

# IBFD

## Taxation of Capital Gains and Offshore Indirect Transfers

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# Agenda

- ▶ **Context and background Capital Gains article**
- ▶ **What is an offshore indirect transfer?**
- ▶ **Impact MLI and 2017 OECD and UN Models**
- ▶ **DD-V2 of the platform for collaboration on tax**
- ▶ **Specific examples**

# OECD/UN Models on Capital Gains

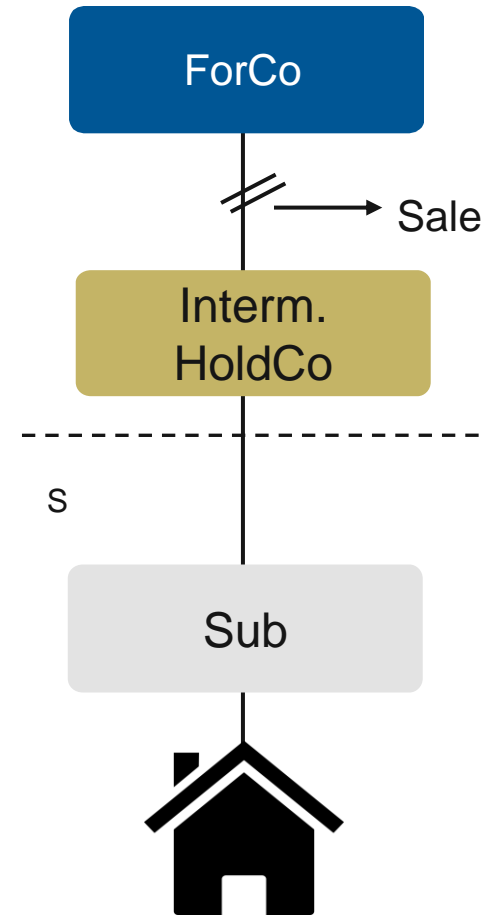
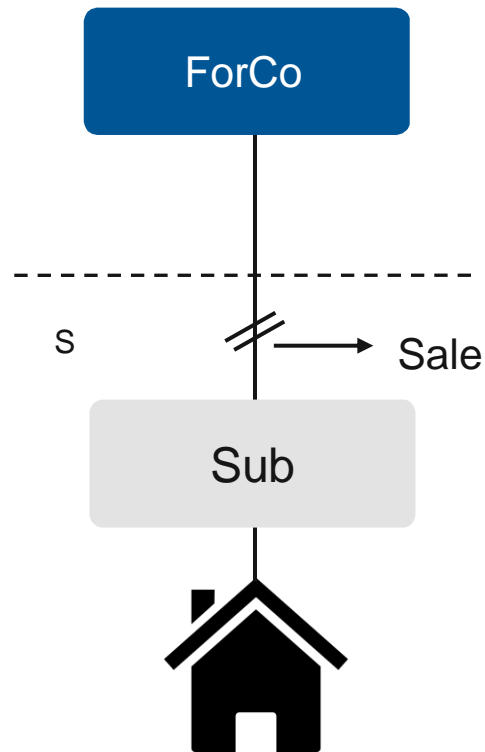
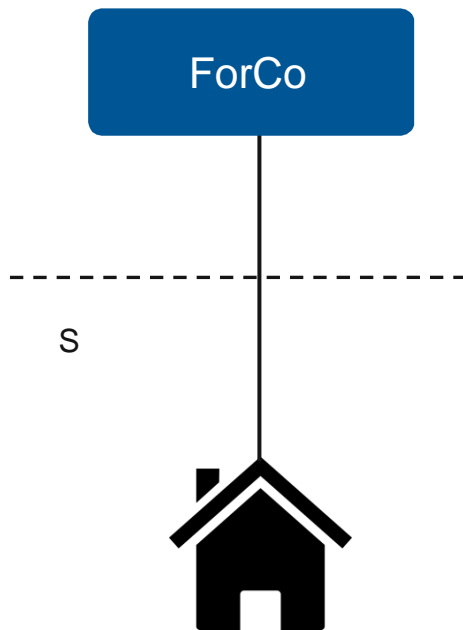
Provision	Capital asset	Taxing rights
13(1) OECD Model 13(1) UN Model	Immovable property	Immovable property state and residence state
13(2) OECD Model 13(2) UN Model	Movable property of a permanent establishment	Permanent establishment state and residence state
13(3) OECD Model 13(3) UN Model	Ships or aircraft operated in international traffic	State of the enterprise operating the ships and aircraft
13(4) OECD Model 13(4) UN Model	Shares in real estate company	Immovable property state and residence state
13(5) UN Model	Substantial shareholding	Source state and residence state
13(5) OECD Model 13(6) UN Model	General rule (other capital gains)	Residence state

# Gains on the Sale of Shares in Real Estate Companies

Art. 13(4) of the OECD Model and the UN Model:

Gains derived by a resident of a Contracting State from the alienation of shares (...), may be taxed in the other Contracting State if, (...) these shares (...) derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

