Morison KSi

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Editorial

Sachin Vasudeva

At the beginning of 2020, the threat of COVID-19 was not taken seriously by many countries and as the virus spread its tentacles, its impact on people and economies across the world has been deadly. Lockdowns imposed by governments have crippled the world economy, which will require immense support from governments globally if it is to recover.

An important aspect of such support is a tax-friendly approach to global tax issues. Pursuant to OECD recommendations, many countries issued guidance to deal with the unintended consequences of the lockdown. In addition to these tax-friendly measures, it would be useful for governments to help address the transfer pricing (TP) issues arising from the pandemic:

- Low margins due to economic downturn
- Adjustments to TP models if there has been any shift or reallocation of functions, risks and assets
- Change in existing funding arrangements
- Reduction in intra-group margins
- Benefit test vis-à-vis special services provides by head office during the pandemic
- Margins of captive service providers
- Renegotiation of Advance Pricing Agreements APAs.

Documentation would be required to demonstrate that these changes were necessitated by the pandemic, detailing aspects such as:

- Restrictions on movement of people
- Fall in demand
- Disruption of supply chain
- Restructuring carried out, and its impact on the FAR analysis.

Tax challenges apart, the year 2020 is proving to be a very difficult year; while we are just at the halfway stage, people have already started commenting that they will be glad to see the end of it. It seems that on 31 December, we will celebrate not just the start of 2021 but also the end of what has been a particularly challenging year.

I express my gratitude to all the member firms that have contributed to this edition of the newsletter. I sincerely hope that the contents are useful to members and their clients. Feedback and suggestions are always welcome by e-mail to sarah@morisonksi.com.

Sachin Vasudeva

Country Focus AUSTRALIA

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Australian Taxation Office guidance on international tax issues arising from COVID-19

Due to the COVID-19 pandemic, most countries have imposed international travel bans and restrictions. These control measures may give rise to uncertainties to corporate entities and individuals in relation to their tax residency status and related tax issues.

The COVID-19 crisis has also caused unprecedented disruption to businesses. Many corporate groups are facing challenges to meet their tax obligations during these uncertain times.

In response to the concerns of corporate entities and individuals who are affected by the COVID-19 pandemic, the Australian Taxation Office (ATO) has released guidance on the following issues.

Permanent establishment

Foreign-incorporated companies that are not Australian residents may have employees physically present in Australia for an extended period of time due to international travel restrictions. These foreign companies could be concerned about potential effects on their tax affairs because of the presence of employees in Australia.

The ATO has confirmed that the effect of COVID-19 will not, in itself, result in a foreign-incorporated company having an Australian permanent establishment (PE) if it meets all the following criteria:

- The foreign-incorporated company did not have a PE in Australia before the effects of COVID-19.
- There are no other changes in the company's circumstances.

The unplanned presence of employees in Australia is the short-term result of them being temporarily relocated or restricted in their travel as a consequence of COVID-19.

If the above conditions are met, the ATO will not apply compliance resources to determine if the foreign-incorporated company has a PE in Australia.

Foreign-incorporated company's tax residency

A company that is not incorporated in Australia can be treated as an Australian resident for Australian tax purposes if it carries on business in Australia and has its central management and control (CM&C) in Australia. Under the ATO guidelines, if a company has CM&C in Australia, it must necessarily carry on business in Australia.

CM&C refers to the control and direction of a company's operations – the place where high-level decisions are made that set the company's general policies and determine the direction of its operations. A key factor in determining the location of the CM&C is where the board meetings are held.

Some foreign-incorporated companies that are not Australian tax residents may temporarily suspend their normal pattern of board meetings held overseas because either:

- There are overseas travel bans or restrictions; or
- The board has made the decision to suspend international travel because of the present uncertainties around international travel due to COVID-19.

The ATO has confirmed that if these companies instead hold board meetings in Australia or directors attend board meetings from Australia due to the effects of COVID-19, this will not by itself, in the absence of other changes in the company's circumstances, change the company's residency status for Australian tax purposes and that the ATO will not apply compliance resources to determine whether the company's CM&C is in Australia.

Individual tax residency

There are circumstances where an individual who is not an Australian resident may have to stay in Australia for longer than expected, or where an individual who is an Australian resident is delayed overseas because of COVID-19. These situations can give rise to uncertainty about that individual's residential status.

The ATO's general position is that if an individual who is an Australian resident usually living and working in Australia has to remain overseas due to COVID-19, there

Under the Australian transfer pricing (TP) rules, entities with international related-party transactions are required to prepare TP documentation by the time of lodgement of their tax returns for the relevant income year

should be no change to that individual's Australian tax obligations.

The ATO is also of the view that if an individual who is not an Australian resident is delayed in Australia for some weeks or months because of COVID-19, then that individual will not become an Australian resident for tax purposes, as long as they usually live overseas permanently and intend to return their home country as soon as they can. However, if they stay in Australia for a lengthy period and do not intend to return to their country of residence when they are able to do so, then the individual's circumstances will need to be analysed in detail to ascertain their residency status.

Ultimately, whether someone is a resident of Australia is a question of fact that must be assessed based on individual circumstances.

Transfer pricing documentation

Under the Australian transfer pricing (TP) rules, entities with international related-party transactions are required to prepare TP documentation by the time of lodgement of their tax returns for the relevant income year. Failing to do so would prevent the entity from establishing a reasonably arguable position, which could result in administrative penalties should the entity become liable for a tax shortfall amount due to TP adjustments.

Where an entity has lodged a tax return earlier than the due date for lodgement and is unable to have TP documentation prepared by the time the return is lodged due to COVID-19, and the entity is subject to a TP adjustment, the ATO may remit the portion of the penalties resulting from the lack of a reasonably arguable position if all the following criteria are met:

- The entity's lodgement due date for its income tax return was between 1 March and 15 July 2020
- TP documentation was in place for the previous income year
- There has been no material change to the entity's related-party arrangements since the last income year
- The entity completes its TP documentation on or before its lodgement due date
- The entity's TP position is otherwise reasonably arguable.

Thin capitalisation rules

For thin capitalisation purposes, entities that previously relied on the safe-harbour method may face a reduction in the maximum allowable debt because of a significant reduction in assets value or an increase in debts due to COVID-19.

The ATO has suggested that for the purpose of calculating average values for thin capitalisation amounts, the selection of alternative valuation measurement periods could allow a degree of smoothing of values in situations where wide variations have occurred throughout the income year.

The ATO has also confirmed that if an entity will otherwise need to rely on the arm's-length debt test for the relevant year as a direct consequence of COVID-19, the ATO will not dedicate compliance resources to reviewing the application of the arm's-length debt test if the following requirements are met, other than to verify that the entity's use of the test was directly as a consequence of COVID-19:

- The entity would have satisfied the safe-harbour test but for the COVID-19-related balance sheet effects
- It is expected that the entity will use its best endeavours to apply all criteria of the arm's-length debt test
- For entities that are classified as inward-investing entities (and not also outward-investing entities), no additional related-party funding is received, other than short-term (<12 months) debt facilities. The ATO expects any new capital to be provided by equity
- For inward-investing entities, the use of the arm's-length debt test was not because dividends were paid, thereby weakening the Australian balance sheet.

