into bilateral agreements so as to use the information exchanged to tackle other crimes and corruption. Further, the Panel headed by **Mr Milind Kothari (Managing Partner, BDO India LLP)** discussed Tax Technologies.

Panel discussion on recent tax reforms in the United States covered developments like GILTI, BEAT, FDII, etc. While discussing BEAT, **Ms Pragya Saksena (Joint Secretary, FT&TR-1, Govt. of India)** stated that BEAT is going to have huge impact on US MNCs having Indian captive affiliates and thus can impact Indian business.

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She said that BEAT is contradictory to provisions of Non-discrimination clause of India – USA DTAA. She also informed that the matter is being discussed with USA authorities.

The panel discussion on '**International Taxation of Digitized Business: Current Scenario' led by Sol Picciotto, (Professor International Center for Tax Leamington, UK**) witnessed active deliberation on the issues of taxing the digital business. **Prof. Govind Sriram (Research and Teaching Associate, WU, Wien, Austria)** extensively elaborated on the comparison between the EU digital service tax with the Indian Equalisation levy. He highlighted that EU digital service tax is targeted tax on the specialized services intending to target user value creation whereas the Indian equalization levy is much broader levy on specified services, the scope of which can be expanded. He further highlighted that EU digital service tax is based on taxable revenues in member State where users are located (IP address/other geolocation) whereas under Indian Equalisation levy, revenues are taxable in India based on service recipient and not users. He further highlighted that that this could lead to double taxation in various jurisdictions with an example. **Ms. Mindy Herzfeld (Professor University of Florida Levin College of Law, Florida, USA)** deliberated extensively on significant digital presence and significant economic presence, highlighting the differences in definition provided by various jurisdictions like Israel, India, Slovakia. She further discussed principles for allocation of income under EU law and touched upon Formulary Apportionment Approach. She stressed upon "Giving countries a right to tax the profits of foreign companies that derive value from a material and active user base within their jurisdiction, even in the absence of those companies having a permanent establishment."

Mr.Akhilesh Ranjan (Principal Chief Commissioner of Income-tax, India) clarified that equalization levy is not contrary to Indian tax treaties and is not resulting in tax dodging. Mr. Ranjan agreed with Mr. Mike Williams that it is difficult to define the digital presence. He stated that the issue is not taxing digital services but it is much broader, considering that in today's scenario business can be carried out without physical presence. According to Mr. Ranjan, the UK digital tax is not really addressing the problem and is half way solution. **Mr. Nishith Desai (Founder and Managing Partner, Nishith Desai and Associates)** suggested out of box solution to the most debated issue of taxing the digital business by suggesting that there should be 'one world one tax'. He suggested that taxpayer should be given a defined global rate and he should be allowed to deposit the tax amount in the escrow account, which later the countries can divide amongst themselves. He stated that this would reduce the hardship for the taxpayer and reduce the considerable litigation. He highlighted the grave problem that under the BEPS regime, the 'base' or 'source' has not been defined globally, which is the first step. He remarked that 'tax terrorism' has now shifted towards 'tax imperialism' whereby more and more countries are encroaching upon the sovereignty of the other countries resulting into extra territoriality. He stated that sovereignty of the countries is getting diluted. He further highlighted that value creation and profits are not same and stated that value creation should be subjected to VAT and not Income-tax.

Day 2 of the conference opened with the address by Mr. **Akhilesh Ranjan (Chief Commissioner of Income-tax, India)** on the BEPS implementation in India. Mr. Ranjan remarked that the earlier known 'tax planning' is now termed as 'abuse of treaty' and elaborated on how unethical things are held unacceptable in present times with an increased focus on 'substance'. Further, he stated that though the genesis of BEPS project does not really address concerns of source countries, India still participated enthusiastically. He demonstrated how well India has implemented the BEPS recommendations by signing the MLI, by adopting most provisions of the MLI, by putting the legal framework in place for the CbCR. However, he highlighted that one of the challenges of current tax system is utilizing the CbCR information for risk assessment process. On BEPS Action 5 front, Mr. Ranjan updated that that "we have offered our supposedly preferential regime to international community for reviews and have not seen any adverse comments on it." Next, with respect to dispute resolution, he expressed that India is committed to resolve MAP cases on time. However, on India's reservation on mandatory arbitration, he opined that the world has not appreciated India's stand of losing sovereignty, in proper context. He explained that "giving up sovereignty in favour of 3rd person who is not your treaty partner, is very strange and beyond comprehension." He categorically clarified that there is no scope for relaxation on this point in near future. He further updated that India will soon ratify the MLI in few months.