# Summary of OIT Tax Planning



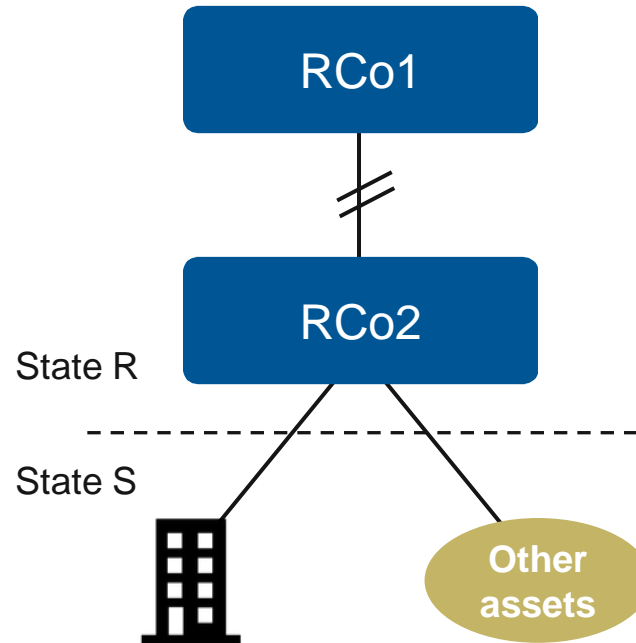
## Issues

- ▶ Domestic Law S
- ▶ DTT between state of seller and S

## Capital gains real estate entities; art. 13(4)

- ▶ BEPS Action 6
- ▶ “New” art. 13(4)
- ▶ Source state taxation on gains on the disposal of interests in “real estate entities”
- ▶ An entity is a “real estate entity” if the 50% value threshold is met at any time during a retrospective 365-day testing period
- ▶ Ownership interests that are comparable to shares are also covered by art. 13(4)
- ▶ Anti-cumulation provision in Commentary

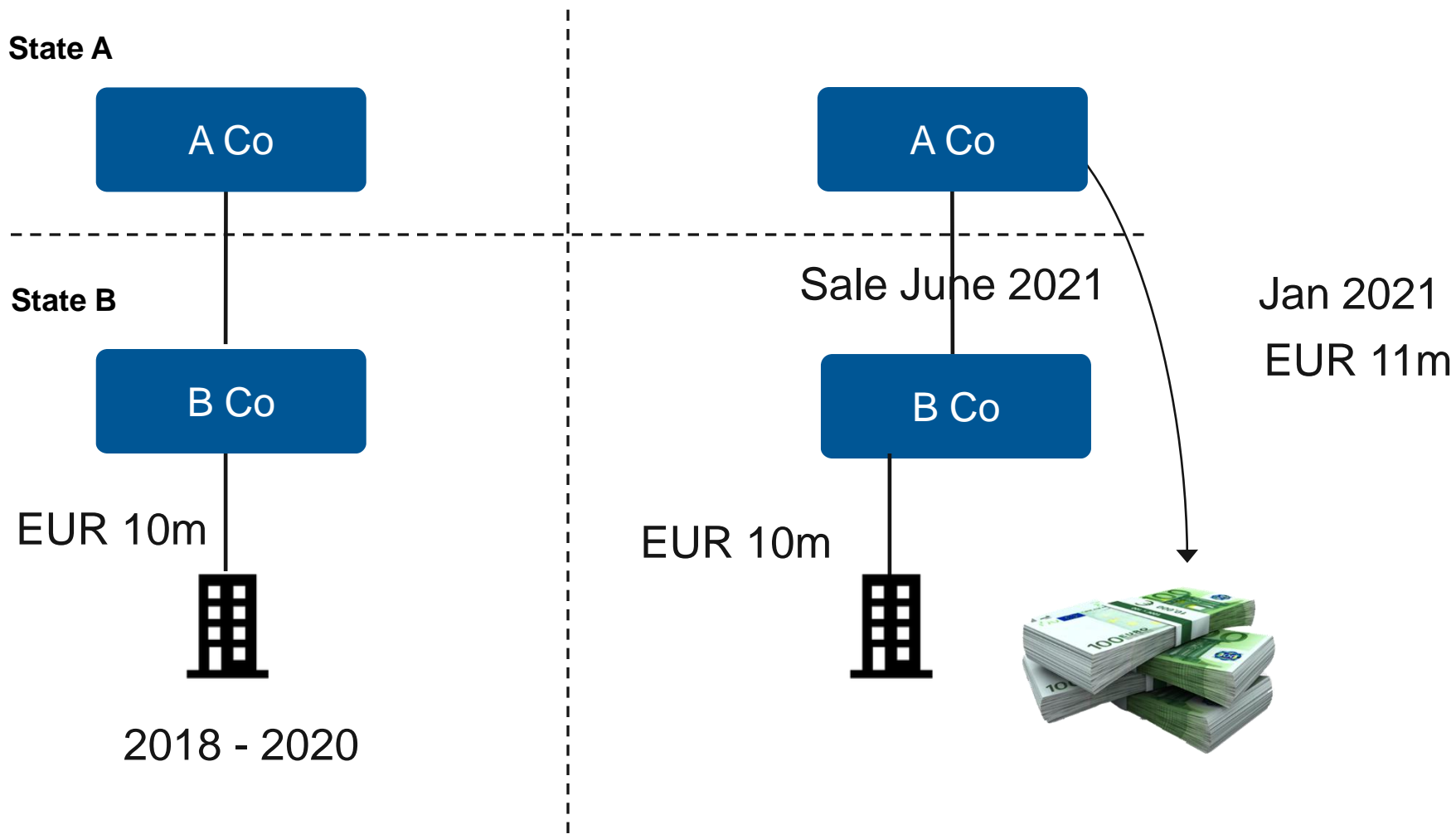
# Capital Gains on Real Estate Entities



- *Value immovable property > 50% value shares during any of preceding 365 days?*

