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Article 13 (Capital Gains)

Article 13 (CAPITAL GAINS): the practical implications of paragraph 4

In the Ninth session of UN Committee of Experts on International Cooperation in Tax Matters (the UN Tax Committee) in October, 2013 it was decided to have a conference room paper on the practical implications of paragraph 4 of Article 13, i.e., a paper on country practices in relation to Article 13(4).

2. Article 13 of the United Nations Model Double Taxation Convention provides as under:

1. *Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*

2. *Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.*

3. *Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircrafts or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.*

* E/C.18/2014/1

4. *Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:*
   (a) *Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.*
   (b) *For the purpose of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.*

5. *Gains, other than those pertaining to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.*

6. *Gains from the alienation of any property other than that referred to in paragraphs 1,2,3,4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.*

3. First three paragraphs of Article 13 of the United Nations Model Convention are similar to the first three paragraphs of Article 13 of the OECD Model Convention. Paragraph 4 broadly corresponds to paragraph 4 of the OECD Model Convention and paragraph 5 is a distinct provision in the United Nations Model Convention. Paragraph 6 is the same as paragraph 5 of the OECD Model Convention but adjusted to take into account the insertion of the additional paragraph.

4. The general rule contained in Article 13 is that gains from the alienation of property are taxable only in the state of which the alienator is a resident-to this rule there are exceptions for immovable property, the business property of a permanent establishment, ships, aircraft and related property, alienation of shares of a company or of an interest in other entities deriving their value directly or indirectly principally from immovable property and alienation of shares if the alienator directly or indirectly holds specified percentage of the capital of the company during a period of twelve months prior to alienation.

5. The Article 13 lays down the rules for allocation of taxing rights between the residence state and the source state in the context of capital gains. However, it cannot be construed as giving a State the right to tax capital gains if such right is not provided for in its domestic law. The Article does not specify to what kind of tax it applies, it is understood that the Article applies to all kinds of taxes levied by a Contracting State on capital gains. A comparison of the tax laws of certain countries shows that the taxation of capital gains varies from country to country:

- in some countries capital gains are not deemed to be taxable income;
- in some other countries capital gains accrued to an enterprise are taxed, but capital gains made by an individual outside the course of his trade or business are not taxed;
- in some other countries capital gains made by an individual outside the course of his trade or business are taxed, but in such cases taxation often applies only in specified cases, e.g. profits from the sale of immovable property or speculative gains (where an asset was bought to be resold).

6. The taxes on capital gains vary from country to country. In some countries capital gains are taxed as ordinary income while in other countries capital gains are taxed at concessional rates. Most States taxing capital gains do so when an alienation of capital assets takes place. Some of them, however, tax only so-called realised capital gains. Under certain circumstances, though there is alienation no realised capital gain is recognised for tax purposes (e.g. when the alienation proceeds are used for acquiring new assets). Whether or not there is a realisation has to be determined according to the applicable domestic law as Article 13 does not define ‘capital gains’ or ‘alienation’.

7. Paragraph 1 of Article 13 states that gains from alienation of immovable property may be taxed in the state in which it is situated. This rule corresponds to the provisions of Article 6 and of paragraph 1 of Article 22. Paragraph 1 of Article 13 deal only with gains which a resident of a contracting state derives from the alienation of immovable property situated in the other contracting state. The rules of paragraph 1 are supplemented by those of paragraph 4. Paragraph 2 deals with movable property forming part of the business property of a permanent establishment of an enterprise or pertaining to a fixed base for performing independent personal services. An exception from the rule of paragraph 2 is provided for ships and aircraft operated in international traffic and for ports engaged in inland waterways transport and movable property pertaining to the operation of such ships, aircraft and boats. The gains from the alienation of such assets are taxable only in the state in which the place of effective management of the enterprise operating such ships, aircraft and boats is situated.

8. The paragraph 4 of Article 13 of the UN Model Double Taxation Convention broadly corresponds to paragraph 4 of the OECD Model Convention, which reads as under:

> ‘Gains derived by a resident of a contracting state from the alienation of shares deriving more than 50 % of their value directly or indirectly from immovable property situated in the other contracting state may be taxed in that other state.’

By providing that gains from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from the immovable property situated in a Contracting State may be taxed in that State, paragraph 4 of Article 13 of OECD Model Convention provides that gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in that State. Paragraph 4 of Article 13 allows the taxation of the entire gain attributable to the shares to which it applies even where part of the value of the share is derived from property other than immovable property located in the source State. The determination of whether shares of a company derive more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property).

9. The paragraph 4 of Article 13 of the United Nations Model Double Taxation Convention, which broadly corresponds to paragraph 4 of Article 13 of the OECD Model Convention, allows a Contracting State to tax a gain on an alienation of shares of a company or on an alienation of interests in other entities, the property of which consists principally of immovable property situated in that State. The Commentary on Article 13 (4) of the United Nations Model Convention says that it is designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of a company to hold such property, it is necessary to tax the sale of shares in such a company. This is especially so where ownership of the shares carries the right to occupy the property. In order to achieve its objective, paragraph 4 would have to apply regardless of whether the company is a resident of the Contracting State in which the immovable property is situated or a resident of another State. In 1999, the former Group of Experts decided to amend paragraph 4 to expand its scope to include interests in partnerships, trusts and estates which own immovable property. It also decided to exclude from its scope such entities whose property consists directly or indirectly principally of immovable property used by them in their business activities. However, this exclusion will not apply to an immovable property management company, partnership, trust or estate. In order to fulfil its purpose, paragraph 4 must apply whether the company, partnership, trust or estate owns the immovable property directly or indirectly, such as through one or more interposed entities. For the purpose of this paragraph, the term “principally” in relation to the ownership of an immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by such company, partnership, trust or estate.

