4th INTERNATIONAL RRC AT SPAIN

From 10 to 20th August 2012

BARCELONA • MALAGA • SEVILLA • MADRID

Organised by

ALL GUJARAT FEDERATION OF TAX CONSULTANTS

2012-2013

21st YEAR

114, Income Tax Office, 1st Floor, Narayan Chambers, Nr. Nehru Bridge,
Ashram Road, Ahmedabad - 380 009. Gujarat (India)
Phone : +91-79-2657 5612 E-mail : president@agftc.co.in Web : www.agftc.co.in

INDEX

IMPORTANT ISSUES IN TAXATION

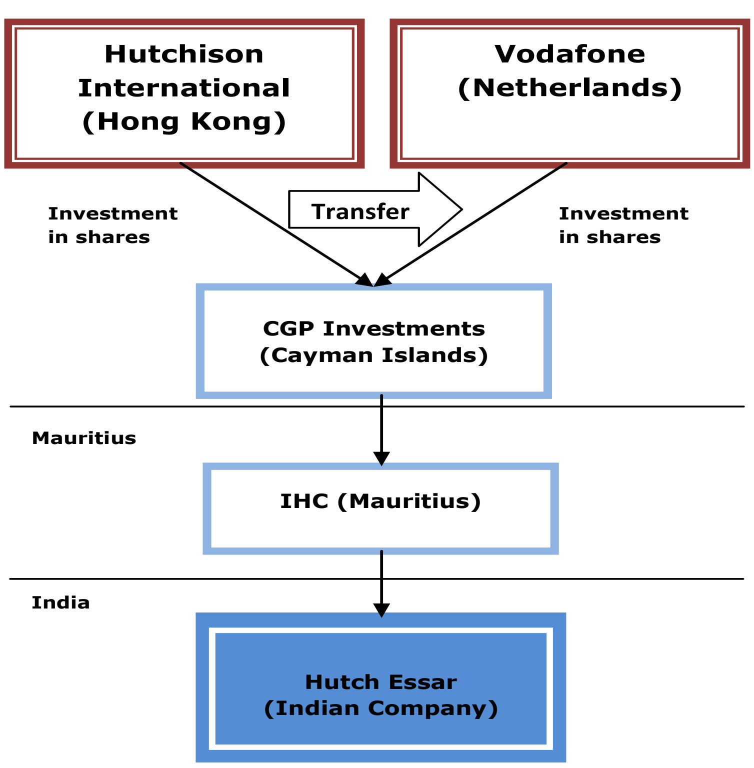
C.A K.D. Shah

Vodafone Case in a nutshell

Background

Since September 2007, the world has been watching very closely the Vodafone case being dealt by the Tax Authorities in India. It all began with a show cause notice issued to Vodafone BV (based in the Netherlands), holding it to be an "assessee in default" for not withholding tax at source when it made payments to a Hutchison Group company (based in Cayman Island) for acquiring shares of another Cayman Island company i.e the company that was holding shares of the subsdiaries that ultimately were holding the operational company in India – Vodafone Ltd (earstwhile Hutchison Essar Limited). Such change in shareholding resulted in a change in the controlling interest of an operating Indian cellular services company.

Vodafone Ltd (Earstwhile Hutchison Essar) is an Indian company. All the shares of Vodafone are held by a special purpose vehicle (SPV) in different International Holding Jurisdictions (IHC's). Vodafone, a UK-based group, acquired from Hutchison (Hong-Kong) for a total consideration of $ 11 billion (about Rs 44,000 crore). The transaction resulted in capital gains in the hands of the Cayman Island Company owned by Hutchison by virtue of sale of share of the Cayman Island Company which held controlling interest in Hutchison Essar the Indian Co. India's tax department served a "show cause notice" to Vodafone about the alleged tax liability



The main reason is that the very foundation of international tax norms appeared to be shaken. It had been a well accepted view that while gains arising to a non resident from transfer of shares in an Indian company are liable to tax in India (subject to tax treaty provisions as in some tax treaties the gain is not taxable in the source country), the gain arising to a non resident from transfer outside India of shares of a foreign company to another nonresident would normally not be chargeable to tax in India

Main issues arising out of the Vodafone Case

1) Whether the transaction of the sale of shares of a company based in Cayman Island by a non-resident to another non-resident gives rise to capital gains tax in India i.e. whether india has rights to tax indirect transfer of underlying assets as well

2) Whether arrangement / structuring was a transaction of tax evasion or tax avoidance

3) Whether Vodafone is liable to withhold taxes on the payments made to hutch

Contention of the Tax Department

The Tax Department is countering that, as Vodafone's (Earstwhile Hutchison Essar) operating assets were based in India, it is justified to tax the transaction. In support of this argument, the department feels that the structuring is in a manner that it facilitates tax evasion thereby invoking common law principles, such as lifting the corporate veil, a way of cutting through complex corporate structures to find the ultimate beneficial owner of the asset.

