



International news and analysis to help you with your international tax strategy.



Focus on: OECD – COUNCIL OF EUROPE Convention on Mutual Administrative Assistance in Tax Matters to be revised

On 6 April 2010 the OECD announced that the OECD and the Council of Europe (CoE) have agreed on an update to an international treaty that aims to help governments enforce their tax laws, as part of the worldwide drive to combat cross-border tax evasion.

The update takes the form of a protocol amending the Convention on Mutual Administrative Assistance in Tax Matters for which the two multilateral organizations are the custodians. Its effect is to align the Convention to the international standard on information exchange for tax purposes by allowing for the exchange of bank information.

The protocol will be opened for signature on the occasion of the OECD's annual Ministerial Meeting in Paris on 27-28 May 2010. This initiative responds to a call by G20 leaders at their April 2009 summit for proposals as to ways to help developing countries secure the benefits of the new cooperative tax environment. The UK's Prime Minister Gordon Brown, as chair of the G20, indicated that "it would be helpful, in this regard, if an effective multilateral mechanism could be developed".

The protocol will enter into force 3 months after the ratification by five parties to the Convention. Equally, a party which ratifies it after the protocol has entered into force will be bound by it after 3 months from the ratification.

Once the amending protocol enters into force, any member country of the CoE or of the OECD, which is not yet a party to the original Convention, will become a party to the Convention as amended by the protocol upon ratification, unless it explicitly expresses the will to adhere exclusively to the un-amended Convention. Non-OECD/CoE countries will only be able to adhere to the Convention as amended by the protocol.

The original Convention entered into force in 1995. It currently groups 14 countries – Azerbaijan, Belgium, Denmark, Finland, France, Iceland, Italy, the Netherlands, Norway, Poland, Sweden, United Kingdom, United States, and Ukraine – with Canada, Germany and Spain having signed it but not yet ratified it. Other OECD and CoE members, including some that are G20 countries, are looking at becoming parties to the Convention, and it is now being opened up to other countries that are not members of either the OECD or the CoE.

This will enable developing countries to become parties to the amended Convention and benefit from the new, more transparent tax-cooperation environment. The protocol provides, among other things, for exchange of information, multilateral simultaneous tax examinations, service of documents and cross-border assistance in tax collection, while respecting national sovereignty and the rights of taxpayers and ensuring extensive safeguards to protect the confidentiality of the information exchanged.

INDIA

Decision on unincorporated JVs

The Authority for Advance Rulings (AAR) delivered a ruling dated 23 March 2010 in the case of Hyundai Rotem Co., Korea and Anr. v. DIT (798-799/2008) wherein the AAR provided guidance on circumstances when an unincorporated joint venture or a consortium should be treated as an association of persons (AoP) under the provisions of the Income Tax Act, 1961 (ITA).

(a) Facts. A consortium agreement was entered into between Mitsubishi Corporation, Japan (MC), Hyundai Rotem Company, Korea (Rotem), Mitsubishi Electric Corporation, Japan (MELCO) and BEML Limited, India (BEML) for the purpose of bidding for, and executing, a project for Delhi Metro Rail Corporation (DMRC). As per the terms of the agreement, a list of skills-set and responsibilities was provided for the members as follows:

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- MC would act as the consortium leader;
- Rotem would undertake the mechanical works;
- MELCO would undertake the electrical works; and
- BEML would undertake the localization works.

(b) Issue. The Taxpayers (MC and Rotem) approached the AAR and requested the AAR to clarify whether the consortium constituted an AoP under the provisions of the ITA.

(c) Decision. The AAR in its decision referred to the meaning of the term "associate" as explained by the Supreme Court of India in CIT v. Indira Balakrishna (1960 39 ITR 546) wherein the Supreme Court elaborated on the term to mean "to join in common purpose, or to join in an action".

The Tax Authorities relied on the decision of the AAR in the case of GeoConsult ZT GmbH (see TNS:2008-08-13:IN-2) wherein it was held that an AoP was constituted. The Taxpayers relied on the ruling of Van Oord Acz BV (248 ITR 399) wherein it was held that an AoP was not constituted. The AAR noted that a thorough analysis of the features of the entity, the work allocation, and the arrangements and the agreements entered into as well as the facts and circumstances surrounding them, were essential in arriving at a conclusion as to the characterization of an entity as an AoP.

The AAR ruled in the favour of the Taxpayers, and held that such a consortium arrangement would not constitute an AoP under the ITA for the following reasons:

- the consortium agreement was entered into only for the purpose of participating in the tender, and clearly stated that the parties did not intend to constitute a joint venture or a partnership;
- each consortium member would only share gross receipts, and be responsible for its respective profits, losses and expenditures;
- segregation of work between the members based on their respective skills-set, such work not being capable of being assigned to or being supervised by another consortium member in case of default by one of the members; and
- separate guarantee and undertakings were given to the DMRC from the parent company of each consortium member for separate scope of work to be performed.