10. Paragraph 4 of Article 13 has been designed to prevent the avoidance of taxes on the gains from the sale of immovable property, therefore, it necessitates to examine the County practices in implementation of the said provision. Several implementation issues arise in applying the paragraph 4 of Article 13 of the United Nations Model Double Taxation Convention in taxing transactions involving transfer of shares of a company, interest, partnership, trust etc. deriving their value directly or indirectly, principally from immovable property situated in a contracting state. The basic focus of this Technical Note is to analyse country practices about these ground level implementation issues and examine if any best international practice can emerge which would allow in dealing with those issues consistent with the spirit of the United Nations Model Double Taxation Convention. The issues have been divided under broad categories of taxpayer issues, tax administration issues and other issues. A summary of country practices (the details are at Annex-1) and further proposals and suggestions are given as follows.

11. The first issue is about knowledge by the alienator of shares of a company, partnership, trust, etc. as to whether the property of that company consists principally of ‘immovable property’ situated in a particular country and discharge his or her tax obligations to that country. The knowledge may be derived from the financial statements of the company etc. or directly from the company etc. itself. However, the accuracy of this information would depend on the comprehensiveness of the financial reporting or the influence of that shareholder (whether the shareholding is substantial or significant). Some countries like Australia, Netherlands and South Africa extend this capital gains taxation rule to non-

residents with interest over a threshold and these “connected” entities with a company are expected to know the segmentation of assets of that company into immovable property assets. The situation in US is unique in the sense that FIRPTA Rule creates a deeming fiction that any interest in a domestic company could be construed as a US real property interest (USRPI) unless the taxpayer establishes otherwise. If the taxpayer’s interest in the domestic corporation is a USRPI or the taxpayer does not establish that its interest is not a USRPI, any gain recognised from the disposition of such interest is subject to U.S. federal income tax. The presumption is rebuttable by the foreign person and the US corporation is to determine if it is US real property holding corporation (USRPHC) and this fact has to be communicated by the US corporation to the foreign shareholder, transferee and also to the Internal Revenue Service (IRS) within a specified time. There are some exceptions to the taxation of such dispositions of shares of corporations predominantly holding real estate like for publically traded shares below a certain threshold.

12. The second issue is ascertaining the position of assets on the date of alienation of assets, which may fall between the two balance sheets’ dates. The difficulty is genuine and if the entity is not “connected” it is very difficult to get the status of the company, but has been addressed by increasing the frequency of disclosure (monthly or quarterly) and by fixing a “look back period” of 3 or 5 years as is the case in China and US or allowing the taxpayer to submit the audited accounts of the company for the financial year which is closest to the date of alienation, as in the case of Malaysia, or allowing the calculation of immovable property’s portion in company assets based on the balance sheet on the last working date prior to the date of alienation of shares, as in the case of Russian Federation. In the “look back period” the character of the company is assumed to be the same (e.g., USRPHC) and the state, where the property is situated, gets the taxing right.

13. The next issue is public disclosure of location of immovable properties of the companies, e.g., in the balance sheets, and the access by the taxpayer of this information to know his tax liability. While it may be easy to access this information in certain types of industries, like, mining, infrastructural industries etc., in others only values of such immovable properties could be derived from financial statements. However, generally almost all countries (except Mexico, which says such information is available in public domain) have expressed the view that it would be very difficult to obtain this information, except from the company itself.

14. In cases where the taxpayer transacts in shares based on only price information and not on the basis of financials of a company, then the full responsibility is on him only to get complete information and determine his tax liability. In case of publically listed shares, some information about the financials of that company may be in public domain and if the shareholding is substantial, the access of financial information is easy.

15. The next category of issues relate to tax administration. It is felt that since the words “immovable property” have not been defined in Article 13 (4), the meaning of these may be sourced to domestic laws of States. Many countries have accepted this position and have given the definition of “immovable property” or “real property” to mean land and unsevered products and structures attached to land. However, in some countries, the tax legislation does not contain any definition of “immovable property.” The country-specific definitions are given in the Annex-1 giving responses to the questionnaire prepared for eliciting responses

on Article 13 (4) of the United Nations Model Double Taxation Convention. Personal property is treated as real property as in the case of US, when (i) the personal property is used in mining, farming and forestry; (ii) the personal property is used in the improvement of real property (e.g., construction equipment); (iii) the personal property is used in the operation of a lodging facility; or (iv) the personal property is used by a lessor in the leasing of furnished office or other work space to lessees.

16. The next issue for tax administrators is the determination of the date reckoned for determining if the immovable property of a company constitutes more than 50% of the total assets. The country practices vary on this issue. However, for most of the countries, the date of alienation or transfer is reckoned for determining the threshold value. However, in some countries, the “look back” rule applies, e.g., China and US. For some others, the closest reporting date is taken into account for this purpose.

17. The question if the book value, cost or fair market value of the assets of a company etc. is to be reckoned to determine the taxability on account of alienation of shares or interests deriving their value principally from the immovable property in the source country has not evoked any single standardised response. The countries which stated that it is book value, are, China, Mexico and the Russian Federation, whereas the remaining countries, which have responded, have stated that it is fair market value.

18. Extending the valuation question further, it was asked if all assets on the books are to be reckoned or assets not in the books, such as, goodwill or other intangible assets are also to be reckoned. Most countries have stated that only those assets which are part of the books are reckoned, however, countries, such as, Azerbaijan, Mexico, Netherlands, Norway, South Africa and US, have stated that all assets, including intangible assets, e.g., goodwill, are included in valuation of assets.

19. The issue of tax administrators getting information about non-resident-to-non-resident transfer of shares of a company, whose “immovable property” is situated in the source country, is really complex and this information is difficult to get, except through collaboration between the two countries involved or through disclosure by seller or through a specific requisition from the company itself. That implies that this information is not automatically made available by companies, but it depends on the efficiency of the tax administrators to gather this information. However, some countries require periodic updating of shareholding or approval from the Government authorities for such transfer (Australia, Brazil, Malaysia).