# Capital Gains on Indirect Real Estate Interests

## Why apply a testing period?





# Art. 9 of the MLI – Capital Gains on Real Estate Entities

## Alternative 1

- ▶ Applies to CTA provisions similar to art. 13(4) of the OECD Model (“real estate entities”)
- ▶ Source state taxation on gains on the disposal of interests in real estate entities
  1. Introduction of retrospective 365-day period in testing value threshold
  2. Also applicable to interests comparable to shares

## **Compatibility clause**

- ▶ In place of or in the absence of a testing period in an existing provision on real estate entities
- ▶ Extension of ownership interests covered applies in addition to any shares or rights already covered by existing provisions

## Alternative 2

- ▶ Parties may opt to replace existing CTA provisions entirely with the new art. 13(4) of the OECD Model as per the Final Report on BEPS Action 6, or add this provision to CTAs currently lacking a provision on real estate entities

## **Compatibility clause**

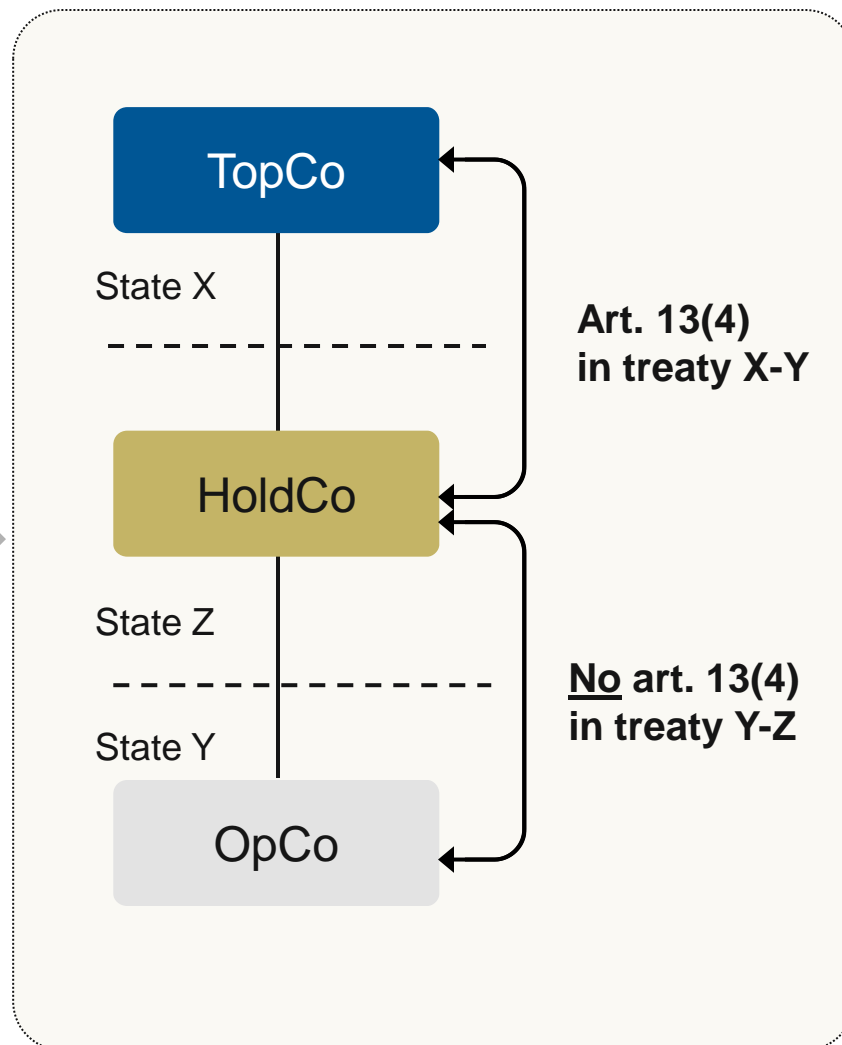
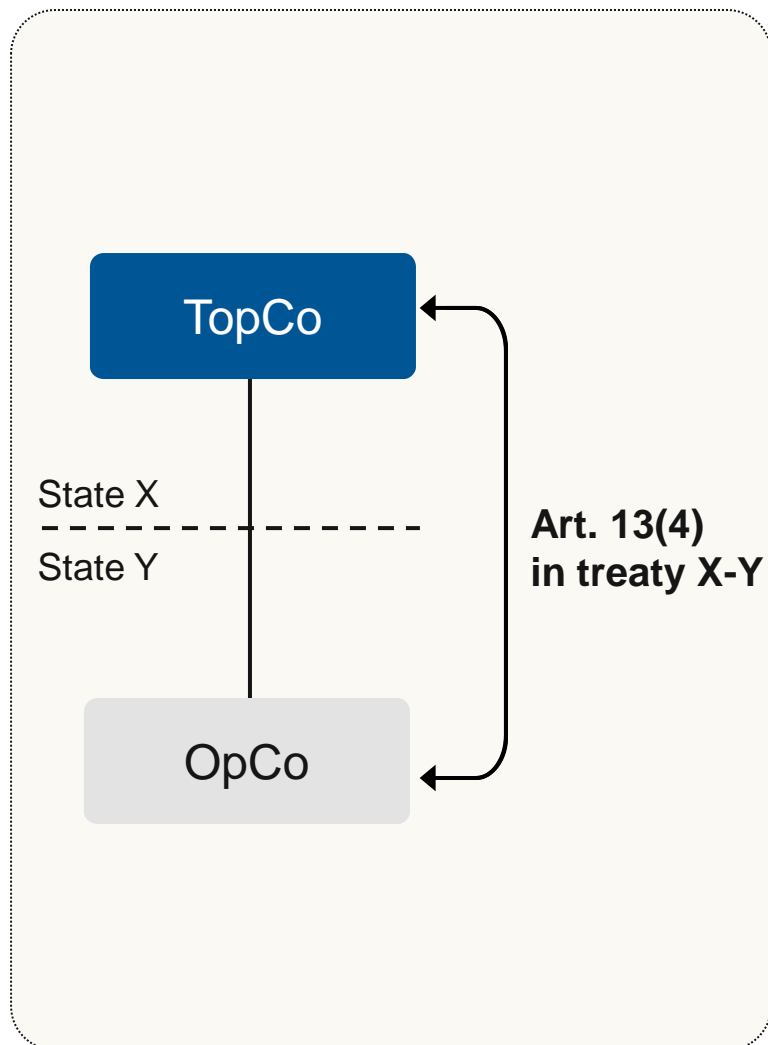
- ▶ In place of or in the absence of existing provisions on real estate entities