The ATO expects entities to prepare documents that support the application of the arm's-length debt test.

Country Focus BRAZIL

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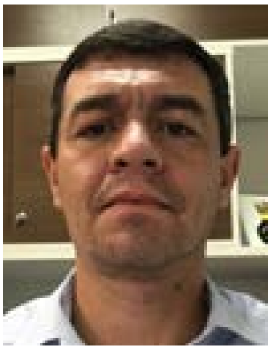

'Goodwill' since Law 12.973/2014

Before Law 12.973/2014, 'goodwill' consisted of the positive difference between the acquisition cost of an investment and the equity value of the investee in proportion to the acquisition. Paragraph 3 of article 20 of Decree-Law No. 1.598/77 provided that the economic basis of goodwill had to be based on a statement to be prepared by the taxpayer, but there was no legal provision explaining the term 'statement'. Goodwill was immediately amortisable for accounting purposes; but for tax purposes, there was a postponement of the amortisation of goodwill that was linked to the incorporation, division or merger of the investee and investor legal entities or by the disposal of the investment.

Law 12.973/2014 brought a new methodology for determining the goodwill arising as a result of acquisitions made from 2015 onwards, with the 'surplus value' portion being supported by a report signed by an independent expert. The acquisition cost of the investment evaluated by the equity method shall be broken down into:

I. Net Equity Value;

II. Gain or Loss Portion, corresponding to the fair value of the net assets of the investee, in proportion to the interest of the acquiree and the value of the Net Equity.

   (II.1) The Value of the Gain and Loss Portion will be based on an Independent Expert Report to be filed with the Brazilian Federal Revenue or whose summary must be registered with the Registry of Deeds and Documents by the last business day of the 13th month following the acquisition of the investment, even if the value is 'Zero'.

III. Goodwill that will correspond to the difference between the Acquisition Cost of the investment and the sum of the amounts addressed in items 'I' and 'II'.

The accounting record of the amounts mentioned in items 'I' to 'III' must be recorded in separate sub-accounts.

The acquisition of the equity interest subject to the evaluation of the owners' equity now requires:

- First, the measurement of identifiable assets acquired, and liabilities assumed at fair value
- Subsequently, the recognition of goodwill for future profitability or the gain from the advantageous purchase.

With respect to the appraisal report, it should also be noted that the protocol at the Brazilian Federal Revenue (RFB) requires the submission of the report using an RFB electronic process, and the acquirer must also inform the number of the electronic process in the first Taxable Income Control Register, tax calculation book (LALUR) corresponding to the year of acquisition of the investment. This procedure exempts registration of the summary at the Registry of Deeds and Documents.

However, if the protocol mentioned in the previous paragraph is not followed, the summary of the report must be registered at the Registry of Deeds of Documents and contain at least the following information:

- Qualification of the transferee, transferor and acquired
- Acquisition date
- Percentage acquired of voting stock and total capital
- Main reasons and description of the transaction, including potential voting rights
- Discrimination and fair value of the items making up the total consideration transferred
- Individualised list of identifiable assets acquired and liabilities assumed with their respective carrying amounts and fair values
- Identification and signature of the independent expert and the person responsible for the transferee.

Failure to comply with the report registration carried out by the independent expert implies:

- If the investment is sold, the surplus value cannot be used as cost to calculate the capital gains/loss
- The surplus of the assets over the equity would be treated as a capital loss
- Goodwill is not deductible for tax purposes.

Of note, the report will be disregarded in the event that the data it contains proves to have relevant defects and inaccuracies.

With the advent of Law 12.973/2014, there is no longer the possibility of an immediate and continuous amortisation of goodwill. The amortisation will begin immediately after the absorption of assets as a result of the corporate operation of incorporation, merger or division that the amortisation/exclusion shall be made on an ongoing basis, at a fixed rate throughout the amortisation/exclusion period and in a fraction not exceeding 1/60 (one sixtieth) for each month of the calculation period.

On 17 March 2020, the Brazilian Tax Authorities clarified through the Ruling Request 13/2020 that the 'dependent part' is considered when there is a relationship of control between the acquirer and the transferor on social participation directly or indirectly according to Law 6.707/79 article 243 paragraph 2. In the comparison between Tax Consult 13/2020 and Tax Consult 223/2019, there was no change in the comments previously made.

The table below provides hypothetical numbers to illustrate how the calculation of goodwill has changed since Law 12.973/2014.

The introduction of Law 12.973/2014 means that corporate acquisition operations are required to be accompanied by specialist professionals having expertise in the preparation of the 'surplus value report' aiming at an adequate calculation of the goodwill.

Before Law 12.973/2014		After Law 12.973/2014	
(+) Acquisition cost	R$ 1,000,000	(+) Acquisition cost	R$ 1,000,000
		(–) Surplus value supported by report	R$ 200,000
(–) Net equity value	R$ 700,000	(–) Net equity value	R$ 700,000
(=) Positive difference = Goodwill	R$ 300,000	(=) Positive difference = Goodwill	R$ 100,000

FOOTNOTE

1. *In Brazil, the accounting and tax treatment of goodwill is provided for in the Brazilian Accounting Pronouncements Committee (CPC) No. 04(R1) – Correlation to the International Accounting Standards IAS 38 (IASB – BV2010), Law 12.973/2014, Normative Ruling 1.700/2017 articles 178–197, Tax Consult 223/2019, Tax Consult 19/2020.*

Country Focus FRANCE

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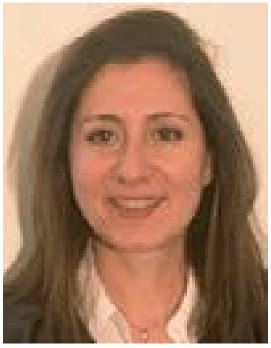

The extension of the French list of non-cooperative states and territories: Overview of restrictive tax measures

To comply with the commitments made in the fight against international tax evasion, France, like other states, introduced the concept of 'non-cooperative states and territories' (NCST) into its legislation. NCST are defined by article 238-0-A of the Code General des Impôts (CGI; French Tax Code) as 'political entities that refuse international standards for the exchange of tax information'.

A Decree of 6 January 2020 amends the NCST list, which now includes 13 states or territories (an increase from seven): American Samoa, Anguilla, Bahamas, British Virgin Islands, Fiji, Guam, Oman, Panama, Samoa, Seychelles, US Virgin Islands, Vanuatu, and Trinidad and Tobago.

In contrast, six states – Botswana, Brunei, Guatemala, Marshall Islands, Nauru, and Niue – were withdrawn, since they entered into an administrative assistance agreement with France to exchange information necessary for the application of tax legislation.