20. The issue as to how the tax administrators come to know of the abusive escape by shareholders with controlling stake in a company, whose “immovable property” is 50% or more, as the company can borrow short term to slip below 50% threshold and what are the safeguards in the domestic law to tackle such a situation, has received varied responses. Some countries have responded to say that these countries may invoke general anti-avoidance provisions (Australia, Japan, Norway, South Africa), while some have stated that debt is not reckoned to reduce the immovable property assets below 50% threshold or allowed subject to some safeguards (China, Malaysia, Mexico and US).

21. The capital gains covered in para 4 of the Article 13 of the United Nations Model Double Taxation Convention are from alienation of shares of a company, interests in

partnerships and trusts etc.. However, the question if the domestic legislation covers alienation of shares in companies only or these extend to other interests, such as, those in partnerships or trusts has received a near uniform reply. While most countries have stated that all interests are covered, some countries, like China and Zambia have replied that these relate to only companies.

22. Some countries have given information on the actions taken or proposed to be taken to further improve the integrity and robustness of foreign residents' regime in relation to disposal of source country real property interests. Australia would introduce a 10% withholding tax with effect from July, 2016. US has suggested that the circumstances when the shares are treated as real estate interests should be appropriately circumscribed looking at the spirit of the UN Convention and there should not be any mechanical application of 50% test. For example, a manufacturing company can be USRPHC simply because it has a heavy investment in plant and machinery. Likewise, a services company which does not require a high physical capital can be USRPHC by virtues of owning the office building from which it operates.

Conclusion

23. The purpose of paragraph 4 of Article 13 of the United Nations Model Tax Convention is to prevent the avoidance of taxes on the gains from sale of immovable property through incorporation of a company or trust or partnership. This paragraph can render help to a country in tackling such cases of tax avoidance only when its domestic law contains a provision to this effect. In the absence of such a provision in the domestic law, the treaty provision becomes otiose as mere existence of paragraph 4 in Article 13 cannot be construed as giving a State the right to tax capital gains arising as a result of transfer of shares deriving their value directly or indirectly principally from immovable property situated in that State. Therefore, to make effective use of the provisions of paragraph 4 of Article 13 of the UN Model Convention, it is essential for the countries including the same in their treaties to have the enabling provision in their domestic law.

24. The information gathered from various countries indicates that there are following implementation issues relating to paragraph 4 of article 13:

- Lack of information with the alienator that the share of a company or interest in any other entity derives its value directly or indirectly principally from immovable property situated in a particular State.
- Ascertaining the value of immovable property on the date of alienation of shares or interest which may fall between the two balance sheet dates.
- No definition of immovable property.
- Whether book value or fair market value to be adopted for ascertaining the tax liability
- Whether all the assets appearing in the balance sheet are to be taken or not appearing in the book, such as, goodwill etc., are also to be taken into account for the determining tax liability.
- How to ensure payment of taxes when the transaction is between two non-residents,

25. Non-availability of information to the alienator regarding the ownership of immovable property by company or other entity, its location and the value of assets are some of the issues, which impact effective implementation of this provision. These issues can be addressed by countries by putting in place a regulatory framework for comprehensive financial reporting by the company or other entities to ensure disclosure of the details of immovable property owned by a company or other entity in their jurisdiction to the shareholders of the company or to the persons having interest in partnership, trust, estate, as the case may be. We may move towards having greater transparency in the segment reporting by companies and other entities so that kinds of assets owned by them could be clearly discernible and the rights of the contracting states to tax gains arising from transfers of shares of companies or of interests in other entities involving underlying immovable property could be preserved. Therefore, countries should demand more transparency in the valuation principles, segment accounting reports and location of immovable properties so that tax liability can be easily determinable in the case of a taxpayer and this provision may be effectively used in tackling the issue of avoidance of taxes on the gains from the alienation of shares of a company or of interest in other entities, deriving their value principally from immovable property.

26. The issue of ascertaining the value of immovable property on the date of alienation of shares or interest, which may fall between two balance sheet dates, and whether the book value, cost or fair market value be adopted for ascertaining the tax liability, can be addressed by clarifying the country's position in their domestic law or rules made thereunder. The countries, which do not have a definition of immovable property in their tax legislation, should include the same if they have or intent to include paragraph 4 of Article 13 in their tax treaties. The rules, regarding reckoning of intangible assets, such as, goodwill, etc. for the purposes of valuation of total assets, should be clearly laid down by the countries to ensure effective implementation of Paragraph 4 of Article 13 of the United Nations Model Tax Convention. The issue of difficulty faced by tax administrators getting information about non-resident to-non-resident transfer of shares of a company or of interests in partnership or trust etc, whose immovable property is situated in their jurisdiction, can be tackled through effective exchange of information, for example, spontaneous exchange of information between two countries.

Annex-1

Capital Gains from the Alienation of Shares in the Immovable Property Rich Entities

1. Taxpayer issues

a) How does a taxpayer in your tax jurisdiction who alienates shares know that the property of the company, partnership, trust etc. whose shares have been alienated consists principally of 'immovable property' situated in a particular country and discharge his or her tax obligations to that country.

AUSTRALIA

It is likely that a foreign resident taxpayer would generally be aware of the Australian Capital Gains Tax (CGT) implications that stem from such alienation events, given the fact that the relevant legislation in Division 855 of the Australian Income Tax Assessment Act 1997 only applies where they have a significant ownership interest in the relevant 'land rich' entity, i.e. 10% or more (known as a non-portfolio interest).*

However the extent to which they would know about their tax obligations would also depend upon factors such as:

- whether the taxpayer has sufficient control to demand that a market valuation be undertaken to determine whether the entity qualifies as 'land rich', e.g. when they own less than 50% of the interests in the entity;

- whether the information the taxpayer requires to determine whether an entity is land rich or not is accessible from the entity itself or in the public domain e.g. consolidated financial reports and analyst reports; and

- whether the taxpayer is aware of the taxation rules that apply. In the Australian context, information is available on the Australian Taxation Office website and it is likely that a foreign resident in these situations would have a tax agent in Australia acting on their behalf.