## Art. 9 of the MLI – Capital Gains on Real Estate Entities

### Permitted reservations

- ▶ No minimum standard
- ▶ Full or partial opt-out allowed
- ▶ Opt-out of alternative 2 with respect to CTAs that already contain a provision concerning real estate entities
- ▶ Full opt-out: 46/86
- ▶ Replace or add revised art. 13(4): 37/86

# Example Treaty Shopping



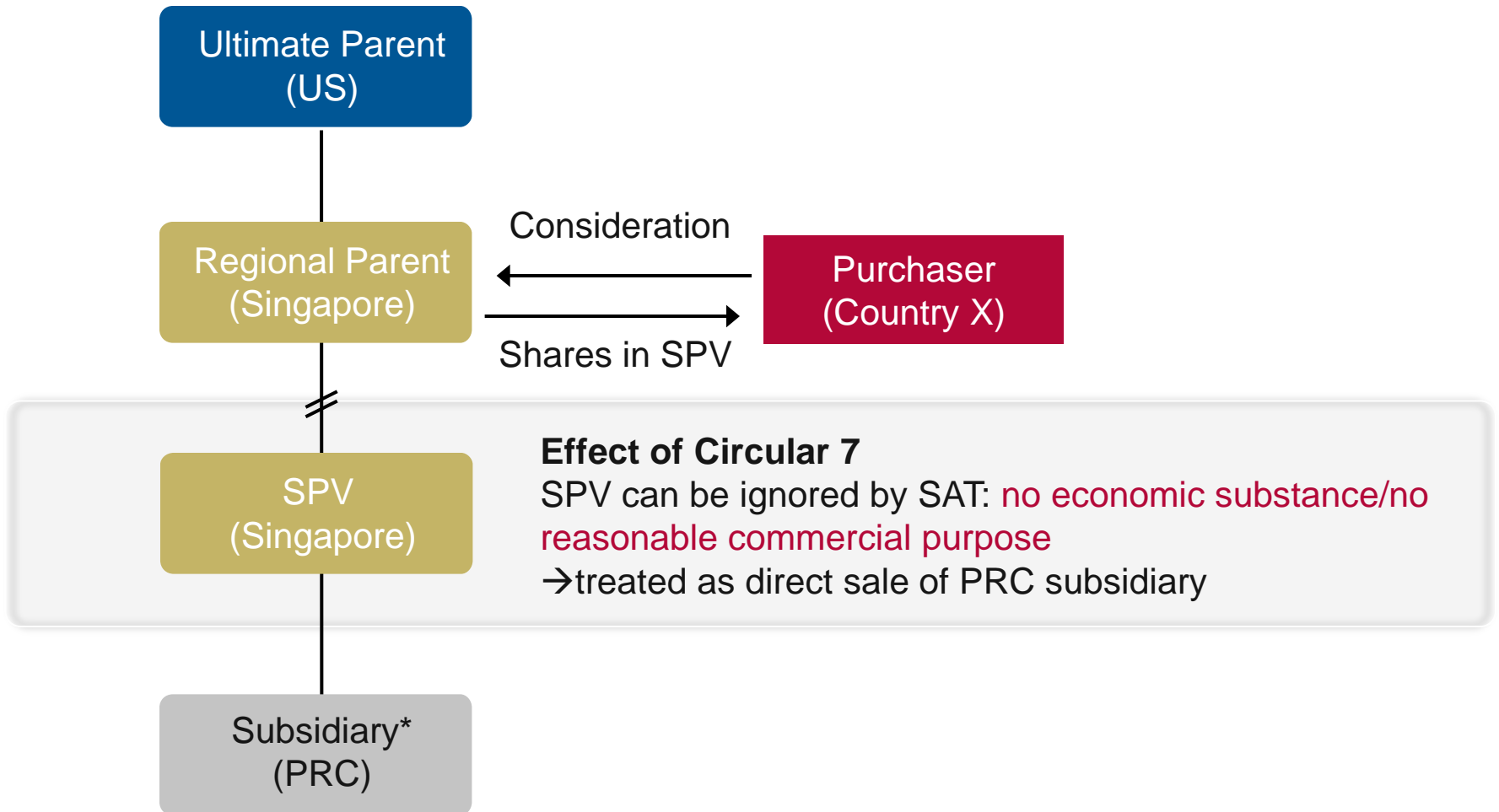
## IMF, OECD, UN and World Bank's "Toolkit" Regarding Offshore Indirect Transfer (OIT)