On transfer pricing, he pondered "whether arm's length principle has any relevance now or should we go back to – formulary apportionment approach". On the global front, he threw light that US have almost discarded the relevance of arms length standard, while implementing BEAT proposals. Further, he highlighted that arms length principles may not be enough to address profit attribution for digitalized economy and new rules may be necessary.

Lastly, on redrafting of new direct tax law, Mr. Ranjan updated that the work is in progress and he assured that new law aims to achieve India's objective of imparting 'tax certainty'.

Panel led by **Mr. Dinesh Kanabar (CEO, Dhruva Advisors LLP)** discussed BEPS and Indian Tax Policy, Practice and Compliance in future. **Mr. Pranav Sayta (Partner & National Leader – Transaction Tax E&Y LLP, India)** talked about difficulties with respect to the determination of Significant Economic Presence for tax withholding purpose. He said that it is not feasible to do withholding tax compliance in absence of regulations as to threshold and determination of SEP. **Mr. Mukesh Butani (Managing Partner, BMR Legal, India)** pointed out that India is one of 12 countries who have adopted the Principle Purpose Test and Simplified LOB. However, these countries are not India's significant trade partners, thus limiting its impact.

Mr. Pascal Saint-Amans (Director, OECD) delivered a captivating address on the BEPS project progress. He pointed out that in the recent G20 Summit, 8 leaders spoke about tax issues particularly digital economy taxation. Mr. Pascal highlighted that 2018 has been the year of implementation witnessing MLI implementation, exchange of information and rulings, review of more than 100 regimes by Forum for Harmful Tax Practices. He stated that OECD as promised has designed rules and ensured its implementation. He emphasized on substance requirement and stated that even the zero tax jurisdictions need to establish the substance. He further highlighted that exchange of CbC Reports has started and the bigger challenge lies in using that information. He stated that OECD will publish consolidated and anonymised CBC data which would give general public an idea as to where profits are located and where the taxes are paid. Mr. Pascal also highlighted that US Senate has adopted most of BEPS recommendations. While discussing the progress on taxation of digitalized economy, he highlighted that the more fundamental debate is emerging on reallocation of taxing right, revision of nexus rule and limitation of the existing arm's length principle in profit allocation.

The **session on International Taxation of Digitized Business: Recent OECD Proposals led by Sol Picciotto, Professor, International Centre for Tax & Development, UK** witnessed discussions on this debated tax topic. **Mr. Rasmi Ranjan Das (Joint Secretary – TPL 1 Government of India)** reiterated that we cannot focus on specific business models but should look at the larger problem of establishing nexus, reallocation of taxing rights and profit allocation. He further highlighted that despite BEPS Action Plan 1-15, the tax base has not increased to a great extent. The Panel also discussed possible relevant factors which impact value creation and need of guidance from OECD on this aspect. The panel concluded that going forward, the resolution and consensus needs to be achieved in the long term and the shift is required towards profit split approach. Resultantly, once the long term measures are put into place, the interim measures would go away.

The day further witnessed enthralling panel discussions on **Tax Trend in Merger and Acquisition and Judicial Tax Perception of the Permanent Establishment.**

Day 3 of the conference started with panel discussion on **Resolution of Tax Disputes in the post BEPS World.** At the outset, **Justice PP Bhatt, (President of ITAT & Chairman of the session)** outlined the exceptional contribution by Income Tax Appellate Tribunal in tax jurisprudence. Speaking of Action Plan 14, he noted that it does not have a mention about any judicial forum and has mention only about MAP and other alternate dispute resolution procedures. Mr.Bhatt stated that the statutory judicial bodies cannot be altogether ignored in the process of making the judiciary process more effective. **Mr. Rajesh Ramlol (President of IFA, Mauritius)** further suggested that we must have a defined system for dispute resolution and there has to be a standard to enhance the MAP procedures. He mentioned that for a system to be successful, it must have good safeguards and basic basic assurances from the counsels of the parties to abide and respect the outcome of the procedures.

Mr. Jeffrey Owens (Former OECD Tax Policy Director) pointed out that from the perspective of business, Action Plan 14 is very important in view of the increasing number of unresolved disputes. He

noted that the concerns surrounding the arbitration processes particularly the developing countries is the lack of transparency, the cost and the capacity of the arbitrators. He suggested that to make the arbitration process efficient, the countries need to set criterion and qualifications for the arbitrators.