Further the tax department contended that if a transfer of assets takes place outside India which has consequential transfer impact of ownership in India then entire income derived from such transfers is also taxable in India.

Further the department contended that since the income is taxable in India, Section 195 pertaining to TDS is automatically attracted and such payments are subject to withholding taxes

The Verdict by Supreme Court

1) It is fairly well-established that if the acquisition involved a direct transfer of shares of an Indian company, the same would trigger taxable capital gains under the Act. However cases involving indirect transfers have no mention in the Indian judiciary system. In this landmark judgment, the Learned Court has observed that the indirect matter transfer, would not be taxable in India.

2) ***The court has also recognized that use of holding company structures and offshore financial centres are driven by business/commercial rationale and having such a tax planning tool in international structures, does not imply tax avoidance or tax evasion***.

Our Comments

This decision of the Supreme Court has reinforced the faith of domestic and foreign investors in the Indian Judiciary system which has indicated that certainty and stability form the basic foundation of any fiscal system and they are integral to the rule of law.

The judgment will restore tremendous amount of confidence back into the investment channels in India since they were under quiet a bit of an uncertain territorial zone on account of high tax incidence

One of the hottest buring issues in International tax is pertaining to TDS on payments to be made. Hence we as practicioners will always be bombarded with questions from clients to seek advise on areas of “Payments made to Non Residents and applicability of TDS” This topic is so wide and ocean in size that it would take entire 10 days of this tour to finish the topic. Hence, I have decided to only touch upon the very very basics of TDS on payments made to Foreign Residents.

The concepts regarding applicability of withholding taxes for payments made outside India are as below

Either one of the event will take place:

(i) **The foreign payment is subject to TDS**:

(ii) **The foreign payment is not subjected to TDS**

To understand whether a particular payment is subject to TDS or not following tests / questions will have to be fulfilled:

Whether the payee is a resident as per tax laws in India – Then yes all payments will be subject to TDS

Whether the payee has stayed for a period of 182 days in India in a calender year – Then yes though being a foreign national he will be subject to TDS i.e. Salaries paid to Technical Experts

However, the most important tests are as follows. 1) The payment either needs to be on account of business income or royalty or fees for technical services. Hence in case if payments are in nature of any of these three reasons then the payments will be subject to TDS. Even though the recipients being foreign nationals having no use of the TDS credit available still TDS will be required to be done. The following tests need to be applied

1) Whether the payments are in the nature of business income for the payee: ***The income can be taxed as business income in the hands of payee only and only if the payee has a business connection in India - This is as per article 7 of most of the treaties. Hence only if the receipeint has a business connection in India then only such income can be taxed in India thereby subject to TDS. Examples of Business connection are subsidiary company, branch office, liason office etc of the recipient. In case the recipient does not have business connection then under no circumstances India can tax the income as business income***

2) Whether the payments are in the nature of royalty of Fees for technical services : As per section 9(1)(vi) and section 9(1)(vii) payments will be taxed in the hands of payee under all circumstances excepting the case where ***" Services are provided outside India and utlised outside India". Hence only if services are provided as well as utilized outside india only then will it be outside the purview to tax in India. Hence this is a wider section wherein lot of payment may come under the ambit of TDS***

If answers to both the questions are negative then most probably TDS will not have to be made to payments made to foreign nationals. These are the basic rules of TDS. We can discuss these priniciples with a case law of Ishika Khawijima.

Direct Taxes: Key take away decided in recent Case laws (applicable to industry at large)

WHETHER AMOUNTS PAID AS REGULARISATION FEES TOWARDS ILLEGAL CONSTRUCTIONS TO BE ADDED TO COSTS OR NOT?

Background and Facts

The taxpayer constructed a building. While constructing the aforesaid building the taxpayer violated certain regulations of local development authorities. However, the local corporation regularised the building plan under the newly added provisions of Town and Country Planning Amendment Ordinance, 2000 (Ordinance) on certain payments. This matter was referred to tax tribunal

Tax officer's contention

The Tax officer held that since the payment towards regularisation fees was penal in nature, it could not be added to the cost of the building. Therefore, the taxpayer was not entitled to claim depreciation on that additional amount capitalised by the taxpayer.