- ▶ **This joint initiative, known as “Platform for Collaboration on Tax”, released a draft toolkit which:**
  - ▶ discusses when an OIT occurs
  - ▶ concludes that there is a strong case to allocate capital gains taxation rights in case of an indirect transfer of immovable assets to the country where those assets are located
    - ▶ and that countries should adopt a broad category of immovable property subject to taxation, including gains arising in relation to “location specific rents”, for instance telecom licences and other rights issued by government
    - ▶ definition of immovable property and enforcement/collection rules are included
  - ▶ presents two options for domestic taxation rules: (i) a deemed disposal rule and (ii) a sourcing rule
    - ▶ choice is left to the countries

## Examples of Countries' Approaches to Capture OITs

- ▶ For instance China, based on domestic GAAR (“reasonable commercial purpose of transaction/arrangement”); see e.g. the double Sing holding structure
- ▶ India, based on domestic sourcing rules; see e.g. Vodafone
- ▶ Or Tanzania with a deemed disposal rule: when indirect ownership of a Tanzanian entity changes by more than 50%

# Capital Gains Planning – Indirect Transfers – China

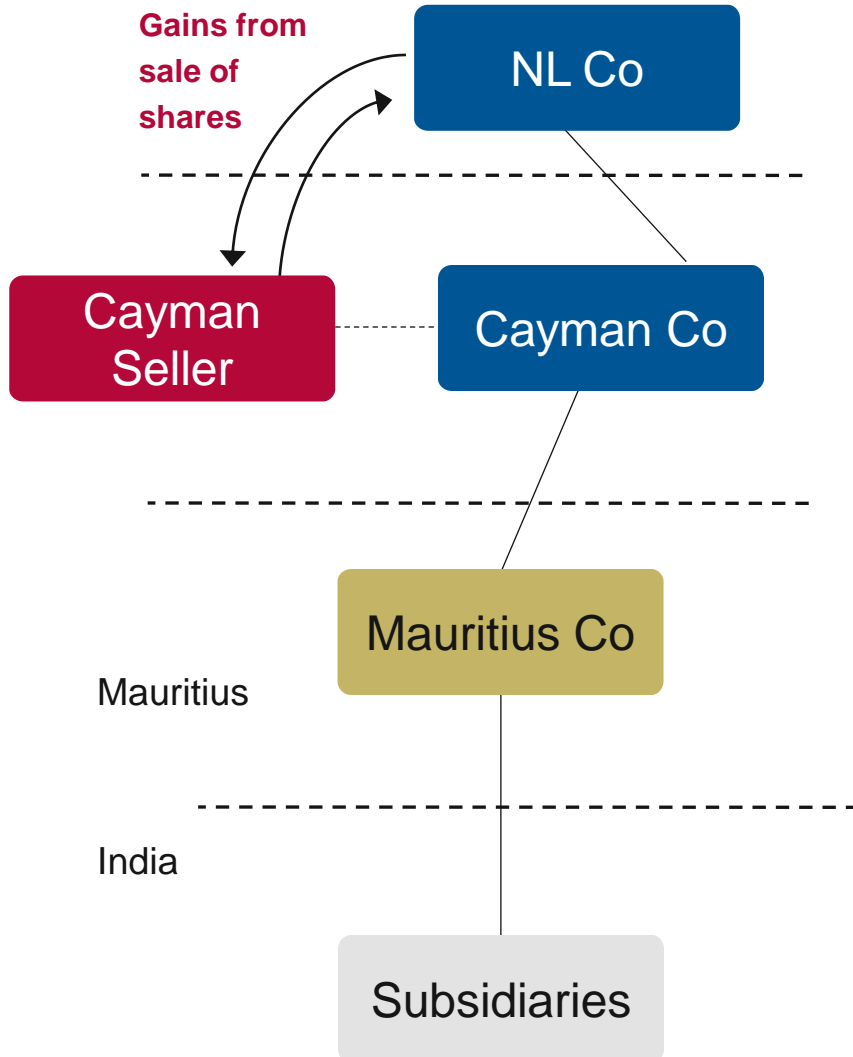


# China: Presence or Absence of “Reasonable Commercial Purpose”

The following factors should be analysed:

- ▶ Whether the main value of the overseas enterprise is directly or indirectly derived from the taxable properties in China
- ▶ Whether the assets of the overseas enterprise mainly directly or indirectly consist of the investment in China, or whether its income is mainly directly or indirectly derived from China
- ▶ Whether the functions actually performed or risks actually assumed by the overseas enterprise or its subsidiaries holding the taxable properties in China can prove the economic substance of the organizational structure
- ▶ The duration of existence of the shareholders, business models and the organizational structure of the overseas enterprise
- ▶ The income tax position concerning the indirect transfer outside China
- ▶ The possibility of the substitution of an indirect transfer with a direct transfer
- ▶ The application of a tax treaty or an arrangement (related to Hong Kong or Macau) to an indirect transfer
- ▶ Other related factors