UNITED STATES

IRS updates Publication 901 on US income tax treaties

The US Internal Revenue Service (IRS) has updated its Publication 901 on US income tax treaties. The publication includes a list of all current US income tax treaties together with the general effective date of each and a table with the tax rates for interest, dividends, capital gains, royalties, copyrights, rents, pensions, and social security payments.

Also included are summaries of the relevant provisions of each US treaty regarding taxation of personal services income, taxation of income received by professors, teachers and researchers, taxation of income received by students and apprentices, and taxation of wages and pensions paid by foreign governments.

The publication carries a revision date of April 2010, and was updated to include information for the new US income tax treaty with Italy the new US protocol with France, both of which entered into force at the end of 2009. The publication includes a Reminder section that notes that:

- US taxpayers must disclose treaty-based return positions to the IRS, i.e. positions that US tax is reduced or eliminated by a US tax treaty;
- The US-USSR income tax treaty remains effective for certain members of the Commonwealth of Independent States (i.e. Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan);
- The US-China treaty does not apply to Hong Kong; and
- The US-Iceland treaty signed 23 October 2007 was generally effective on 1 January 2009 subject to an election to apply the prior treaty for a 12-month period.

GERMANY

Ministry of Finance issues guidance on disclosure obligations

In a recently published decree dated 15 April 2010, the Ministry Finance provides guidance on the disclosure obligations set out in Sec. 138 of the General Tax Code (GTC). Section 138 of the GTC stipulates that taxpayer with a permanent home or habitual abode, or place of management or legal seat, in Germany, must notify the tax authorities of:

- the establishment or acquisition of a business or permanent establishment abroad;
- any participation in a foreign partnership or relevant change in such participation; and

- the acquisition of shares in non-resident corporate entities, if the acquisitions results in a direct participation of at least 10% or in an indirect participation of at least 25% of the capital of the non-resident corporate entity, or if the acquisition costs exceed EUR 150,000.

The guidance clarifies that the acquisition of shares in non-resident corporate entities does not trigger the disclosure obligation if the acquired participation is less than 1% of the capital of the non-resident entity, even though the investment exceeds the threshold of EUR 150,000. Further exceptions apply to financial institutions and insurance companies.

In addition, the guidance stipulates that for resident partners in foreign partnerships, if the partnership income is assessed with effect for all resident partners, the disclosure obligation under Sec. 138 GTC may be fulfilled by the foreign partnership or a trustee. If the required information is not disclosed in time or at all, any penalties will be levied on the resident partners.

The information must be disclosed within 1 month after the respective event occurred. If a taxpayer fails to comply with the disclosure obligations, it is considered an administrative offence which will result in a monetary penalty.

INTERNATIONAL MODELS

Guernsey Protected Cell Company

The Island of Guernsey pioneered the cell company concept by introducing the Protected Cell Company (PCC) in 1997, which are widely used across the financial service world as an alternative approach for the structuring of products. As well as adopting the innovative Incorporated Cell Company (ICC), Guernsey has also developed a regulatory infrastructure that enables a particularly wide application of the cellular company concept.

PCCs and ICCs can be formed in Guernsey, to conduct any type of business that would otherwise be undertaken through a conventional company.

A PCC is a single legal entity made up of individual "cells" that can be used to undertake the business activities of many different clients. A cell within a PCC may be owned solely by the PCC owner(s) or individual cells can be owned by third parties. Each cell has its own capital and the assets and liabilities of each cell are ring-fenced by law from the liabilities attributable to any other cell. A PCC has two classes of shares: core and cellular. The core capital is issued to the PCC's owners and attracts voting and distribution rights, but only over the core capital. Cellular shares, in the form of redeemable preference shares, are issued to each cell owner. Cellular shares have limited status, no voting rights, and distribution rights only applying in respect of the specific cell's activities. A PCC is a third party company, and the control of activities in a PCC cell is divested by management contract. In practice, the directors of the PCC would not take action against the wishes of the owner(s) of any of the individual cells. This divestment of control can help to increase tax efficiencies.

Cells within a captive insurance PCC offer similar advantages to the benefits enjoyed by a captive insurance company. A cell behaves in the same way as a wholly owned captive insurance company with respect to its underwriting activities and, as with a captive insurance company a cell remains exposed to potential losses for the risks retained.

Among the others, there is no minimum capital requirement, operating expenses and start up costs are lower. there is the potential to segregate profits from the parent company's accounts

A PCC (or cell) can be used for self-insurance and for the funding of a company's Employee Benefit Trust (EBT).

The company forms an EBT which in turn takes entitlement to the profits of a cell in an existing PCC. This cell is used to self-insure the company. Premiums are paid into the cell and the cell then re-insures in the wholesale market. Profits that accumulate in the cell are then available to be paid as distributions to the EBT and may then be paid out in accordance with the terms of the EBT or held for future distributions (for example when an employee retires outside of the UK).

This has the effect of converting corporate profits into individual employee benefits in a tax efficient manner. In this way, legitimate business expenses (the company's insurance premiums) can be used to fund an EBT.

