MILESTONE TAX NEWS

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Clear. Concise. Commercial.

# The Milestone Outlook

**Happy New Year to all our readers. We hope that 2013 will bring you prosperity, health and happiness.**

We are pleased to announce our latest recruit, Tony Hennessy, who has joined us on a consultancy basis from Grant Thornton. Tony has a great many years of experience in UK and international tax and we are very pleased to have him on board.

The theme in this month's edition is tax avoidance. Once again this is a front page news item and there seems to be no let up. Sally has written a feature on Ebay's Indian tax case that neatly illustrates what the UK and other high tax jurisdictions could do to tax the profits of online retailers that have a limited presence in a country. We also discuss the new rules applicable to high value residential property here in the UK. A limited window of opportunity exists to restructure existing investments and we would be delighted to help if you have a case to discuss.

Happy reading!

**The Milestone Tax Team**

## DEAL OF THE WEEK

## Solutions to the new annual residential property tax

We are currently advising a number of trust companies and banks with regard to the new rules affecting the ownership of high value UK residential property by "non-natural persons".

The new regime will affect companies, partnerships with at least one corporate member and collective investment schemes (as defined in section 235 FSMA 2000). From 1 April 2013, the following changes come into force:

- an Annual Residential Property Tax (**ARPT**) will apply to properties worth more than £2mn already held by a non-natural person; and
- UK capital gains tax (28%) on the sale of UK properties by a non-resident non-natural person.

For new acquisitions by non-UK domiciled individuals who are intending to occupy a residential property, the structure of choice is likely to be the "double trust" structure. That said, we have also been considering the use of a foreign incorporated partnership that we believe will be very effective in numerous situations.

Under the basic double trust structure:

- APRT does not apply (because the trust is not a "non-natural person");
- UK inheritance tax is mitigated through the use of debt finance.

For existing structures, stamp duty land tax is an important consideration if a reorganisation is intended. Likewise, capital gains tax will have to be very carefully considered in circumstances where an offshore trust is the ultimate owner of the property and trust beneficiaries are resident in the UK.

## ALSO IN THIS ISSUE...



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## INDIA

# Victory for the taxpayer in eBay International AG v ACIT

This case, in which eBay has scored a victory for the taxpayer in the Indian courts, provides a useful illustration as to how foreign web-based operations might efficiently operate in the Indian market.

EBay International AG ("**EBay AG**"), a Swiss incorporated and Swiss resident company, operated the EBay India website using resources located in Switzerland. EBay AG typically generates a commission paid by sellers for facilitating the sale via its website. In relation to the operation of the EBay India website, EBay AG entered into Marketing Support Agreements with two of its Indian subsidiaries pursuant to which the Indian subsidiaries provided marketing services.

The Court had to consider two key issues:

(i) whether the Indian subsidiaries constituted a PE of EBay AG on the basis they were operating as "dependent agents". On this point, the court ruled this was not the case because the Indian subsidiaries were not entering into contracts on behalf of EBay AG, nor maintaining a stock of goods, nor manufacturing goods on behalf of EBay AG; and

(ii)whether payments made to EBay AG were subject to withholding tax on the basis they were 'fees for technical services' ("**FTS**"). On this point, the court ruled that the services provided by EBay AG were not "technical" in nature. Just because the transactions between sellers and buyers were routed through the EBay website, which in turn came into existence through technical endeavour, did not mean the users of the website were availing of any technical service from EBay.

With regard to the PE issue, it should be noted that Indian domestic law and India's tax treaties typically operate to include a "Services PE" concept whereby the performance of services in India can constitute a PE. In addition, the "Dependent Agent PE" concept in Indian treaties is typically widened to deem a PE not only where a dependent agent enters into contracts on behalf of the foreign entity, but also where a dependent agent either

(i) maintains a stock of goods from which he regularly makes deliveries for the foreign entity; or

(ii)manufactures goods for the foreign entity.

This is a broader definition than that typically found in countries which conform to the OECD Model treaty in respect of which a PE only arises where the foreign investor has a "fixed place" or concludes contracts through a "dependent agent" in the source jurisdiction.

As an aside, if the UK would widen its PE definition in this manner, the consequence is that Amazon's UK based fulfilment centres would constitute a UK PE of the Luxembourg resident European sales company. Profits of Amazon Luxembourg relating to UK sales would thereby be attributable to the UK PE and subject to UK tax. This would appear to offer at least a partial solution to the current debate on the taxation of multinationals. Of course, before tinkering with such a fundamental cornerstone of the UK tax system one has to give due consideration to the law of unintended consequences. In particular, international tax treaties are based on the principle of reciprocity and if the UK were to re-negotiate its PE definition in this manner, an additional consequence would be that certain UK based multinationals (such as Rolls Royce) would have to pay a greater proportion of tax in overseas jurisdictions.

With regard to the withholding tax issue, India imposes withholding tax not only on passive income (i.e. dividends, interest and royalties) but also on a wide variety of payments such as fees for technical and professional services, insurance commissions, and capital gains.