Tax payer's contention

The tax payer contended that Regularisation fees paid was not penal in nature but it was towards condonation for deviation from original sanction and for accepting revised plan for construction.

The final verdict

Normally expenditure in penal nature is not allowed as an allowable expense under provisions of Tax however, the Tax Tribunal held that the restriction provided under Section 37 of the IT Act on deduction of penal expenditure ***is not applicable to depreciation claim which is covered under Section 32 of the Act.*** Further, Section 43(1) of the Act which defines 'actual cost' of fixed asset does not mention anywhere - to exclude expenditure which is of penal nature incurred for purchasing/installing such fixed asset.

ADDITIONAL DEPRECIATION IN CASE OF NEW PLANT AND MACHINERY (P&M) PURCHASED AFTER 30TH SEPTEMBER AND PUT TO USE FOR LESS THAN 180 DAYS

A very interesting debate going on these days is regarding additional depreciation to be claimed on P&M used for less than 180 days. In order to provide incentive to the industry at large, tax laws permit assessees for additional depreciation @ 20% (Over and above regular depreciation which is 15%) in case new P&M is purchased and installed. Hence, an overall depreciation of 35% can be claimed in the year new P&M is purchased and installed.

In case when such P&M is purchased post 30th September and used for less than 180 days, then the additional depreciation benefit gets curtailed only upto 10 % (half of 20%)) as full benefit of 20% cannot be given since P&M used for less than 180 days. The interesting question is whether the 10% curtailed depreciation benefit can be claimed in the next year or the full benefit dies a natural death?

It is opined that statutory right of claiming additional depreciation @ 20 % has already been earned in the year of acquisition and installation. This cannot be curtailed just because of the fact that machinery is purchased post 30th September. Intention of the government is to promote investments hence such benefit should be passed on to the tax payers.

Interestingly very few assesses are at present aware about this benefit provision whereby the balance additional depreciation can be claimed in the succeeding year as well

PROFITS UNDER PORTFOLIO MANAGEMENT SERVICES (PMS) CONSTRUED AS CAPITAL GAINS AND NOT BUSINESS INCOME

The taxpayer invests surplus funds generated from business and Professional activities through PMS which is reflected as investments in the balance sheet. The rationale behind classifying profits as capital gains and not business income is that PMS generally comprises of people who have surplus funds from their own business/allied activities but do not have relevant time and expertise to invest on their own. The intention behind such model is "Wealth maximization and not Profit Maximization". Moreover the decision of investing is completely in the hands of portfolio manager wherein no control pertaining to decision making is left with the investor. ***Had the investor wanted to carry on the business activity he would have bought and sold the shares on his own. This comes with the basic presumption that "business is never delegated to others to be done"***

EXPENSES OF WIFE ON A FOREIGN TOUR

If the board of directors of assessee-company had thought it fit to spend on foreign tour of accompanying wife of managing director then such expenditure is allowable u/s 37 of the Income Tax Act, 1961. It is not necessary that the wife should have a business nexus when on the tour. Just accompanying the directors who are on a tour for official purpose is a good enough reason to claim the expenditure. The only requirement is that the resolution regarding wife accompanying the directors should be placed and approved by the board. Hence, in order to summarize if the board deems it fit for the wife to accompany the directors then it is not left upon the tax officers to question the business purpose

NO CAPITAL GAINS IF TRANSFER OF SHARES IN INDIA BY WAY OF GIFT

With intentions to streamline its Indian operations in a more efficient manner a non-resident company transferred its entire shareholding in Indian subsidiary to another group company ***without consideration***. It was held that the transfer is a gift and, therefore, applicant is not liable to pay any capital gain tax on such transfer. Thus even if asset i.e. shares is situated in India or the value in the shares is substantially derived from India still no capital gains can be levied. Further, in absence of any income accruing by transfer of shares, transfer pricing provisions would not apply to such transfer.

TAX LIABILITY IN CASE OF WAIVER OF LOAN OR ONE TIME SETTLEMENT (OTS) WITH THE BANKERS

A very important judgment in terms of OTS done with banks has come up. In is suggested that Taxability of waiver of loan by bank would depend upon purpose for which said loan was taken. Consequentially, if loan was taken for trading purpose and was treated as such from very beginning in books of accounts, waiver thereof may result in income, more so when it was transferred to profit and loss account. Hence such OTS or waiver will never result into taxable income. ***However, if loan was taken for acquiring capital asset, waiver thereof would not amount to any income liable to tax,***

GLIMPSES ON FEMA

By Samir Divatia

Advocate

Globalization has opened up enormous opportunity for the Indian entrepreneur and investors as regards international trade and commerce. The regulations relating to managing foreign exchange has received paradigm shift since liberalized policy of Govt. from 1999. The opening up of economy, relaxed foreign exchange policy, liberalized remittance facility, current account convertibility etc. have made not only the professional but even to the common man to have a working knowledge of FEMA. Therefore, an attempt is made in this short write up to glimpse of this Act, though the magnitude and complexity of transaction, frequent notifications/circulars etc require deep study of the subject.