Speaking of peer reviews and its importance in implementation of Action Plan 14, **Mr. Rajat Bansal (Joint Secretary (Foreign Tax and Tax Research) and Competent Authority, GoI)** highlighted that it is based on the inputs sought and provided by various countries that the minimum standards are met and shortcomings, if any are taken care of. Mr. Bansal deliberated that importance of Action Plan 14 is being realised with the increasing MAP inventory and is essentially based on preventing disputes, access to MAP, implementation of MAP and capturing the essence of minimum standards. Rajat concluded stating that Action 14 is going to have a very good effect on the dispute resolution scenario in India.

Justice Pramod Kumar (Member, ITAT) deliberating the need for going beyond BEPS, stated that the arbitration process as outlined in Action Plan 14 though inevitable, is not going to be infallible. Hence, he suggested that the well-established judicial forums in India are to be made best use of. Speaking of the global recognition of ITAT, Mr. Pramod Kumar concluded with a remark that any form of reform in the dispute resolution process without considering the ITAT and other Indian judicial forums may not be efficient.

Justice G.S.Pannu (Member, ITAT) brought out that in today's world, globalised businesses call for globalised tax administration and globalised jurisprudence. He reiterated that ITAT can play a very important role in developing a globalised jurisprudence as the blending of the technical expertise and judicial process in ITAT is unique. Mr. Pannu suggested that we must aim at building a 'resource centre' consisting of all the technical expertise and urged that with the right knowledge, right perspective and globalised jurisprudence development, we may be able to do good with arbitration.

Analysing the staggering volume of pending litigation in India, **Mr. Himanshu Sinha (Partner, Trilegal)**, stated that there is absence of clear rules laid down in acceptance of OECD guidelines in India. He suggested that to to bring about certainty, the Government needs to legislate and crystalise on whether to accept or differ from the Guidelines . He further suggested that ITAT has to be given an option to settle a case in cases where both sides weigh equally. Lastly, Mr. Sinha suggested that CBDT's evaluation approach of Revenue authorities based on their passing of Revenue favour orders has to be relooked at in order to reduce the unfavorable orders and thereby the pending litigations.

Mr. Sunil Moti Lala (Advocate, SML Tax Chamber) began his address by reading out ITAT's motto i.e., 'Nishpaksh Sulabh Satvar Nyay', which means impartial, easy and speedy justice and pointing that it is by far a unanimous view that ITAT is one of the best judicial forums. Given this, he explained that it is because of the journey prior to ITAT (hassles at the assessment and DRP levels) and post ITAT (further appeals by Revenue to High Courts) that makes one think of alternate dispute resolution options. Mr. Lala pointed since, the Government has not been able to make the pre and post journey easy for the citizens, MAP and thereby Action Plan-14 have assumed importance.

The session was succeeded by captivating discussions on **Impact of New Technologies on International Taxation and Artificial Avoidance of Permanent Establishment Status under Action 7**

Later, panel on **Transfer Pricing Developments** led by **Mr. T.P. Ostwal (Partner, T.P. Ostwal & Associates)** deliberated on the future of Arm's Length principle especially in light of BEPS Actions 8-10 on Transfer Pricing and OECD's Revised Guidance on "Transactional Profit Split Method". At the outset, Mr. T.P. Ostwal expressed that countries are now leaning towards formulary apportionment/ profit split method, especially post BEPS Actions 8-10 proposals and new ideas are emerging in this regard. On intangibles, **Mr. Vijay Iyer (Partner, Ernst & Young LLP)** stated that Action 8 contemplates that intangibles will arise where the critical value drivers are located (tested on the basis of DEMPE functions) and since *"DEMPE is likely to be spread across jurisdictions… countries are inclining towards profit split approach"*. He further clarified that qualitative factors should determine local intangible creation and cost incurrence itself is not determinative of DEMPE.

Mr. Rahul Mitra (Partner, Dhruva Advisors LLP), with the help of a case study, then explained the practical scenario of applying profit split method in respect of marketing intangibles in case of a distrib-

utor & manufacturer. Thereafter, Panel then pondered over an interesting aspect of whether market can be considered to be an intangible, thus leading to FARM over FAR analysis. In this regard, Mr. Ostwal informed that developing countries like India and China are strongly suggesting that market should be given importance, especially in the digital world.