In addition to the technical concerns, a foreign investor must bear in mind that India has a relatively aggressive tax authority (who, it is rumoured, are rewarded by reference to taxes collected) and a relatively slow judicial system (partly as a result of the size of the population relative to the number of judges). As such, foreign investors into India should not be surprised to encounter aggressive tax assessments and prolonged tax litigation.

## SWITZERLAND

# Wegelin & Co closes doors for business

The latest victim of cross-border enforcement and the long reach of the US authorities is the oldest bank in Switzerland, Wegelin & Co, which has been forced to close following a guilty plea to indictment for assisting Americans evade taxes.

The activities Wegelin engaged in were not, it is assumed, unique to Wegelin. Tax evasion is not, strictly speaking, a crime in Switzerland. Coupled with Switzerland's deeply entrenched privacy laws, the Swiss banks considered it "normal practice" to assist and encourage wealthy Americans to defraud the Internal Revenue Service (IRS). The forthcoming implementation of FATCA will only serve to draw the net tighter and it would be no surprise to see other Swiss banks bite the dust like Wegelin.

The cosy days of numbered accounts, fiscal black holes and the shroud of bank secrecy are well and truly over. And, not a minute too soon.

## UK / ISLE OF MAN

# Information sharing agreements in the pipeline

Running with the theme of international tax co-operation, the Isle of Man and UK governments have also announced that they will enter into an automatic information sharing agreement with the aim of combating cross-border tax evasion. The UK government has announced that it also intends to enter similar agreements with Jersey and Guernsey.

It is anticipated that these agreements will be in a similar form to the FATCA between the US and UK and will involve the automatic sharing of information on tax residents between the UK and Isle of Man on an annual basis. Of course, the UK / US FATCA agreement imposes similar mutual reporting requirements.

The idea behind these latest agreements is that it will provide HMRC with details of those UK persons with taxable income being held in Isle of Man, Jersey and Guernsey bank accounts. Although it is not illegal to hold foreign bank accounts, UK taxpayers are required to disclose details of any such accounts and their funds that may be subject to UK taxation.

## UK ANTI-AVOIDANCE

# How effective are HMRC anti-avoidance techniques?

When stories such as Starbucks' tax avoidance hit the news, it gives politicians (and Richard Murphy) something to soapbox about. This is fair enough – we live in a democracy in which debate is healthy. But it must be a sensible debate and one that does not preach about morality. Otherwise, such a debate would be subjective and lack sound reasoning.

Following this recent growing discord, we have begun to wonder about HMRC's targeting of 'tax avoidance'. Indeed, HMRC has a 65-strong team of experts who specialise in transfer pricing policies to prevent abusive cross-jurisdictional pricing arrangements among Group companies. According to reports, the team investigates 770 of the largest companies involving up to £1 billion of tax from transfer pricing arrangements. If HMRC had failed to investigate the well-known multinationals that have been in the press recently, there would be something afoot. In light of all this, it seems that HMRC needs to re-think its strategy. The UK has extensive mechanisms to prevent profits being sheltered abroad, not to mention the introduction of GAAR and international information sharing agreements being reached. A practical solution to curb 'tax avoidance' by multinationals would be a cap on deductibility of inter-company expenses such that the totality of financing costs, royalties, license fees and management fees does not strip the cupboard bare.

Also, take for example, HMRC's 'naming and shaming' of tax evaders. HMRC published a list of those guilty of crimes such as VAT fraud where the amount of tax evaded apparently totals £3 billion per year. Compared with the "avoidance" measures used by Starbucks, Amazon, Google, Facebook (oh, the list goes on…) that are targeting £1 billion per year, HMRC may be better to focus on crime (i.e. tax evasion) that takes away substantially more from the government's coffers. And let's not forget, tax evasion (deliberately not paying the tax you should) is illegal; avoidance (structuring your tax affairs in the most efficient way) is legal.

The line has been confused further by the Crown Prosecution Service's (**CPS**) latest announcement to crackdown on "dishonest tax avoidance schemes". One wonders how much of this is simply bowing to the current misconception that tax avoidance is bad. The problem is that "dishonesty" implies fraud. You cannot have fraudulent tax avoidance – this is tax evasion. The CPS will hopefully take advice on this matter before wasting taxpayers' money on prosecutions that won't stand up in a court of law.

## FRANCE

# 75% tax rate – will this affect the UK?

Continuing with the theme of avoidance, Gerrard Depardieu has shown just what individuals can do if they aren't happy with high income tax rates. Since France announced it would introduce a 75% tax rate for its highest earning individuals, a flurry of emigration of high-net worth individuals is anticipated.

The proposed 75% rate of tax is an example of politics interfering with sensible policymaking. Tax is often used as a political football (see for instance the Public Accounts Committee and their handling of large corporate tax), and Monseiur Hollande's tax hike will do more harm than good (as he is finding out). The ideology around the 75% is clear: that the rich must pay more. But with the rate likely to affect only 1,500 people (and in its current form is unconstitutional) its effect will be nominal in terms of raising taxes. However, the negative impact is already being seen. Cameron's gesture of rolling out the red carpet is being taken up by growing numbers of high net worth individuals who find the 75% rate abhorrent. It does, however, strike us as being slightly at odds with his recent pop at tax avoidance whilst in Davos.

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