# Vodafone Case



- ▶ **NL Co bought 1 share of Cayman Co from Cayman Seller**
- ▶ **Cayman Co owns a number of subsidiaries in India via an entity in Mauritius**
- ▶ **Values of the share are ascribed to the subsidiaries in India**
- ▶ **Tax authority seeks to claim withholding tax on capital gains as the gains are considered to have accrued in India**
- ▶ **Issue: whether India can claim source taxing right over the capital gains**



## Vodafone: Clarification in Indian Domestic Law

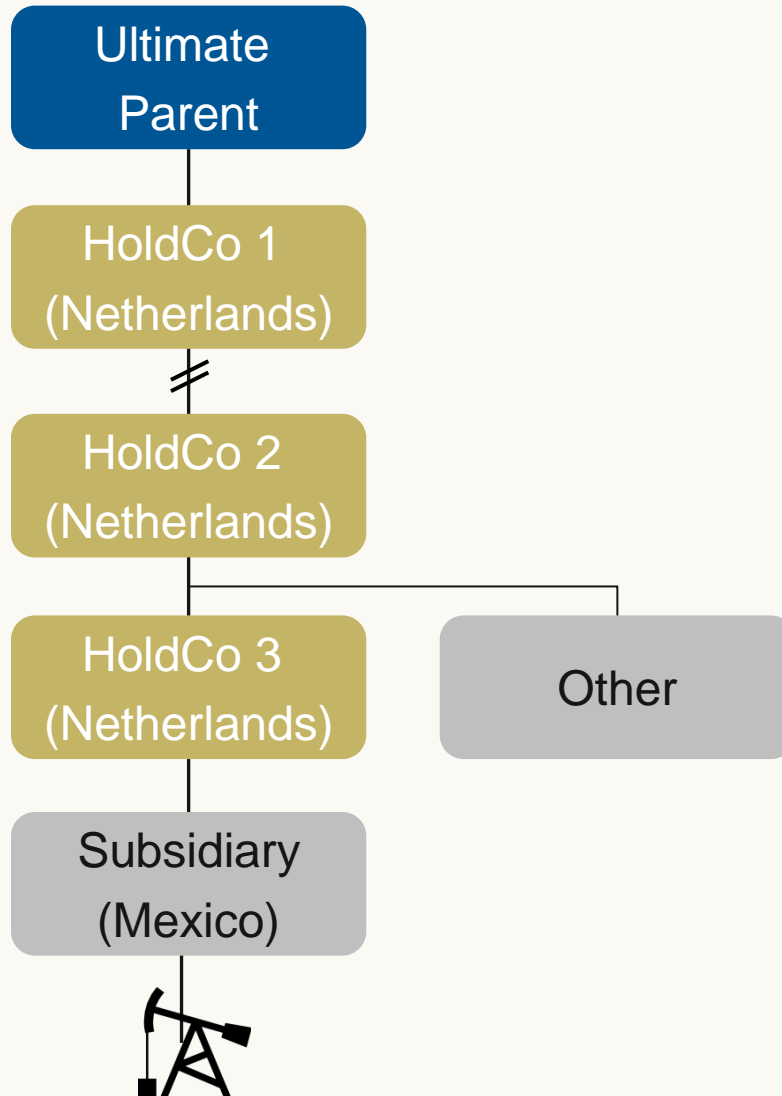
Income deemed to accrue or arise in India.

9. (1) The following incomes shall be deemed to accrue or arise in India :—

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a **capital asset situated in India**.

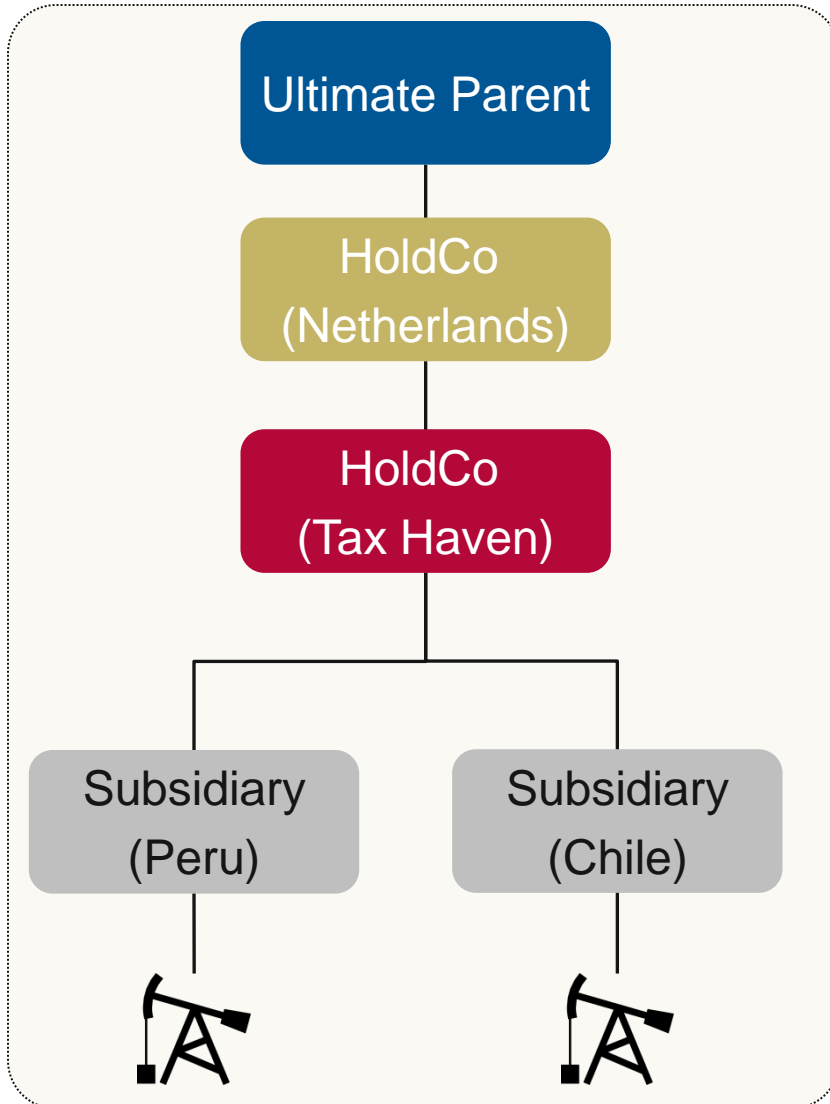
***Explanation 5.*—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India; (introduced in 2012 with retrospective effect from 1 April 1962).**