* Please note: The responses to this questionnaire focus on CGT in Australia, as this is where the majority of transactions involving alienation of interests pertaining to immovable property are likely to have a tax impact. In limited situations however, alienation of interests, not limited to the CGT shareholding threshold, which have been acquired for the purpose of profit making by sale, may be taxable on revenue account in Australia e.g. certain disposals of interests by private equity firms. However, whether or not the gains and losses have Australian tax consequences will depend on the application of any relevant tax treaty (and in

particular articles allocating taxing rights over business profits and the alienation of real property).

AZERBAIJAN

Shareholder/taxpayer can get that information from the accountant of the company or other person in charge and holds that information before alienating shares.

BRAZIL

The percentage of the value of the shares that consists of immovable property is irrelevant under Brazilian Law and Brazilian DTCs to determine the capital gains taxation (see item 4).

CHINA

In most cases, the taxpayer has learned about composition of the property of an entity before the investment, especially for a listed company whose information is publicized. If the taxpayer is not informed of this beforehand, he can ask the entity to provide such information before share alienation in order to find out whether he bears tax obligations in that country or not.

Mr. Nilesh Kapadia (on India)

The taxpayer would not generally know if the condition has been satisfied, unless he / his family / associates were in charge of the management of the company, partnership, trust, etc.

As such, for taxpayers alienating shares of closely held companies, for instance, would generally know if this is the case, unless they are a minority. However, for such situations, as also for listed companies, one may refer to the I GAAP requirements for segment wise reporting in the audited accounts, and segment wise reporting also includes geographical segments.

The segment wise reporting is generally quite general, but it would highlight in cases where significant value of assets are in a particular territory. Hence, there could be situations where the segment reporting reveals significant assets in a territory, what proportion thereof constitutes immovable property may not be known immediately.

Besides, the segment reporting would be done based on historical cost basis, while perhaps Article 13(4) requires determination w.r.t. market values,

Further, segment reporting would apply to companies only, and not to other entities like partnerships or trusts, etc.

Mr. T.P. Ostwal (on India)

There is no specific statutory prescribed mechanism under the law to ascertain this fact. However, in practice, typically, at the time of alienating shares of a particular company, partnership, trust, etc. (‘entity’/ ‘entities’, as the case may be), the taxpayer in our tax jurisdiction would ascertain that the said entities whose shares it proposes to alienate consists principally of ‘immovable property’ based on the latest audited financial statements of the respective entity. General practice is to examine the latest audited financial statements of concerned entity to ascertain its asset and to discern if immovable property (ies) are major/ principal assets of the entity. Wherever applicable, valuation reports are also examined to ascertain if value of shares disposed of principally derives its value from immovable properties owned by the entity.

JAPAN

Generally speaking, a taxpayer who alienates whose shares which consist principally of immovable property should be aware of such nature of the shares alienated, as a shareholder. Also, a taxpayer is supposed to make his best effort, as a shareholder, to get necessary information to fulfil his tax obligation, if he is liable to any tax in a foreign jurisdiction, when he engages in such a transaction of alienation of shares. (In Japan, shareholders are able to obtain financial information of the issuers of shares.)

JAPAN (MIYATAKE & FUJITA)

The taxpayer has to inquire the company whether the shares consists principally of immovable property.

In Japan's tax treaties, specific percentage 50% is specified instead of "principally" (except for Japan-Singapore tax treaty) and that percentage is judged by reference to the market value in Japan, but it is often difficult to determine the market value.

MALAYSIA

Since the company whose shares have been alienated must be a controlled company, the shareholders can have access to the company's account. Therefore, the shareholder/taxpayer is able to know the type of property that the company owns and its status (whether the company is a real property company).

MEXICO

Through all the accounting records and the reports issued by the company, like financial statements

NETHERLANDS

There is no special way in which a Netherlands resident can be aware of that. Given the fact that our tax treaty policy is to restrict the application of art 13(4) to residents with interest above a certain threshold, most taxpayers for whom this could be relevant, will be 'connected' entities and will in practice know. E.g. because both entities have the same board of directors.

NORWAY

An investor should be expected to know or have access to information on the assets owned by a company in which he owns shares, and also the location of its immovable property. There is no system of monitoring or enforcing in such situations tax obligations to countries where immovable property is situated.

THE RUSSIAN FEDERATION

Such portion of immovable property can be calculated based on company's book value of assets and book value of immovable property. Purchase of shares as capital investments with a purpose of capital gains assumes company that alienates shares has to disclose some obligatory information. Otherwise information can be received from all reliable legal sources. Article 309 of Tax Code of the Russian Federation (further – Tax Code) regulates taxation of gains on shares issued by companies, where 50% of assets is immovable property.

SOUTH AFRICA

A taxpayer who holds shares in a company may not have access to this information unless it holds a significant interest that would entitle it to the financial statements or management accounts of the company.

A partner in a partnership should have access to this information as it is obliged to account for its share of the income and net assets of the partnership.

A beneficiary of a trust, unless the beneficiary was also a trustee, may not have access to this information in the case of a discretionary interest but probably would in the case of a vested interest.

In a reversed situation where a non-resident disposes of shares in a company owning mainly immovable property, under South Africa's domestic law the non-resident will be taxable on capital gains on the disposal of shares in the property company if at least 20 per cent of the equity shares are held in the company.