These provisions apply to newly listed states or territories since April 2020. They cease to apply to states or territories removed from the list on the date of publication of the order, namely 7 January 2020.

NCST qualification leads to the application of restrictive tax measures that target transactions carried out by French residents trading with NCST as well as French transactions carried out by residents of NCST.

French residents trading with NCST

Strengthening anti-tax fraud and evasion measures

In general, Articles 209 B and 123 bis of the CGI are intended to deter French tax residents, legal or natural persons, from locating, for tax reasons, a portion of their profits and income in foreign entities subject to a privileged tax regime within the meaning of article 238 A of the CGI.

These anti-abuse schemes are strengthened when the foreign entities concerned are established or domiciled in an NCST.

Article 209 B is intended to discourage companies liable for corporate income tax from locating part of their profits in countries with a privileged tax regime. More specifically, this article allows the tax administration, under certain conditions, to tax in France the profits made by foreign subsidiaries or branches of French companies established in countries offering a privileged tax regime.

The specific anti-abuse measure is that a French company can't deduct taxes withheld on dividends, interest and royalties by a foreign entity located in an NCST from the taxes due on its income.

Article 123 bis establishes the principle of taxation of deemed revenues of assets held by individuals through entities whose assets are mostly financial and set in a country offering a privileged tax regime, when their participation in those entities exceeds 10%.

The specific anti-abuse measures introduced regarding the 10% detention requirement involving taxation in France is presumed to be met when the individual has transferred property or rights to a legal entity located in an NCST; in this case, the deemed revenue is determined by applying a flat rate to the portion of assets held.

Strengthening the prohibition on deduction of expenses

In principle, under article 238 A of the CGI, financial expenses, royalties for the transfer of operating licences, patents of invention, trademarks, or remuneration of services paid or payable by a French individual or legal person to individuals or legal entities domiciled or established in a state where they benefit from a privileged tax, are admitted in deductible charges only if the debtor proves that the expenses correspond to real transactions and that they are not abnormal or exaggerated.

However, under article 238 A al. 3 and 4, expenses mentioned above and any payments made on an account in a financial institution established in an NCST are presumed to be not tax deductible for the establishment of the corporate income tax or individual income tax, unless the debtor

can provide proof that the expenses – in addition of being real transactions, not abnormal or exaggerated – have primarily an object and effect other than to allow the location of those expenses in an NCST.

Excluding the parent company scheme for dividends

According to articles 145 and 216 of the CGI, and subject to certain conditions, dividends distributed by a subsidiary to its parent company are exempt from corporate income tax in France (parent company scheme).

However, under section 145, 6-d of the CGI, dividends distributed by subsidiaries established in an NCST are excluded from the scope of the parent company plan, unless the parent company provides evidence that the activity of the subsidiary corresponds to actual transactions that have neither the purpose nor the effect of allowing, for the purpose of tax evasion, the location of profits in an NCST.

Introducing a specific documentary requirement on transfer pricing documentation

Subject to fulfilling certain conditions of article L 13 AA of the Book of Tax Procedures, companies established in France must provide transfer pricing (TP) documentation in connection with transactions of any kind carried out with related legal entities established or incorporated outside France. When transactions of any kind are made with one or more associated companies established or incorporated in an NCST, TP documentation is strengthened.

French-sourced transactions by NCST residents

Increase in withholding rates on real estate income and capital gains

Article 244 bis and article 244 bis A of the CGI provide, for the usual real estate profits and capital gains, a withholding tax of 28% when they are carried out by taxpayers or by companies (in whatever form) that are not established in France. The tax withholding on capital gains is reduced to 19% for individuals. Finally, article 244 bis B also provides that the sale of shares held in French companies by non-resident shareholders is subject to a tax withholding tax of 30% for individuals and 28% for legal entities.

When profits are made by persons or companies domiciled, established, or incorporated in an NCST, the tax withholding rate is increased to 75%.

Increase in withholding rates on interests and dividends

Article 125 A of the CGI stipulates that fixed interest from bonds, equity, intercompany account of associates, etc. paid to individuals domiciled in France are subject to a withholding tax of 12.8%. As far as dividends are concerned, article 119 bis provides that dividends paid to companies based in the European Union are subject to withholding tax at a rate of 15%. For individuals, this rate is set at 12.8%.

The withholding tax rate is set at 75% when income or dividends are paid to individuals or companies having their tax domicile or being established in an NCST.

Increase in withholding tax on royalties and non-salary incomes

Articles 182 A bis and 182 B of the CGI provide for the payment of a withholding tax on two income categories:

- Salaries or any sums paid for French artistic performances (performers, directors, etc.) by a debtor who operates in France to foreign companies that do not have a permanent professional installation in France. The remunerations that correspond to these artistic performances are subject to a withholding tax of 15% subject to the application of international tax treaties. This rate is increased to 75% when the beneficiary of the sums paid in return for these artistic services provided in France is established in an NCST.
- Service fee paid by a debtor established in France to beneficiaries who do not have a permanent professional facility in France (article 182 B of the CGI) for services (advice, IT, service delivery, research, testing, etc.), sub-processed abroad and used in France, are also subject to withholding tax. The basis for calculating this withholding tax is the gross service revenue before VAT paid to the foreign company. The applicable rate is 28% (15% for sports services provided in France).

The inclusion of an NCST on the French list leads to the application of a whole series of restrictive anti-abuse tax measures concerning transactions that are carried out in France

This amount is increased to 75% when the beneficiary of the sums paid, in return for these benefits provided in France, is established in an NCST.

Most of the above withholding tax may be exempted from this increase if the debtor provides evidence that these amounts correspond to real transactions that primarily have an object and effect other than to allow their location in an NCST.

Thus, the inclusion of an NCST on the French list leads to the application of a whole series of restrictive anti-abuse tax measures concerning transactions that are carried out in France. French taxpayers, as well as individuals or companies established or domiciled in an NCST, will therefore have to reassess their French tax obligations according to this new list.

Country Focus
INDIA

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Relaxation in residency conditions for individuals stranded in India due to COVID-19

The COVID-19 pandemic is redefining the concept of an international health crisis, and currently represents the greatest global challenge we have faced since World War II. Since its emergence in Southeast Asia in late 2019, the virus has spread to every continent except Antarctica. Apart from its tragic mortality rates, the pandemic has affected the daily lives of people around the world. As a result of lockdowns implemented around the globe, the world economy is under tremendous stress. Travel restrictions have left people stranded; apart from trying to protect the health of their citizens and announcing economic stimulus packages, many governments have also been faced with the difficulties of bringing their citizens home.

The involuntary presence of NRIs and foreign nationals in India due to COVID-19 can affect their residency status from a taxation perspective. According to Indian income tax law, the taxability of overseas income and disclosure of overseas assets in a particular financial year (i.e., April to March) depends on the individual's residential status, which in turn depends on their number of days of stay in India as defined in section 6 of the Indian Income Tax Act. Whether an individual is considered resident in India, non-resident, or not ordinarily resident (NOR) partly depends on the period for which they are in India during the previous year and/or preceding years.