Dr. Hasnain Shroff (Partner & Head - Transfer Pricing (West), BSR & Co LLP) then gave an overview of Action 9, stating that risk assuming functions (strategic, financial etc.) will determine where risk is located. He further clarified that the underlying theme of Action 9 is to ensure that inappropriate return does not get aligned to an entity simply because they have contractually accepted risk or contributed capital.**Dr. Petruzzi Raffaele (Managing Director, WU Transfer Pricing Center)** added that taxpayer's functional / value chain analysis is critical and it is important to check the profitability of the whole MNE Group to see if sufficient profits accrue to the entity that is performing the functions. **Mr. Sanjeev Sharma (APA Commissioner)** urged that agreements should be drafted in such a way that they comprehensively reflect of the functions/ conduct of the parties and are not executed just a documentation formality.

On low value adding services under Action 10, the Panel agreed that Indian Safe Harbour Rules address this issue to a large extent even though India has opted out of OECD's proposals on the same under the BEPS Project. The Panel also briefly touched upon the open issues on application of Profit Split Method i.e. absence of guidelines on determining operating cost/ profit, indirect costs, what happens in a loss scenario etc.

Day 3 also witnessed some riveting and enthralling Panel discussions on **Permanent Establishment**s, **Blockchain Technology** and **GST**.

SPECIAL SESSION ON THE UN MODEL DEVELOPMENTS

Radhakishan Rawal

Chairman: Nishit Desai

Presentation: Michael Lennard (Video recording)

Panel leader: Uday Ved

Panelists: Rajat Bansal, T.P.Ostwal, Sol Picciotto, Radhakishan Rawal, Dhruv Sanghvi

Policy Issues

Sol Picciotto, emeritus professor at Lancaster University and senior fellow of the International Centre for Tax and Development, began the session by discussing the challenges facing the UN Tax Committee. With the creation of the Inclusive Framework for BEPS, open to all countries willing to accept the BEPS project minimum commitments, the OECD had become a de facto world tax organisation. Yet it clearly does not have the legitimacy to claim such a global status conferred by the mantle of the United Nations. Coordination through the Platform for Collaboration on Tax does little to correct the institutional imbalances that weaken the voice of developing countries in international tax matters. A central problem continues to be the lack of resources for the UN Committee, with only a handful of staff, a fraction of those now commanded by the OECD. Despite the promises made by states in the Addis Ababa conference on financing for development to increase development aid for tax work, only India had contributed to the UN Committee's appeal for contributions to its Trust Fund, although the European Commission had also provided selective support.

He suggested that despite these obstacles, the UN Committee could do more to carve out policy space. A good exemplar was the achievement of the new article 12A on Fees for Technical Services, which filled an important gap. Regrettably, the subcommittee on BEPS had essentially limited its work to assimilating the BEPS project reports to the UN treaty model. An important issue which seems to have been overlooked was the implications of the revisions to the article 5 definitions of a PE for article 7 on attribution of profits to a PE. The reports produced for the BEPS project on this question were based on the 'authorised OECD approach' (AOA), which had been adopted by the OECD only in 2010, but rejected by the UN Committee. A footnote in the final BEPS report of 2018 on attribution of profits to PEs, resulting from comments by African members of the Inclusive Framework, noted that the report did not intend to extend the application of the AOA to countries that have not

adopted it in their treaties or domestic legislation. Yet no work has been done to clarify how the UN Committee's version of article 7 should be applied to the expanded article 5 definitions.

Another area in which the UN Committee could, in his view, do work which would complement the OECD and help especially small and poor developing countries, was article 9. The UN Practical Manual on Transfer Pricing, revised in 2017, remains a contradictory document. Its Part A provides a very different perspective than do the OECD Guidelines, with a good explanation of the integrated nature of multinational enterprises. Part D is also distinctive, in providing helpful accounts of approaches adopted and difficulties encountered by some leading developing countries. However, the bulk of the Manual essentially recommends the orthodox OECD methods and approaches. In Prof. Picciotto's view, these do not fulfil the Manual's aims of providing a practical approach. His recent research had shown that almost all African countries had domestic legislation allowing adjustment of the accounts of associated enterprises, often modelled on article 9 of tax treaties. Some 17 countries, around half the total, had also adopted more detailed regulations, usually based on the OECD Guidelines, although mostly since 2012. Yet very few of these countries had established a strategy for enforcement. The OECD approach entails an individual facts and circumstances and functional analysis of each entity, requiring specialised knowledge of its business model as well as of the transfer pricing methodologies. This is a daunting task even for developed countries. There is an urgent need to develop simplified transfer pricing methods, which could be easily administered by tax authorities, and reduce compliance costs while providing for business.