## Examples Indirect Transfers – Mexico



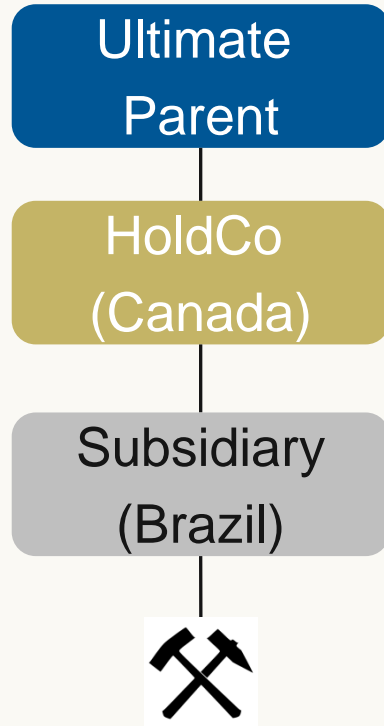
- ▶ > 50% of value represented indirectly by immovable property situated in Mexico
- ▶ Income deemed to arise from Mexican source
- ▶ Treaty protection under art. 13(5) of the Mexico-Netherlands treaty?

## Examples Indirect Transfers – Peru and Chile



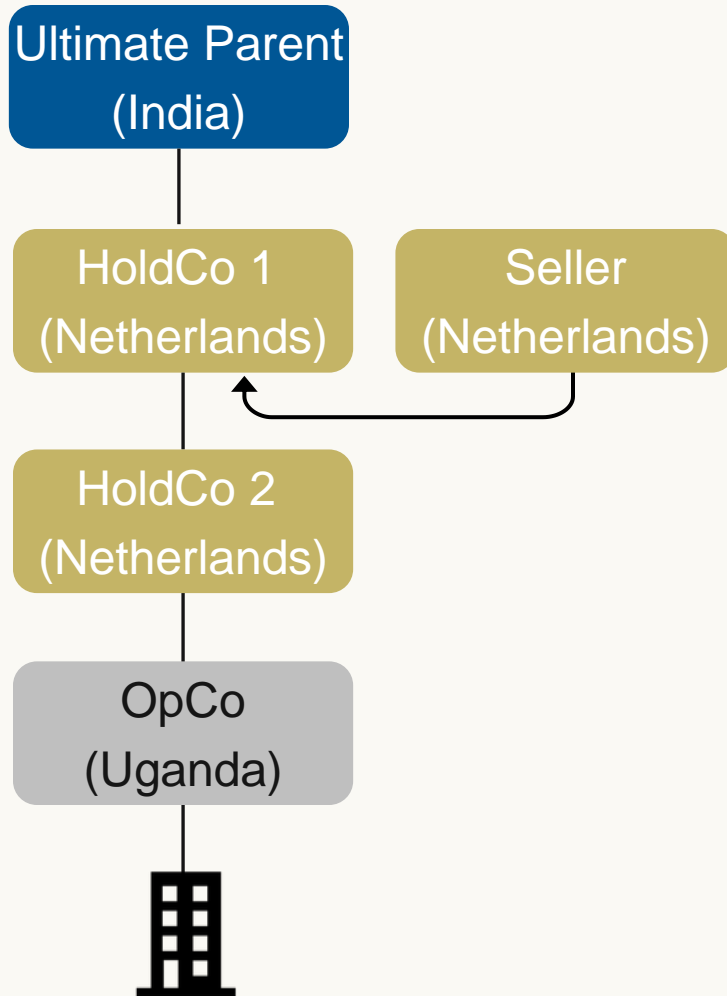
- ▶ Objective: eliminate tax haven from corporate structure
- ▶ No local tax reasons
- ▶ Options considered:
  - ▶ merger
  - ▶ transfer of seat/ conversion to Luxembourg/Netherlands
- ▶ > 20% value threshold
- ▶ Taxable event?