Currently, an individual is said to be resident in India in any previous year, if:

- they were in India for a period of 182 days or more in that year or
- they were in India for a period of 365 days or more during the 4 years preceding the relevant previous year, and were in India for a period or periods amounting overall to 60 days or more in that relevant previous year.

Further, any Indian citizen or person of Indian origin who visits India is considered resident if they reside in India for a period exceeding 182[1] days in the relevant year and more than 365 days in the preceding 4 years.

Instances had come to the government's notice of various individuals who had come on a visit to India during FY 2019/20 for a particular duration and intended to leave India before the end of the financial year (i.e. before 31 March 2020) in order to maintain their status as non-resident or NOR in India. However, the lockdown and suspension of international flights resulting from the outbreak of COVID-19 has forced them to prolong their stay in India. Concerns were expressed that this extra stay in India might qualify them as a resident of India under section 6 of the Indian Income Tax Act.

To avoid genuine hardship in such cases, the Indian government has recently announced certain relaxations for the purpose of determining the residential status under Section 6 of the Act during FY 2019/20 in respect of individuals who came to India on a visit before 22 March 2020[2] and had intended to leave India on or before 31 March 2020. According to a government circular, the following days will not be considered when calculating the number of days of stay in India for the purpose of determining residential status for FY 2019/20:

- Where an individual was unable to leave India on/before 31 March 2020: from 22 March 2020 to 31 March 2020
- Where an individual had been in quarantine in India on/after 1 March 2020 and had departed on an evacuation flight on/before 31 March 2020: from the beginning of the quarantine until the date of departure
- Where an individual had been in quarantine in India on/after 1 March 2020 and had been unable to leave India on/before 31 March 2020: from the beginning of the quarantine to 31 March 2020
- Where an individual had departed on an evacuation flight on or before 31 March 2020: from 22 March 2020 until the date of departure.

With these relaxations, the government hopes to resolve any ambiguity around the residential status of individuals for

FOOTNOTE

1. *With effect from financial year (FY) 2020/21, the period of stay has been reduced from 182 to 120 days in respect of an Indian citizen or person of Indian origin whose total income other than income from foreign source exceeds INR 1.5 million.*
2. *India announced its 'Janta Curfew' on 22 March 2020 and also suspended international air flights, followed by complete lockdown (a 14-day phase 1) from 25 March onwards.*

FY 2019/20 by addressing the concerns of non-residents and other foreign nationals who arrived in India but could not return to their respective countries due to travel and 'stay at home' restrictions associated with the COVID-19 pandemic.

Country Focus ITALY

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Parent–subsidiary directive and DTAAs: The new path in regulatory coordination taken by the Italian Supreme Court

In the field of international double taxation, it can be difficult to coordinate double tax treaties with the parent–subsidiary directive. Here, we report a decision of the Italian Supreme Court relating to the refund of imputative tax credit on dividends paid by Italian subsidiaries to their UK parent companies. Until now, the prevailing interpretation of Italian laws was that the company should be denied the tax credit reimbursement when dividends are paid without applying withholding tax in Italy pursuant to the parent–subsidiary directive. The Supreme Court ruling of January 2020 reopens the issue by reverting the case to the Appeal Court, asking them to consider the overall tax burden of corporate profits. The decision suggests a new approach to the taxation of outbound dividends.

Background

The Italian approach towards taxation of dividends paid to international parent companies has evolved over some time, but has always been a controversial issue. The domestic tax code provides that no double taxation should be levied in any case. More specifically: 'The same tax may not be applied more than once on the basis of the same assumption, not even in respect of different persons'. As currently formulated, Italian law (article 163 DPR 917/1986 of the Italian Tax Code) excludes both economic double taxation and juridical double taxation. In order to pursue the objective of the aforementioned article, Italy has established different mechanisms to avoid double taxation, in particular on cross-border dividends.

Italy's double taxation avoidance agreements (DTAAs) signed with France and the UK illustrate the intent to agree on an effective method to avoid not only double taxation on the dividend itself in more than one country, but also the economic double taxation of corporate income. Indeed, both agreements include a provision that grants an 'indirect tax credit' to the parent company that received dividends from an Italian subsidiary, to mitigate the taxation levied on the dividend in the residency country of the parent company.

The provisions included in the tax treaties pre-dated adoption of the parent–subsidiary directive, which has chosen a different method to avoid double taxation on dividends – that is, the exemption from any withholdings in the origin state.

Nonetheless, the same directive provided under article 7 (2) that 'This directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends'. As a consequence, the tax treaty between Italy and UK, like that with France, remained in effect, despite continuing dispute around coordination of the two regulatory approaches.

The specific case

The decision analysed concerned the claim for reimbursement of tax credit on dividends paid by an Italian company to its parent company, resident in the UK, as provided under article 10 of the tax treaty (the agreement with France includes a similar provision).

The Regional Commission had rejected the appeal proposed by the taxpayer against the first-degree judgment, which already rejected the request, proposing that the foreign parent had already 'benefited from the exemption of the withholding tax on dividends, under art. 27 of Italian DPR 600/1973, that is, the implementation of the parent–subsidiary directive'.

The Supreme Court, in its ruling, reverted the case to the Regional Commission 'to analyse whether, in the specific case, the system described in the judgment of the

The Supreme Court's approach introduces the interesting principle that in determining the taxes due in Italy on dividends, the tax regime of other countries must also be taken into account. Coupled with the issue of tax avoidance, this is an important principle: in essence, both are measures to normalise tax levels that are lower than usual

Regional Commission actually avoided double taxation and also averted the risk, in accordance with the principle of tax neutrality of the directive'.

Prior to the judgment reviewed here, the apparent consensus interpretation was that the provisions contained in the agreements with France and Great Britain – provisions under which the parent company is entitled to the repayment of an indirect tax credit corresponding to the actual domestic taxes levied on 50% of the income paid out as dividends by the Italian subsidiary company – are alternatives to, and not cumulative with, the withholding tax exemption provided by the parent–subsidiary directive. The approach was absolute: once the dividend is paid without withholding tax, the non-resident member is automatically excluded from the right to obtain a refund of the tax credit.

In its absoluteness, this thesis seemed questionable. However, the Supreme Court's refusal of claims for the payment of tax credit to shareholders of Italian subsidiaries residing in France and Great Britain were fundamentally based on the consideration that both the directive and the tax treaties with France and the UK have the common objective of eliminating double taxation. This common goal 'can never actually determine the distortion represented by an improper double benefit, that is, a double non-imposition'.

In theory, the point is reasonable. If the combined application of provisions from different sources results in an outcome that is inconsistent with the general principles of the law, then there is room for an interpretation capable of restoring consistency to the system.