1.1 FEMA extends to the whole of India

1.2 It also applies to all branches, offices and agencies located outside India, which are owned or controlled by a person resident in India.

1.3 It applies to any contravention committed outside India by any such branch, office or agency if FEMA is applicable to person committing the contravention.

1.4 A person resident in India cannot acquire, hold, own, possess or transfer any foreign exchange, foreign security or immovable property which is situated outside India.

1.5 The situs of the foreign exchange, foreign security and immovable property is important and is to be determined in each case. The terms foreign exchange and foreign security have been defined under section 2(n) and 2(o) of FEMA respectively.

1.6 Section 6(3) and section 9 of the Act empower RBI to enact regulations relating to transactions which may be covered by section 4.

1.7 Exceptions and relaxation to section 4

(i) Section 6(4) of the Act permits a person resident in India to transfer or invest in foreign currency, foreign security or immovable property outside India if he has acquired the same when he was resident outside India or if he has inherited the same from a person resident outside India. He can continue to hold and own such assets even after he has become a person resident in India.

(ii) Restrictions mentioned in paragraph 5.1 above are relaxed under section 9 in the following cases:

(a) The foreign exchange held outside India is acquired or received before 8th July 1947 or it represents income accrued thereon provided the foreign exchange is held outside India in pursuance of a general or special permission of RBI.

(b) Foreign exchange acquired by way of gift or inheritance from a person referred to in (a) above. However, RBI may specify the limit up to which such foreign exchange may be held outside India.

(c) Possession of foreign currency and foreign coins up to such limits as may be specified by RBI.

(d) Holding of foreign currency account up to a limit as may be specified by RBI

(e) Foreign exchange acquired from employment, business, trades, gift, vocation, services, inheritance, honorarium or any other legitimate means. RBI may specify the limit up to which such foreign exchange may be exempt from the operation of section 4.

(f) RBI has power to specify any other receipt in foreign exchange, which may be eligible for exemption from the purview of s. 4.

1.8 Provisions of FEMA are applicable to a transaction. However, whether FEMA would apply to a particular transaction would depend upon the residential status of the person undertaking the transaction. Section 2(v)and 2(w) of FEMA Act defines the person resident in India and person resident outside India. The circular No.45 dt. 8.12.2003 relating to Indian students studying abroad should be kept in mind.

1.9 Under FEMA, all foreign exchange transactions are classified into two broad categories – current account and capital account transactions.

1.10 The current account transactions are generally those which are frequently required to be carried on in the course of business or pertain to income on investments or those for which anyone will need foreign exchange. On the other hand capital account transactions broadly speaking affect the assets and liabilities outside India of a resident Indian or the assets and liabilities in India of nonresident. Thus, it is an economic definition and not accounting or legal. Thus, the transaction of gift or donation abroad is on current account whereas purchase of immovable property or investment outside India is on capital account.

1.11 Recently, the rules relating to current account and capital account transactions have been liberalized quite widely

1.12 There are regulations relating to maintenance of bank account and holding of foreign currency, coins by the residents and non residents. Broadly speaking the non resident can maintain with an authorized dealer NRE account, FCNR account, NRO account. There are rules relating to permitted credits and debits in the afore said three accounts. It includes re-patriation also.

1.13 There are also rules pertaining to borrowing and lending in rupees, including deposits by resident from or to non residents. RBI has issued regulations in this regard from time to time.

1.14 A distinguishing and interesting feature of FEMA is the Liberalized Remittance Scheme. Broadly speaking, under this scheme, a general permission is granted to all resident individuals(PAN holders) including minors to freely remit outside India or transfer money to NRO account of their close relatives up to US$ 2 lacs (or any other freely convertible foreign currency) in each financial year for any permissible current or capital account transactions or both. The effect of liberalized remittance scheme would be as under in respect of some of cases

S. No	Remittance facility	Earlier limits	New limits
1	Liberalized Remittance scheme	US $ 25,000	US $ 200,000
2	Gifts	US $ 5,000	Nil – part of above limit
3	Donations	US $ 5,000	Nil – Part of above limit

SPAIN – TAX HIGHLIGHTS

Jigar Mukesh Patel

LL.M.(USA) International Tax Attorney

1. General Taxes Law (Act) & Specific Tax Legislations

The General Taxes Law (Income-tax) in Spain has 249 sections and 1 Volume of voluminous Regulations. In addition to this, there are separate tax acts for Personal Income Tax, Corporate Tax and Tax for Non-Residents. In Spain, income tax is levied both at the National Level and at the Local Provincial Level.