UN Model 2017

The UN Model was revised in the year 2017. The main differences between the Articles of this version of the United Nations Model Convention and the previous version published in 2012 are as follows:

- A modified title of the Convention and a new preamble of the Convention emphasizing that treaties should not create opportunities for tax avoidance or evasion, including through treaty shopping;
- A new version of Article 1 that includes a fiscally transparent entity clause, and a saving clause which clarifies that residence taxation is generally preserved under tax treaties;
- A modified version of Article 4 that includes a

new "tie breaker" rule for determining the treaty residence of dual-resident persons other than individuals;

- A modified version of Article 5 to prevent the avoidance of permanent establishment status;
- A modified Article 10 to change the circumstances in which a lower rate applies for dividends on direct ownership of shares above a 25% threshold;
- A new Article 12A to provide for source taxation of fees for technical services;
- A new version of Article 13, paragraph 4 to modify the scope of the land-rich company rule;
- A modified version of Article 13, paragraph 5 for consistency with Article 13, paragraph 4;
- Changes to Articles 23A and 23B to clarify that there is no obligation to provide relief for tax imposed on a solely residence basis;
- A new Article 29 that contains provisions relating to entitlement to treaty benefits. These include a limitation on benefits rule, a third state permanent establishment rule and a general anti-abuse rule.

Further, there have been changes to the Commentaries on the Articles to reflect the changes made to the Articles.

Alignment with the OECD BEPS Project

The changes made to the UN Model in the 2017 update also include BEPS related measures. The measures adopted in the UN Model are broadly aligned to the OECD / G20 BEPS measures. While adopting these measures, the key differences between the OECD and UN Model are also considered. There is no MLI for the UN Model, however the text of the OECD MLI is flexible and can be applied on the treaties based on the UN Model as well. However, if the UN tax committee adopts an altogether new provision which is not included in the OECD MLI (say related to digital economy), then in absence of MLI support the same cannot be included in the existing tax treaties.

Hybrid entities

There is a major change in Article 1 of the UN Model Convention. The updated Model now provides that income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State. The provisions of the paragraph ensure that income of such entities or arrangements is treated, for the purposes of the Convention, in accordance with the principles reflected in the 1999 report of the Committee on Fiscal Affairs entitled "The Application of the OECD Model Tax Convention to Partnerships".

Comparable provision can be found in the tax treaty signed by India with US[1]. As per the provisional reservation, India will not adopt this provision in the Indian tax treaties.

Article 4(3)

Previously, whereby a person other than individual was resident in both the contracting countries then such entity was deemed to be a resident only in the country in which its place of effective management was situated.

Revised paragraph 3 of Article 4 of the UN Model Convention states where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

Historically there have not been many disputes as regards residential status of corporate entities in India. However, with the change in provisions of the tax treaties, if this becomes a major issue, there may be a need to strengthen the Competent Authority mechanism to address the addition work load. If the Competent Authorities take too long to address the issue of residency, it would result in higher uncertainties for the tax payers.

[1] Article 4(1)

Article 12A

One of the major changes in the UN Model is insertion of Article 12A – Fees for Technical Services. This was a work-in-progress in the UN Tax Committee for a long period of time and finally got adopted in the 2017 update of the UN Model. This is not a part of OECD BEPS Measure.

Article 12A can be said to be broadly on the lines of the Article dealing with Fees for Technical Services found in several Indian tax treaties, but contains certain additional features. Most of the Indian tax treaties already have an article dealing with fees for technical services and the treaties where this Article is not adopted the exclusion could be a deliberate exclusion by the treaty negotiators. Article 12A in the UN Model nonetheless is not theoretical from Indian perspective. The UN Commentary on Article 12A could be useful in understanding certain concepts. However, the extent to which such subsequent commentary can be relied for old tax treaties could be an issue[2].

Principal Purpose Test (PPT)

In terms of the principal purpose test a benefit under the Convention 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 this Convention.

The PPT provision is subjective in nature and at the same time also offers adequate escape route to ensure that the treaty benefit is available when it is in accordance with the object and purpose of the relevant provisions of the treaty. OECD Commentary gives good guidance on the interpretation of this provision with several practical examples. Application of PPT would depend on the facts and circumstances of each case and it would be important to have strong substance in the structures.

Digital Economy

The UN tax committee has set a sub-committee to work on taxation of digitalised economy. The sub-committee's work appears to be in initial stages and one will have to wait for some time before the sub-committee comes up with some substantive propositions.

[2] Chapter 12 of book titled Taxation of Cross-Border Services, 2014, Wolters Kluwer publication authored by Radhakishan Rawal contains relevant analysis