THE UNITED STATES

For U.S. federal income tax purposes, immovable property that is located in the United States is referred to as a U.S. real property interest ("USRPI"), (defined in 2(a) below). The provisions that govern the taxation of USRPIs are commonly referred to as FIRPTA and can at times be overly complex and burdensome for unsophisticated taxpayers. Notably, the FIRPTA rules presume that any interest (other than solely as a creditor) in a domestic corporation (see Q3 for the treatment of transparent entities) is a USRPI unless the taxpayer establishes otherwise. Therefore, even if the company whose shares are being alienated does not own any USRPIs, the foreign taxpayer must nevertheless comply with the FIRPTA regime. Thus, it is the foreign taxpayer's responsibility to prove that his or her interest in the U.S. corporation is not a USRPI. If the taxpayer's interest in the corporation is a USRPI or the taxpayer does not establish that their interest is not a USRPI, any gain recognized from the disposition of such interest is subject to U.S. federal income tax.

FIRPTA is enforced via withholding. In the case of a sale, the purchaser must withhold 10 percent of the gross proceeds and remit such proceeds to the IRS within 20 days of the transfer. In the case of distributions from partnerships or corporations or dispositions by partnerships, the withholding tax generally is 35 percent of the gain on distribution or disposition. The withholding tax is credited against the taxpayer's U.S. income tax liability; however, it is not a final tax, and the taxpayer is required to file a U.S. tax return reporting the sale. If the amount of withholding would exceed the tax liability due, there are procedures that allow the foreign taxpayer to request a withholding certificate from the IRS in order to reduce or eliminate the withholding tax. The transferee remains liable for the withholding tax, as well as interest and penalties to the extent the transferee does not comply with its withholding obligation.

In order to rebut the presumption that shares in a domestic corporation are USRPIs, the foreign person must request from the U.S. corporation a notice indicating that the foreign person's interest in such U.S. corporation was not a USRPI on the date of disposition. The notice should generally be requested within 30 days of the disposition. Thus, the taxpayer must ask the company to make a determination of whether the company's assets principally consist of "immovable property."

In order to provide the requested notice to the foreign shareholder, the U.S. corporation must determine whether at any point during the shorter of the shareholder's ownership period or the five year period ending on the date of disposition (the "Testing Period") it was a U.S. real property holding corporation ("USRPHC").
If the U.S. corporation determines that it is not and was not a USRPHC during the Testing Period, it must provide a notice to the foreign shareholder indicating that the foreign shareholder's interest in the U.S. corporation is not a USRPI. The notice must be provided to the transferee in order to avoid withholding. The U.S. corporation must then send a similar notice to the Internal Revenue Service (the "IRS") within 30 days of providing the notice to the foreign shareholder. The notice that was sent to the foreign shareholder must be attached to the notice that is sent to the IRS.

If the U.S. corporation determines that the shareholder's interest in the corporation is a USRPI, or the parties do not comply with above described notice procedures, the disposition by the foreign taxpayer is subject to U.S. federal income tax. The foreign taxpayer must file a U.S. federal income tax return to report any gain recognized from the disposition.

Recognizing the complexity of the compliance rules, the IRS allows taxpayers to comply with a "late notice procedure" to the extent there is reasonable cause for missing any of the deadlines. The late notice procedures eliminate any potential interest and penalties for failure to withhold.

A USRPHC is any corporation if the fair market value ("FMV") of its USRPIs equals or exceeds 50 percent of the FMV of its USRPIs, foreign real property, and assets used in a trade or business. In order to simplify compliance, a corporation is allowed to provide notice that its shares are not USRPIs by making the determination based on book value, rather than fair market value as long as the book value of its USRPIs does not exceed 25 percent of the FMV of its USRPIs, foreign real property, and assets used in a trade or business.

Not all dispositions of shares of corporations predominantly holding real estate are taxable. The most common exceptions are:

1. If the shares are publicly traded and the shareholder has owned no more than five percent of the publicly traded class of shares at any time during the Testing Period described below.

2. If, prior to the disposition of the shares, the corporation has disposed of all of its USRPIs in taxable transactions where gain, if any, was recognized.

3. The shares are disposed of in connection with an exchange that is entitled to non-recognition treatment, provided what the shareholder receives in exchange is within the U.S. taxing jurisdiction and the tax basis in the property received is no greater than the tax basis in the shares disposed of.

Dr. Stephen R. Crow (on the US)

In teaching the US treatment of international transactions, generally the taxation of capital gains is a sourcing issue and the jurisdiction is at the residence of the seller of the property. The exception to that is the FIRPTA rule which says that sale of a real property interest, which includes the sale of stock in a corporation that holds primarily real estate assets, is taxed as though the seller were engaged in a trade or business in the US. FIRPTA contains registration and documentation rules.

ZAMBIA

Only shares that are registered with Zambian Companies Registrar are subject to Zambian taxation.

This implies that if a Zambian taxpayer wants to alienate shares held in another country, they will have to meet their tax obligations in that other country.

<u>b) The balance sheets of entities are on a particular date and reflect the position of assets on that date while the alienation can be on a date which falls between the two balance sheets dates. How does the taxpayer know that the property of the company, partnership, trust etc. consists principally of 'immovable property' situated in a particular country on the date of alienation of shares?</u>

AUSTRALIA

This would be dependent upon factors such as those mentioned above. There also needs to be recognition that not all assets are necessarily recorded on the balance sheet of an entity.

It is likely that a taxpayer who holds a non-portfolio interest would be aware of changes in the assets held by the relevant entity as and when those changes occur. Portfolio interest holders would have more difficulty. However the CGT legislation exempts the latter from tax in Australia.

AZERBAIJAN

Shareholder/taxpayer can get that information from the accountant of the company or other person in charge and holds that information before alienating shares.

BRAZIL

This case is not relevant for tax purposes under Brazilian Law (see item 1(a) and 4).

CHINA

In the domestic law of China, it is stipulated that if the balance sheet of an entity shows that more than 50% of its property is composed of immovable property during any time in three years before the alienation, China will have the taxation right. Therefore, the issue above does not concern us.

Mr. Nilesh Kapadia (on India)

The taxpayer will know this only in case he / his family / associates were in charge of the management of the company, partnership, trust, etc.

In other words, the information is not available directly in public domain.