## Examples Indirect Transfers – Brazil



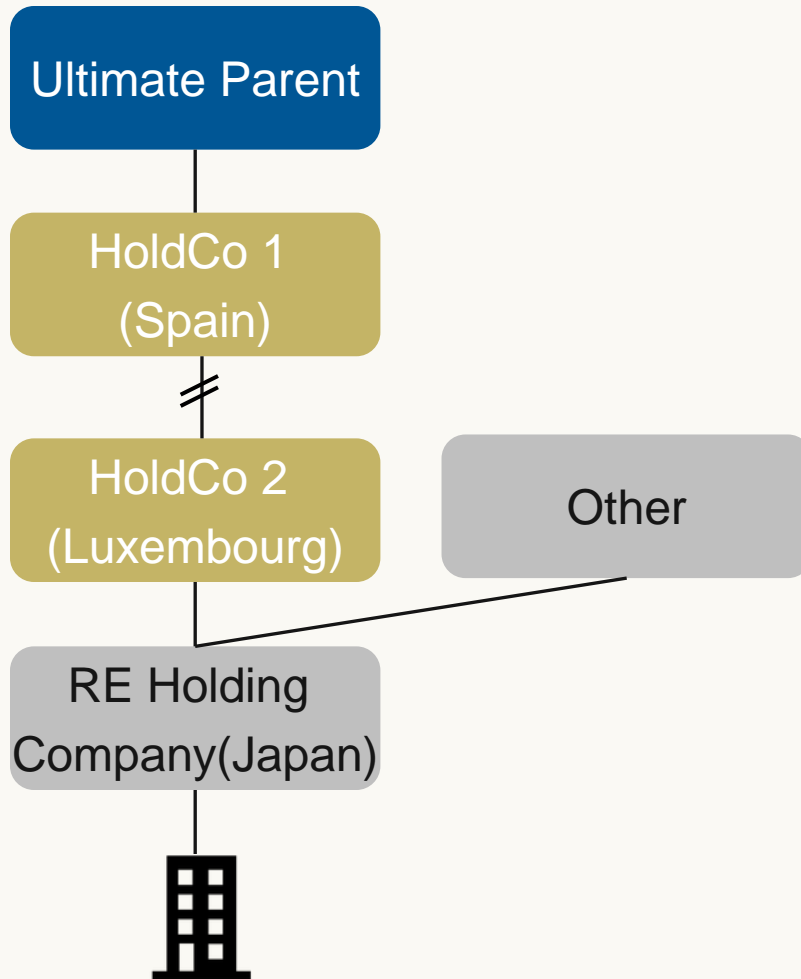
- ▶ Objective: transfer CanadaCo to other jurisdiction
- ▶ Potential 25% Brazilian WHT on difference cost price and FMV of shares BrazilCo

## Examples Indirect Transfers – Uganda



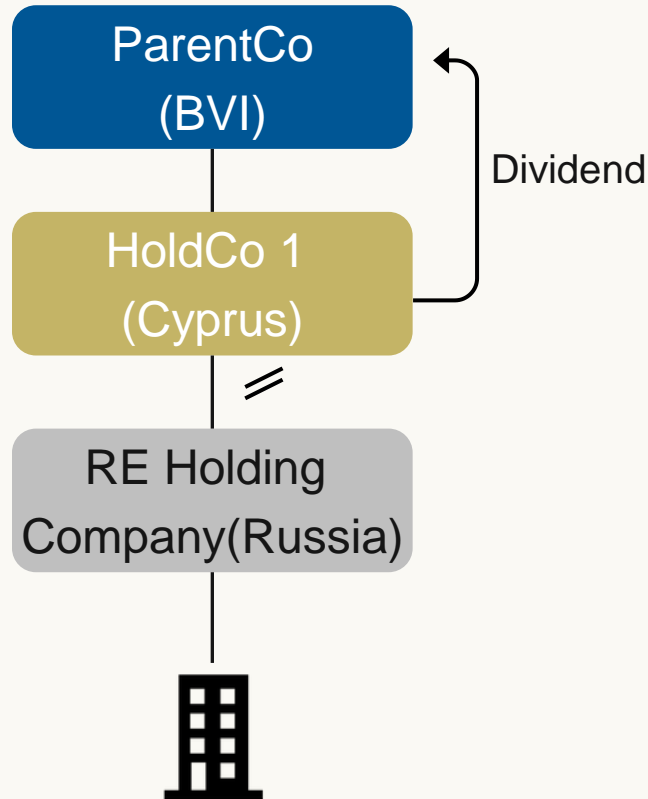
- ▶ Uganda: disposal immovable property; art. 13(1) of the Netherlands-Uganda treaty applicable
- ▶ Income sourced from Uganda?
- ▶ No art. 13(4)-type provision in Netherlands-Uganda treaty
- ▶ Case pending

## Examples Indirect Transfers – Japan



- ▶ FMV of interest in JapanCo > 50% derived directly or indirectly from immovable property in Japan?
- ▶ SpainCo subject to capital gains tax
- ▶ Treaty protection under art. 13 of the Japan-Spain treaty?

## Examples Indirect Transfers – Russia



- ▶ > 50% of assets RussiaCo consisted of immovable property in Russia
- ▶ No treaty protection Cyprus-Russia treaty as CyprusCo is not beneficial owner
- ▶ Treaty updated to include art. 13(4)-type provision

**Thank you for your attention!**