It could be concluded that if, as a result of the parent–subsidiary directive, the foreign parent company does not discount any tax on Italian-source dividends in relation to which it requires the repayment of the tax credit, the latter should be denied because the dividend exemption already fully achieves the objective of eliminating double taxation.

But that is not quite the only way forward: crucially, Italy, France and Great Britain have agreed on a different distribution of tax powers than those that would have resulted from the directive.

While it is unlikely that the taxpayer can cherry-pick the most favourable aspects of each of the two schemes, it may be that they can decide which of the two to apply – as long as they apply it in its entirety.

The judgment in review should therefore be welcomed because it did not follow the previously consolidated orientation. Although the Supreme Court decision is as yet an incomplete interpretation (since it also reverted the case to the second-degree judges, asking a further review and assessment), it does introduce a more complete scope of analysis that considers the overall economics of double taxation and the principle of tax neutrality.

Conclusions and possible further developments

Although the decision is not yet conclusive, it is significant because it has introduced new and progressive concepts to the process. The approach taken by the Supreme Court introduces the interesting principle that in determining the taxes due in Italy on dividends, the tax regime of other countries must also be taken into account.

The Supreme Court's approach introduces the interesting principle that in determining the taxes due in Italy on dividends, the tax regime of other countries must also be taken into account. Coupled with the issue of tax avoidance, this is an important principle: in essence, both are measures to normalise tax levels that are lower than usual.

This is a central theme of the OECD's BEPS Action Plan, with its search for 'right imposition' (and the simplest and most efficient way of applying it) to avoid not only multiple taxation, but also phenomena such as double deductions or double exemptions. Controlled foreign company switch-over clauses, rules on hybrids, and other areas of tax legislation respond to this need, insisting that what happens elsewhere must also be considered as a fiscally relevant fact.

Country Focus MALTA

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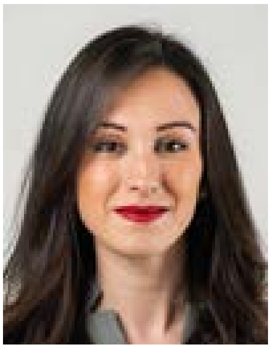

Malta's enactment of hybrid mismatch rules as found within ATAD II

Due to disparities in domestic tax systems, in recent years taxpayers – especially multinational enterprises (MNEs) – have been able to engage in tax avoidance practices in order to mitigate their overall tax burden, which in turn resulted in millions of taxpayer money being 'lost' by governments. Equity, as a key pillar of every tax system, was being corroded: through tax arbitrage, MNEs and high-net-worth individuals were falling through the loops of the tax systems, meaning that the 'ability to pay' principle – which preaches vertical equity between taxpayers – was not being respected.

One of the main tactics used by these aggressive tax planning taxpayers takes the form of a hybrid financial instrument (including e.g. redeemable preference shares, profit participating loans and perpetual debts). The OECD sought to neutralise the tax advantage offered by such an instrument through BEPS Action 2. In contrast to the OECD's position, however, which may be depicted as a soft-law institution, a hard-law status was sought to tackle hybrid mismatch outcomes within the European Union (EU), which was eventually achieved through Anti-Tax Avoidance Directive II (ATAD II). As a member of the EU, Malta was thus obliged to enact ATAD II within its domestic law, which it did last year through Legal Notice (LN) 348 of 2019.

As with ATAD II, these newly introduced Maltese regulations tackle deduction without inclusion (D/NI) and double deduction (DD) outcomes in cross-border transactions, also known as hybrid mismatch outcomes. Essentially, a D/NI outcome occurs when the deduction of a payment or deemed payment is claimed in the jurisdiction in which the payment is made (payer jurisdiction) without a corresponding inclusion for tax purposes of that payment in the jurisdiction where the payment or deemed payment is received (payee jurisdiction). On the other hand, a DD outcome entails a double claim of the same deduction of payment, expenses or losses by the jurisdiction from where the payment was made, the expenses incurred and losses suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction).

Hybrid mismatch outcomes can materialise in various situations, all of which are listed exhaustively in the enacted LN:

A. When the payment under a financial instrument gives rise to a D/NI outcome, subject to the satisfaction of both of the following conditions:
   - Such payment is not included for tax purposes within a reasonable period of time in the payee jurisdiction leading to an indefinite tax debt deferment which, if maintained, could lead to double non-taxation. As per the LN, 'reasonable period of time' entails either the inclusion of such payment in the payee's jurisdiction in a tax period that commences within a year of the end of the payer's tax period, or when, from the case at hand, it is reasonable to expect that the payment will be included in the payee's jurisdiction and the payment terms are those that would be expected to be agreed between independent enterprises; and
   - The mismatch outcome is attributable to differences in the characterisation of the instrument or the payment made under it.

B. When a payment to a hybrid entity (i.e. an entity that is treated as taxable under the laws of a jurisdiction, and whose income/expenditure is treated as income/expenditure of another person/s under the laws of another jurisdiction) or an entity with one or more permanent establishments (PEs) gives rise to a D/NI outcome, which emerges as a result of differences in the allocation of payments between the jurisdictions involved. While with respect to the hybrid entity, such differences would exist between the jurisdiction where the hybrid entity is registered/established and the jurisdiction of any other person having a participation in that hybrid entity, with respect to the PEs scenario, the difference would be either between the head office and a PE or between two or more PEs of the same entity under the

laws of the jurisdictions where the entity operates.

C. A payment gives rise to a D/NI outcome as a result of a payment to a 'disregarded PE' (thus, an establishment that is considered as being a PE under the laws of the head office jurisdiction and is not treated as a PE under the laws of the other jurisdiction).

D. A payment by a hybrid entity, or a deemed payment between the head office and PE or between a number of PEs, gives rise to a D/NI outcome because the payment is disregarded under the laws of the payee jurisdiction.

E. A DD outcome occurs.

It is significant to note that in order for a mismatch outcome to be deemed to have occurred, it is essential for the payments to have been made in one of the ways described below.

1. **Between associated enterprises.** Notably, within the ATAD, the term 'associated enterprises' has been used to replace the 'related parties' concept found under the OECD. Within Maltese law, it is defined generally as including:
   - An entity in which the taxpayer holds directly or indirectly a participation (in terms of voting rights or capital ownership) of at least 25% or is entitled to receive 25% or more of the profits of that entity; or
   - An individual or entity which holds directly or indirectly a participation (in terms of voting rights or capital ownership) in a taxpayer of at least 25% or is entitled to receive at least 25% of the taxpayer's profits.

However, with respect to hybrid entities, the Maltese legislators have decided to amend the 'associated enterprises' definition in certain scenarios such that the 25% threshold is modified to a 50% threshold in the hybrid mismatch outcomes mentioned under (b) to (d) above (in the case of (d), however, it is applicable solely with respect to payments made by a hybrid entity). The term 'associated enterprise' has also been broadened to include also 'an entity that is part of the same consolidated group for financial accounting purposes as the taxpayer, an enterprise in which the taxpayer has a significant influence in the management or an enterprise that has a significant influence in the management of the taxpayer'. Moreover, it has been expressly clarified that a person who acts in concert with another person in respect of the voting rights or capital ownership of an entity shall be deemed as holding a participation in the voting rights or capital ownership as held by the other person.