Mr. T.P. Ostwal (on India)

There is no specific statutory prescribed mechanism under the law dealing with this aspect. However, in practice, in case where the shares of an entity are proposed to be sold on a date falling between two balance sheet dates, reference is made to the broken period balance sheet of the entity whose shares are proposed to be sold to determine whether the assets of entity consists principally of 'immovable property' as on the date of sale. In absence thereof, latest audited financial statements of the entity are relied on. A valuation report based on unaudited financial statement can be a pointer to examine the state of its affairs as compared to last available financial statements.

JAPAN

A shareholder should usually be able to obtain necessary information, including financials and etc., in order to fulfil his obligation to comply with relevant tax laws.

JAPAN (MIYATAKE & FUJITA)

In Japan, the percentage of the immovable property ratio is judged on the date of alienation of shares.

It is very difficult to find it unless the company is a subsidiary of the taxpayer.

MALAYSIA

If the alienation of shares is on a date which falls between two balance sheet dates, the taxpayer is allowed to submit the audited accounts of the company for the financial year which is closest to the date of alienation.

MEXICO

As in the answer to the previous question, this issue will be determined in the financial statements, and, if the case, in the auditor's opinion on them.

NETHERLANDS

Without further asking he will not know.
With respect to this subject I may refer you to one of the issues in Action Item 6 of the OECD/G20 BEPS project in which it is suggested to change the language of art 13(4) into ".....may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property situated in that other State"

NORWAY

In closely held companies shareholders will probably be aware of any substantial sales transactions or acquisitions. In other cases a minority shareholder may not know.

THE RUSSIAN FEDERATION

All information shall be referred to the last reporting date. Calculation of immovable property's portion in company assets can be done based on:

- balance sheet on the last reporting date prior to the date of alienation of shares;
- calculation of property tax on the reporting date.

SOUTH AFRICA

This is not possible to know definitely if the taxpayer does not have access to the financial position at the date of the alienation.

However, if the taxpayer has access to the balance sheets at the beginning or end of the financial year it can deduce, on a balance of probabilities, that the property of the entity consists principally of immovable property.

The taxpayer may not be able to identify the particular country in which the property is held.

THE UNITED STATES

Whether a U.S. corporation is or was a USRPHC is generally determined as of a particular date, referred to as a Determination Date. Shares in a U.S. corporation are USRPIs if the corporation was a USRPHC on any Determination Date during the Testing Period (a five-year lookback period). A Determination Date includes the following:

1. The last day of the corporation's taxable year;

2. The date of each transaction that could cause the corporation to become a USRPHC, such as the date the corporation acquires a USRPI or the date the corporation disposes of foreign real property or of other assets used or held for use in a trade or business; and
3. If the FIRPTA rules treat the corporation as owning assets held by another entity, the date on which that other entity either acquires a USRPI or disposes of foreign real property or of other assets used or held for use in a trade or business.

However, a corporation generally does not have to test for status as a USRPHC until the 120th day after the later of the corporation's date of incorporation or the date on which the corporation first acquires a shareholder.

The regulations also contain a complex set of provisions allowing certain transactions that may occur without triggering a Determination Date. Non-triggering transactions may include the sale of inventory, the satisfaction of receivables arising from the sale of inventory or the performances of services, or the payment of cash for regular business operations. In addition, within certain percentage limits, a corporation generally may dispose of trade or business assets or buy USRPIs without triggering a Determination Date.

Notwithstanding the abovementioned determination dates, a corporation may choose to determine its USRPHC status at the end of each calendar month.

If a disposition occurs between two balance sheet dates, the U.S. corporation must nevertheless be able to demonstrate whether it is a USRPHC on the date of disposition. Thus, a U.S. corporation can rely on the most recent balance sheet (*i.e.* quarterly, monthly, *etc*.) and determine whether there was a material shift in value or whether an additional Determination Date was triggered in between the balance sheet date and the date of disposition by the foreign taxpayer.

Dr. Stephen R. Crow (on the US)

For financial statement purposes, large publicly traded companies issue quarterly statements. Other than that, there is very limited access to financial information, especially on a specific date.

ZAMBIA

This would be difficult to know.

c) Is the location of immovable properties disclosed in the Balance Sheets of companies, partnerships, trusts, etc. available in the public domain in your country? In case the same is not available, where would the taxpayer access information to determine his or her tax obligation?

AUSTRALIA

The preparation of annual financial reports in Australia by various kinds of entities is governed by the Corporations Act 2001. This generally covers listed entities, registered schemes, other disclosing entities, other public companies, large proprietary companies and certain small proprietary companies. For some of those entities, there would likely be notes to the accounts and other reported information available that would contain this level of information. For trusts and partnerships which are not subject to the Corporations legislation, location of such information would not likely be available in the public domain.

When a taxpayer cannot get access to information, or the taxpayer does not have sufficient control to demand that a market valuation be undertaken, the taxpayer is allowed to use the value on the audited accounts of the entity when the asset value is determined under the revaluation method i.e. the fair value of the asset.

Where an entity, the subject of the principal asset test, has no assets that are membership interests to look through, it may not be necessary to value each of its assets. Rather, the market value of the total assets as a whole might be ascertained by reference to the market capitalisation of shares in the entity plus liabilities.

In practice the circumstances in which access to detailed information is required will be limited, as it is only in a small number of industries, such as mining, property development and infrastructure that 50% of assets are held in real property.

AZERBAIJAN

It is not public information, but of course the company itself must know where the immovable property owned by it is located and the shareholder/taxpayer can Shareholder/taxpayer can get that information from the accountant of the company or other person in charge and holds that information before alienating shares.

BRAZIL

There is no obligation to describe in Balance Sheets where the location of immovable properties is. In general, shareholders can have broad access to accounting records of companies and request additional information.

CHINA

I am afraid that location of immovable properties is not publicly available. To determine the tax obligation, taxpayers need to know the value of immovable properties and its percentage in the total value of an entity. Perhaps information about location of immovable properties is not so necessary to determine taxpayers' obligations.