2. Income Tax Rates

A. Individuals

Spain personal annual tax rates 2012 (EUR) (Both State & Local)

Income (EUR)	%
1-17,707	24.75
17,708-33,007	30
33,008-53,407	40
53,408-120,000	47
120,001-175,000	49
175,001 – 300,000	51
300,001 and over	52

Various tax deductions are allowable to the individuals including standard deduction, deduction for child allowance, deduction for dependants, social security contributions etc.

B. Companies

Companies pay tax at 30% (federal tax). Local provinces tax rate may vary from province to province.

3. **<u>Tax Year & Return of Income</u>**

A. <u>Individuals</u> - The tax year is the Calendar Year (January to December). The Return of Income is due <u>within six months of the end of the calendar year</u>, i.e., by 30th June of the following year.

Married couples have the option of filing a Joint Return. Filing joint return proves beneficial in a scenario where there is disparity among the level of income earned by the couple (for e.g., if one taxpayer is in the high bracket and the other in the low bracket, filing joint return may prove beneficial).

B. <u>Companies</u> - The tax year for a company can be any period of 12 months (choice is given to the companies to follow their own particular tax year, subject to consistency). Again, the Return of Income is due within six months from the end of the Company's tax year (however, an extension of 25 days is granted in furtherance to the six month period).

A Group of Companies may be taxed on the basis of a Consolidated Balance Sheet (Concept of Consolidated Returns) if there is a specific holding threshold percentage met (70% or 75% shareholding threshold). May prove beneficial in cases where certain companies in the group have profits and others have losses.

4. **<u>Capital Gains Tax</u>**

<u>Individuals</u> – Capital gains tax levied at progressive rates ranging from 21% to 27% for individuals

<u>Companies</u> – Capital gains is taxable at the standard rate of 30% for companies (i.e. at the normal corporate tax rate)

5. **<u>Tax Administration</u>**

Taxpayers can file appeal before the various tax authorities (administrative/quasi judicial). There is also a concept such as the Administrative Tax Court, which is set up usually by the Ministry of Finance.

As per the tax provisions, any dispute before the administrative authorities is to be resolved <u>within a period of 6 months</u> by the respective authority.

<u>Tax Rulings</u> – The Spanish tax authorities generally may provide binding advance rulings on the tax consequences of a proposed transaction (rulings can be obtained even for domestic transactions).

6. **<u>Tax Courts</u>**

As far as the Courts of Law are concerned, there are no Special Tax Courts, but Courts do hear tax matters. However, it is not very common to have a lot of tax matters being filed before such courts. The Tax Courts, unlike in India, hear very few tax appeals each year. The number of appeals filed before the Tax Courts are much lower in number than in India.

7. Tax Assessments & Levy of Penalties

The normal period for which the tax authorities can reopen tax assessments is 4 years.

Failure to pay tax can result in penalties of <u>between 50% and 150%</u> of the tax owed, plus interest. Late payment can result in penalties <u>between 5% to 20%</u> of the tax involved, plus interest.

8. Other Taxes

A. **Net Wealth Tax:** A net wealth tax (worth tax) at progressive rates from 0.2% to 2.5% was reintroduced for 2011 and 2012 and is levied on the worldwide net worth of resident individuals. of the value of the property every year. For residents the first Euro 108,182 is tax exempt (tax exemption increases to Euros 150,253 if it is primary residence).

B. **Inheritance Tax:** Inheritance and gift taxes are imposed on all Spanish resident heirs, beneficiaries and recipients. Rates range up to 34%.

C. **Transfer Tax:** Transfer tax of 7% (or higher depending on the region) is applicable on transfer of capital asset.

D. **Stamp Duty:** Applicable at 0.5% (increased to 1% in most regions).

E. **Capital Duty:** Individual shareholders receiving goods or cash from liquidation or capital reduction of a company are subject to 1% levy of capital duty.

F. **Goods and Services Tax:** GST is applicable at the standard rate of 18%.

Glimpses of SPAIN