2. **Between a taxpayer and an associated enterprise**; or
3. **Between the head office and a PE**; or
4. **Between two or more PEs**; or
5. **Under a structured arrangement**, defined as an arrangement 'involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch'.

As with ATAD II, an exception as to when notwithstanding the above, the hybrid mismatch rule shall not take place under Maltese law is when a payment is made by a financial trader under an on-market hybrid transfer – meaning a hybrid transfer that is entered into by a financial trader in the ordinary course of business and not as part of a structured arrangement.

For such cases of hybrid mismatch outcomes, Malta's legislators have provided for corrective mechanisms in order to nullify the resulting tax advantage:

- If a hybrid mismatch results in a D/NI outcome, the deduction shall be denied if Malta is the payer jurisdiction; and the amount of the payment that would otherwise give rise to a mismatch outcome shall be included in income if Malta is the payee jurisdiction and the deduction is not denied in the payer jurisdiction.
- If a hybrid mismatch results in a DD outcome, the deduction shall be denied if Malta is the investor jurisdiction; and

Although the new rules are rather technical, which is not in keeping with the concept of simplicity that a tax system should be based upon, they could be regarded as essential in the fight against the tax avoidance schemes exploited by aggressive tax planners using hybrid financial instruments

the deduction shall be denied if Malta is the payer jurisdiction and the deduction is not denied in the investor jurisdiction.

Other corrective mechanisms shall also be utilised where hybrid mismatches arise from 'reverse hybrid mismatches' and 'tax residency mismatches'.

Apart from the regulation concerning reverse hybrid mismatches, which will come into force from 1 January 2022, these amendments entered into effect on 1 January 2020. Although the new rules are rather technical, which is not in keeping with the concept of simplicity that a tax system should be based upon, they could be regarded as essential in the fight against the tax avoidance schemes exploited by aggressive tax planners using hybrid financial instruments. These hybrid mismatch clearly illustrate how the OECD through its BEPS Action Plan (which Malta is party to), and the EU through ATAD II, are seeking to close the loops for tax avoidance through an increased coordination between member states.

Country Focus
SPAIN

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Spain leading in new tax on digital services

In February 2020, the Spanish government gave its approval to draft legislation to create a new tax on certain digital services ('DST').

It is expected that the next phase in the legislative process to continue shortly (after COVID-19), and for the bill to pass with minimum amendments. The DST Act would enter into force 3 months after its publication in the Official State Gazette.

The Spanish government tried to pass similar legislation in January 2019, but this failed when an early general election was called.

The Spanish proposal reflects the dilemmas faced by tax legislators worldwide: How should digital businesses be taxed?

Spain has put forward this transitional measure as it waits for international legislation. In October 2019, the OECD published a proposal to advance international negotiations to ensure that large and highly profitable multinational enterprises, including digital companies, pay tax wherever they have significant consumer-facing activities and generate their profits.

This article summarises the draft legislation, which is likely to be of interest to the international community because it points to what global legislation might look like in the future.

What is the taxable event?

The DST is an indirect tax, as it taxes certain specific services by companies that monetise the contribution generated by different digital users. Therefore, this tax should not be considered as an income or wealth tax and, as a result, should fall outside the scope of the tax treaties entered into by Spain.

The bill proposes a 3% tax on the provision of the following digital services carried out in Spanish territory:

- **Online advertising services:** Digital advertising targeting users of a particular digital platform
- **Online intermediation services:** Digital interfaces allowing users to find and interact with other users, and which may also facilitate the supply of goods or services directly between users
- **Data transfer services:** Transmission of user data that has been generated from user activity on digital interfaces.

The scope of the tax excludes, among others:

- Sale of goods or services between users through an online intermediation service
- Sale of goods or services contracted online on the supplier website where the supplier does not act as intermediary
- Digital services between entities forming part of a group with 100% direct or indirect holding.

Who will have to pay the tax?

Any entity, regardless of where it is established, which, in the previous year, exceeds the following two thresholds (at a group level):

- Total net sales of more than €750 million
- Total revenue from 'digital services' in Spain of more than €3 million.

Where is the place of supply of digital services?

This tax is only for digital services linked in some way to the Spanish territory, and so some rules are set based on where the digital devices are used:

- **Online advertising services:** If the device is in the Spanish territory when the advertising appears on this specific device.
- **Online intermediation services:** Either when, at the time of the conclusion of an operation, a user is taken through the digital interface of a device that at that time is in Spain; or when the account that allows the user to access the digital interface has been opened using a device that at that time is Spain.
- **Data transfer services:** When the data transmitted has been user-generated through a digital interface that has been accessed by a device that at the time of the generation of the data is Spain.

There is a general assumption whereby a particular device of a user is deemed to

The tax base will be the amount of income, excluding, where applicable, VAT or other equivalent taxes, obtained by the taxpayer for each provision of digital services carried out in the Spanish territory

be located based on its internet protocol (IP) address. Nonetheless, evidence to the contrary could be allowed to disprove this assumption.

What is the tax base?

The tax base will be the amount of income, excluding, where applicable, VAT or other equivalent taxes, obtained by the taxpayer for each provision of digital services carried out in the Spanish territory.

How will compliance be enforced?

The new DST will be self-assessed by taxpayers on a quarterly basis. For 2020, transitional rules would apply so that only one payment of the tax would be due at the end of the year.

Moreover, taxpayers would be subject to certain formal obligations, such as:

- Taxpayers not established in the EU would have to appoint a representative
- Systems, mechanisms or arrangements should be in place to establish that user devices are located in the tax territory of Spain
- Records kept to prove the place where the digital services were provided.

Country Focus
SPAIN

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VAT management system based on immediate supply of information

Background

The Spanish tax authorities have introduced a new VAT management system based on immediate supply of information ('SII'). The SII reporting obligation was implemented based on the Royal Decree 596/2016.

The principal aim is that the authorities have almost real-time information to cross-check data, which is considered an effective tool to improve tax control and further assist the taxpayer in meeting their obligations.

What is SII?

This VAT management system is based on keeping a tax record on the Spanish tax authorities' online system, by providing all billing records virtually immediately.

The SII basically consists of electronically transmitting billing records from VAT books. To do this, the taxpayer must send the tax agency billing details electronically (using web services based on exchanging XML messages or, if applicable, by filling out the online form). This information is used automatically to configure the various record books, practically in real time. But taxpayers are not required to send the actual bills.

Taxpayers subject to SII need to report the following VAT books:

- Invoices issued
- Invoices received
- Certain intra-community transactions
- Investment goods.