Mr. T.P. Ostwal (on India)

The location of the immovable property is not required to be disclosed in the financial statements of the Indian entities. However, if fixed assets or investment of an entity includes an immovable property then it is required to be disclosed separately in the audited financial statements. A seller can know the location only upon enquiring with the entity on this aspect.

JAPAN

The location of immovable properties is not required to be disclosed in the Balance Sheets of companies and/or etc., under the Japanese laws.
However, such information of immovable property as ownership and any rights, physical status and etc., is available for public inspection at a local legal affairs bureau (local registry) in Japan.

JAPAN (MIYATAKE & FUJITA)

This information is not available in the public domain, and the taxpayer has to ask the company for the information.

MALAYSIA

Gains from disposal of shares in a controlled company (as defined under Income Tax Act, 1967) which holds real properly directly or indirectly as a major asset (at least 75% of total tangible assets) will be subject to Real Property Gains Tax (RPGT). Since the company is a controlled company the location of its immovable properties is not available in the public domain. The taxpayer would be able to get the information to determine his or her tax obligation from the company directly.

MEXICO

Yes, they are available in the public domain.

NETHERLANDS

Under circumstances companies have to deposit their P&L and balance sheet with the Chamber of Commerce, which would be publicly consultable. However the balance sheets would not necessarily need to clarify which part of the assets are immovable, nor the location of those immovable assets.

NORWAY

Companies' financial accounts including balance sheets are filed with the central registry of accounts and may be accessed by everyone.

THE RUSSIAN FEDERATION

In certain cases public information is disclosed in public sources.
It is out of competence of Federal Tax Service of Russia to determine how the taxpayer gets access to information in order to perform his or her tax obligations.

SOUTH AFRICA

The information regarding the location of immovable property owned by a particular entity may be disclosed in its financial statements but unless the company is listed the information would not be generally available. Shareholders would be entitled to a copy of the financial statements. Details of immovable property could be obtained *via* an electronic deeds registry search but this is probably impracticable.

In the case of a listed company, any person holding at least 20 per cent of the shares in a listed company should be able to access the information from the company. These cases should, however, be few and far between.

THE UNITED STATES

A publicly traded U.S. corporation typically discloses its balance sheet with its annual SEC public filing (*i.e.*, a 10-K). Depending on the corporation, the location of immovable properties may or may not be disclosed. For example, if the corporation is in the oil and gas industry, it may identify whether it acquired or disposed of any exploration rights to drill for oil. In the absence of such information in the public documents and in the case of a non-publicly traded company, the foreign person would need to specifically request information from the U.S. corporation. See Q1(a) for the procedures to accomplish this.

Dr. Stephen R. Crow (on the US)
Sometimes, but not on a consistent basis. I go back to the rule that says the capital gains are taxed at the source which, for US purposes, is defined as the residence of the seller. Under those circumstances, the location of the property, for these purposes, is not that important.

ZAMBIA

It is not available.

<u>d) How does the taxpayer determine the relevant tax obligation in the situation when he or she transacts in shares based on price movement of scrip in a stock exchange and makes no analysis of the financials of the concerned entity?</u>

AUSTRALIA

If the taxpayer is trading in shares, gains would likely constitute income according to ordinary concepts for Australian income tax purposes and be taxed on revenue account. However, whether or not the gains and losses have Australian tax consequences will depend on the application of any relevant tax treaty (and in particular articles allocating taxing rights over business profits and the alienation of real property).
If the gains/losses were held to be on capital account, they would often be disregarded for CGT purposes by a foreign resident by virtue of the operation of the 10% non-portfolio interest test.

AZERBAIJAN

In most cases taxation is postfactum here, as a result of tax audit.

BRAZIL

As regards the percentage of an immovable property of the value of the alienated shares this case is irrelevant for tax purposes under Brazilian Law (see item 1(a) and 4).

The taxation of transactions of shares in a stock exchange is calculated when the tax return is filed. There is also a withholding income tax on each transaction (0.005%) to be offset the income tax due when the tax return is filled.

CHINA

If the taxpayer transacts in a stock exchange, he is investing in listed companies whose information is publicly available. The taxpayer is able to get information of the company he invests in and decides his tax obligation accordingly.

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Mr. T.P. Ostwal (on India)

In India, there are no specific statutory guidelines to determine the tax obligation when a taxpayer transacts in shares based on price movement of scrip in a stock exchange and makes no analysis of the financials of the concerned entity. (ie a case where valuation reports of the shares of entities are not available based on analysis of financial statement of the entity concerned). In such cases, the taxpayer typically treats the transaction as share sale transaction without evaluating implications of Article 13(4), unless contrary information is available with the taxpayer.

JAPAN

[Not addressed]

JAPAN (MIYATAKE & FUJITA)

It is almost impossible to determine the relevant tax obligation in such situation.

MALAYSIA

Only gains from disposal of shares in a controlled company which holds real property or shares in another Real Property Company (RPC) as a major asset will be subject to RPGT in Malaysia. Gains from disposal of shares in public listed companies are not subject to RPGT.

MEXICO

In the case of listed shares, the brokers are responsible for providing the market information regarding prices, products and market conditions.

NETHERLANDS

The way in which or the circumstances under which the taxpayer transfers his shares would in my view not influence his (im)possibilities to be aware of the assets owned by the company in which he owned the shares.

NORWAY

It is very much up to the taxpayer to access relevant information. If he fails to make relevant analyses he would not know the relevant facts.

THE RUSSIAN FEDERATION

There are special articles in Tax Code (f.e. 280, 282, 300-305, 309-310.1 and others) that regulate an order of use of tax obligations.

SOUTH AFRICA

The taxpayer would be unable to determine the tax obligations in the case of a listed entity unless its interest was sufficient to enable it to have access to the financial information of the company, in which case it may still not have sufficient information to determine this.