In the case of simplified bills, issued and received, these may be grouped, provided they meet certain requirements, and the billing records for the corresponding summary entry sent.

Taxpayers can compare the information in their record books with the information supplied by their clients and suppliers, provided these are included in the system.

SII obligations in Spain

This requirement is for those taxpayers who are obliged to follow the monthly filing regime, for example:

- Large businesses (turnover of over €6 million)
- VAT groups
- Registered with REDEME (monthly VAT return registry).

The regulation applies also to non-resident entities.

Furthermore, any taxpayer who wants to can choose to use it. This option means that the taxpayer's self-assessment obligation becomes monthly and they must stay in the system for at least one calendar year in order to exercise the option. The option to adopt SII must be undertaken during the month of November, before the start of the calendar year in which it should come into effect.

Deadlines

SII information needs to be submitted within 4 days from generating an outgoing invoice and within 4 days from the accounting record of an incoming invoice. This term excludes Saturdays, Sundays and national holidays.

Penalties

According to Royal Decree 1072/2017, the penalties on Spanish SII are:

- Late reporting in the Spanish SII: 0.5% of the missed amounts, with a minimum of €300 and maximum of €6000 per quarter. These limits take into account all tax penalties applicable in one quarter
- Errors or omissions in the book of certain intra-community transactions and book of investment goods: Fixed penalty of €150.

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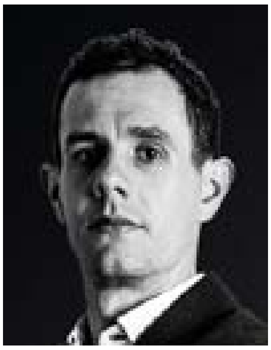

UK land and property tax update

New rules announced and introduced in April 2020 are the latest in a long line of successive changes made by the UK government since 2013 to the way in which purchases, income and capital gains relating to UK land and property are taxed. New or existing investors will need to be advised very carefully in respect of their future UK property transactions.

This articles summarises the recently announced changes and recaps some of the other pertinent changes implemented over the last few years.

Stamp duty land tax (SDLT)

In March, the UK government announced that from April 2021, a 2% SDLT surcharge will apply to non-UK residents purchasing residential property in England and Northern Ireland. This will be applied to the purchase consideration given for residential property by individuals, companies and trusts not resident in the UK. This surcharge will operate in addition to the existing 3% surcharge applied where the purchaser is acquiring another residential property, and not replacing their main residence – meaning a top rate of SDLT of 17% applying to purchase consideration in excess of £1.5 million, in these circumstances (12% standard SDLT rate applied to purchase consideration in excess of £1.5 million, plus an additional 3% surcharge for additional residential properties, and a further 2% surcharge for non-residents).

Changes to the filing and payment deadlines, commencing from March 2019, also mean that purchasers have only 14 days following the purchase to file the appropriate return to HMRC and pay the SDLT.

The UK SDLT regime has very quickly become hugely complex and difficult to administer, even for apparently simple transactions.

The taxation of land and property purchases has devolved in recent years, with Wales adopting a land transaction tax and Scotland a land and buildings transaction tax. While both regimes are very similar to the SDLT regime in England and Northern Ireland, there are currently no plans in either country for this additional non-residents surcharge.

Property income for non-resident companies

From April 2020, non-UK resident companies will come within the charge to UK corporation tax, instead of income tax on profits arising from income profits from UK property.

If the non-resident company's UK property business has carried forward income tax losses, these losses will be brought into the corporation tax regime if the business is continuing at 5 April 2020.

Those in scope will be automatically registered for corporation tax and will be sent a company unique taxpayer reference (UTR), which they should receive by 30 June.

Non-resident capital gains (recap)

From April 2019, non-resident individuals, companies and trusts disposing of UK land and property (or companies that derive their value from UK land and property) are subject to UK capital gains tax (CGT) or corporation tax, as appropriate. Non-resident individuals have been within the scope of UK CGT in respect of their disposals of UK residential property since 2015, but the changes applied from 2019 significantly expand the scope of the charges that can be applied.

A rebasing of the properties is allowed, applying a deemed purchase cost of the property based on the value of the property at either April 2015 or April 2019 depending on the exact circumstances, meaning that only gains accruing since the changes in the non-resident tax regime come into charge in the UK.

Non-resident capital gains must be reported to HMRC and the tax paid within 30 days of the legal conveyance of the property – a similar rule was extended to UK residents disposing of residential property from 6 April 2020.

Annual tax on enveloped dwellings (recap)

The annual tax on enveloped dwellings (ATED) was introduced in April 2013 and applies where UK residential dwellings

> *Clients considering buying land or property in the UK – either for their own use or commercial purposes – should take advice before doing so; and clients who already have land and property in the UK must be aware of their future potential exposure*

with a value of over £500,000 are owned beneficially by a company, partnership (where one of the members of the partnership is a company) or a collective investment vehicle.

The ATED is payable every year by reference to the annual chargeable period, i.e. 1 April to the following 31 March. It is generally payable by 30 April during the chargeable period or within 30 days of acquisition if the dwelling is acquired in-year. The 2020/2021 annual charges range from £3700 (for properties valued between £500,000 and £1 million) to £236,250 (for properties valued in excess of £20 million).

Various exemptions and reliefs are available, but generally need to be reported, so an ATED return will be required to be submitted to HMRC annually, in respect of enveloped properties valued over the £500,000 threshold, even where the charge is nil.

The combined effect of the successive changes has created a complex area to navigate but with forethought, the client's circumstances may permit planning opportunities to mitigate the effects. The important thing is that clients considering buying land or property in the UK – either for their own use or commercial purposes – should take advice before doing so; and clients who already have land and property in the UK must be aware of their future potential exposure.

International Tax Cases

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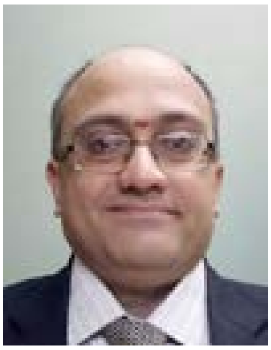

Fowler (Respondent) v Commissioners for Her Majesty's Revenue and Customs (Appellant) [2020] UKSC 22

The UK's Supreme Court entered the annals of judicatial history through its recent ruling in the case of ***Fowler (Respondent) vs Commissioners for Her Majesty's Revenue and Customs (Appellant) [2020] UKSC 22***. The ruling was the Supreme Court's first of its kind, in cases to be heard entirely via a video link following the national lockdown due to the COVID-19 pandemic. This interesting ruling gave thought-provoking insights on (a) the vexed issue of interpreting tax treaties, especially where there were ambiguities as to interpretation; and (b) the extent of applicability and import of deeming fiction of the national law into the tax treaties. Despite the unanimous Supreme Court verdict, however, the UK's adjudicating lower courts were surprisingly divided on the interpretation possibilities.

Facts and background of the case

Mr Martin Fowler, a qualified diver, was a resident of the Republic of South Africa. During the tax years 2011/12 and 2012/13, he undertook diving engagements in the waters of the UK continental shelf. For the purposes of this case, the Court has proceeded on the common ground of the parties that Mr Fowler was in employment.

He had no permanent establishment (PE) in the UK.

Regarding his taxability in the UK, Mr Fowler referred to the deeming provision under section 15 of the UK's Income Tax (Trading and Other Income) Act, 2005 (ITTOIA). This deeming provision provided that an employed seabed diver was 'deemed to be treated' as carrying on of a trade for the purposes of UK income tax. Therefore, he put forth his case that this deeming provision compelled him to be treated as 'carrying on of a trade' for all purposes under the UK income tax law and by deduction, also under the UK–South Africa Double Taxation Avoidance Agreement ('the Treaty'). Given Mr Fowler's access to the provisions of the Treaty, it would be apposite to note, at this juncture, that article 7 of the Treaty provided for self-employed persons to be taxed only where they were resident (i.e., South Africa in the instant facts), whereas article 14 provided that employees 'may' be taxed where they work (i.e. the UK, again in the instant facts). Analysing the provisions of ITTOIA (i.e. deeming provision) with article 7 of the Treaty (which deals with business profits), Mr Fowler asserted that his income was in the nature of business profits for the purposes of the Treaty and in the admitted absence of any PE in the UK, the income derived from the diving activity could not be subjected to UK income tax.

Not impressed by Mr Fowler's contentions, HM Revenue & Customs (HMRC; the UK tax authorities) took the view that Mr Fowler was indeed subject to UK income tax for the aforesaid income derived from employment for the period of 2011 to 2013, and sent him a tax bill.

The litigation elevated itself stage by stage and the courts heard the arguments and analysed the issue. The First Tier Tribunal (FTT) decided the issue in favour of the taxpayer, while the Upper Tribunal (UT) ruled in favour of the HMRC. On further appeal, the Court of Appeals was persuaded by Mr Fowler's arguments, resulting in a verdict in his favour.

It was against this backdrop that the HMRC raised the following issues before the UK Supreme Court for its ruling:

- The first issue was whether, in the facts and under the circumstances, Mr Fowler, who was a qualified, employed diver, was to be treated as carrying on an enterprise by his diving activities on the UK continental shelf, for the purposes of the Treaty.
- The second and connected issue was: In cases where the terms used in the Treaty, if not defined in the Treaty itself, were required to be given meaning from the tax law of the state seeking to recover tax, how far did the effect of the deeming provisions of a tax law extend;

HMRC argued that the deeming fiction created by the ITTOIA did not affect the position as to whether someone was an employee, but only regulated the manner in which an employee was to be subjected to UK income tax

and would it cover a Treaty, especially under the Vienna Convention on the Law of Treaties?

Summary of opposing arguments

Contention of the taxpayer (respondent)

Mr Fowler contended that his income was derived from an activity defined as a 'business' and not as employment due to 'deeming fiction' under section 15 of ITTOIA. The Treaty made 'business' income taxable by the resident state of the taxpayer (i.e. South Africa) as long as that activity did not create a PE, or taxable presence, in the other jurisdiction (i.e. the UK).

He further argued that, since he was deemed as self-employed for UK income tax purposes, he must be treated similarly for the Treaty purposes as well, and was therefore not exigible to tax in the UK.

Contention of the tax authorities (plaintiff)

HMRC argued that the deeming fiction created by the ITTOIA did not affect the position as to whether someone was an employee, but only regulated the manner in which an employee was to be subjected to UK income tax. Extending this argument further, HMRC proposed that this deeming fiction could not imported into the Treaty and hence, for Treaty purposes, Mr Fowler was to be construed as having earned employment income and accordingly, was exigible to income tax under article 14.

Supreme Court verdict

The Supreme Court unanimously allowed HMRC's appeal, and decided against Mr Fowler's contentions, holding that his income was derived from employment for the purposes of the Treaty.

The Supreme Court clarified the issues raised. First, it recognised that 'employment' was not a defined term, in the Treaty. Thus, article 3(2) would come into application, which provided that where a Treaty failed to provide guidance on the definition of a particular term used therein, reference to the extant national law of a contracting state would be referred to and applied.

The Supreme Court then proceeded to decide on which of the two articles of the Treaty – article 7 ('business profits') or article 14 ('income from employment') should be applied to Mr Fowler's case. For this, the Court had to explore the question of whether Mr Fowler's income was to be classified as 'income from trade' or 'income from employment' for the purposes of the Treaty, having regard to the deeming fiction created by the ITTOIA. Upon careful examination of the facts. and after due consideration of current aids to interpretation (e.g. the Vienna Convention and OECD guidelines), the Apex Court arrived at the following conclusions:

- Expressions in the Treaty such as 'salaries, wages and other remuneration', 'employment' and 'enterprise' should be given their ordinary meaning unless domestic legislation altered the meaning they would otherwise have.
- Section 15 of ITTOIA provided that a person who would otherwise be taxed as an employee was instead treated as self-employed for the purposes of domestic income tax. Deeming provisions of this kind created a 'statutory fiction' that did not render a qualifying diver exempt from UK income tax or determine the potential recipients of tax (i.e. UK or South Africa). The Court traced the origins of this fiction to the 1970s in order to allow employed seabed divers, who commonly paid for their own expenses, to access the more generous regime that allowed tax-deductible expenses to be claimed by the self-employed taxpayer. Thus, the Court held that the intended purpose of such fiction was to adjust the basis of taxation of a UK income tax liability, which already existed.
- Drawing inference from article 31(1) of the Vienna Convention and certain UK judicial precedents, the Supreme Court held that a deeming provision must not be applied so far as to produce unjust, absurd or anomalous results unless the Court was compelled to do so by clear language. Therefore, to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying, employed diver immune from UK taxation would be contrary to the purpose of the Treaty and would produce an incongruous result.

- Accordingly, the Court held that Mr Fowler was to be treated as in employment for the purposes of the Treaty and hence, his income was to be governed by article 14 (employment income), thus being exigible to income tax in the UK.

Editorial comments

This judgement is a watershed, and an interesting development in that it seeks to provide guidance on the manner in which a deeming fiction in the domestic law were to be interpreted for the purposes of the Treaty if doing so would provide an unjust, absurd or anomalous result. In its verdict, the Court has traced the original intent of the deeming fiction and then neatly used it as a launch pad to reinforce its deduction of the nature of the impugned income as one from employment for Treaty purposes. Having said this, the Court rightly debunked any weightage to the likely prospect of a double non-taxation situation in the instant facts, resisting any temptation to wade into a potential anti-tax avoidance debate. Lastly, in the current BEPS climate, this ruling could serve as a beacon to help others navigate the widely prevalent deeming concepts – some of which might prove even trickier than the one addressed here – necessitated in the domestic laws of Treaty-paired nations.

The Next Step

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