THE UNITED STATES

A foreign person who held no more than a five percent interest in the publicly traded shares of a corporation during the Testing Period is exempt from all of the afore-described rules. In the event a foreign person has a greater than five percent interest in the publicly traded shares of a corporation and such person does not ask the U.S. corporation to determine its USRPHC status, such person is presumed to have disposed of a USRPI and is subject to U.S. federal income tax on any gain recognized.

Dr. Stephen R. Crow (on the US)

Sourcing rules of the country of residence of the taxpayer.

ZAMBIA

In Zambia, where a taxpayer sells shares, the tax applicable is property transfer tax. This is a tax chargeable on the realised value of the shares being sold. However, shares sale of shares traded on the Stock Exchange are exempt from property transfer tax.

2. Tax Administration issues

a) The phrase 'immovable property' used in this paragraph has not been defined. Paragraph 1 of Article 13 also uses this phrase but makes an explicit reference to Article 6 and therefore the definition of 'immovable property' in Article 6 travels to paragraph 1 of Article 13. However, in paragraph 4 there is no reference to Article 6. This omission inspires the view that in the absence of a definition of 'immovable property' in Article 3, this phrase will have to take its meaning from the domestic law. How is 'immovable property' defined in your country?

AUSTRALIA

The Australian tax legislation does not define 'immovable property' as such.

However the relevant Australian tax legislation in this area (per Division 855 of the Income Tax Assessment Act 1997) is as follows:

A CGT asset is *taxable Australian real property* if it is:

(a) Real property situated in Australia (including a lease of land, if the land is situated n Australia; or
(b) a mining quarrying or prospecting right (to the extent that the right is not real property), if the minerals, petroleum or quarry rights are situated in Australia.

(Section 855-20 ITAA 1997).

Note: Draft legislation has been prepared to clarify that the term ‘immovable property’ encompasses ‘real property’ to the extent that an Australian treaty provides that immovable property has the meaning it has under domestic law.

This legislation is expected to be introduced into the Australian Parliament in July 2014 (*International Tax Agreements Amendment Bill 2014*).

AZERBAIJAN

The term “immovable property” has not been defined in the Tax Code, but it is defined in the Law on the State Registry of the Immovable Property and is read as follows:

Immovable property – land plots, subsoil areas, separate water facilities (water reservoirs) and all objects strongly fixed on the soil, replacement of which is not possible without causing inappropriate damage to their purpose and rights over which are subject to state registration including buildings, installations, residential and non-residential areas, private and country houses, forests and perennial plantings, property complexes.

BRAZIL

It seems reasonable that the definition of “immovable property” used in Article 6 is not restricted to that Article and should be used in the application of Article 13(4). However, according to Brazilian Civil Code immovable properties are (i) the land and all that is naturally or artificially incorporated thereon, as well as for legal effects (ii) ownership rights on real estate property and the legal action that protect the same. On the other hand, the following does not lose the status of real estate: (i) the buildings that, separated from the land but preserving their unity are relocated to another place; (ii) materials that are temporarily segregated from a building that will be later redeployed thereon.

CHINA

According to the Security Law of the People’s Republic of China, immovable property refers to land and other objects that are fixed to the land such as house and forest. Similarly, in the Rules for the Implementation of the Interim Regulations of the People’s Republic of China on Value-added Tax, immovable property is defined as property that cannot be moved or whose movement will result in changes in nature or shape, such as buildings, structures and other objects fixed to the land.

Mr. Nilesh Kapadia (on India)

It is defined in Section 269UA as-

(*d*) "immovable property" means—

(*i*) any land or any building or part of a building, and includes, where any land or any building or part of a building is to be transferred together with any machinery, plant, furniture, fittings or other things, such machinery, plant, furniture, fittings or other things also.

Explanation.—For the purposes of this sub-clause, "land, building, part of a building, machinery, plant, furniture, fittings and other things" include any rights therein ;

(*ii*) any rights in or with respect to any land or any building or a part of a building (whether or not including any machinery, plant, furniture, fittings or other things therein) which has been constructed or which is to be constructed, accruing or arising from any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement of whatever nature), not being a transaction by way of sale, exchange or lease of such land, building or part of a building

Mr. T.P. Ostwal (on India)

1. Under the domestic income tax law Income-tax Act, 1961 ('Act'), 'immovable property' has different meanings for the purpose of different sections. Immovable property has been defined in section 269UA(d) of the Act as follows:

" "immovable property" means—
(i) any land or any building or part of a building, and includes, where any land or any building or part of a building is to be transferred together with any machinery, plant, furniture, fittings or other things, such machinery, plant, furniture, fittings or other things also.

Explanation.—For the purposes of this sub-clause, "land, building, part of a building, machinery, plant, furniture, fittings and other things" include any rights therein ;
(ii) any rights in or with respect to any land or any building or a part of a building (whether or not including any machinery, plant, furniture, fittings or other things therein) which has been constructed or which is to be constructed, accruing or arising from any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement of whatever nature), not being a transaction by way of sale, exchange or lease of such land, building or part of a building ;"

2. For the purpose of determining the forms and modes of investment by a charitable or religious organisation 'immovable property' is defined in negative manner as under:

" Immovable property does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;"

3. Where any transferee transfers an immovable property (for a consideration of INR 5 Millions or more) to an Indian resident, the Indian residents are required to deduct tax at source at the rate of 1% at the time of payment or credit to the transferees account, whichever is earlier as per section 194-IA of the Act. For the purpose of the said section 'immovable property is defined as under:

"immovable property means any land (other than agricultural land) or any building or part of a building"

Similar definition of 'immovable property' is also given in section 194-LA of the Act requiring deduction of tax at source on payment (exceeding INR 200,000) made by any person to an Indian resident towards compensation/ enhanced compensation on compulsory acquisition of any immovable property.

4. There is no general definition of the term Immovable Property under section 2 of the Act.

5. The definition of immovable property does not cover immovable property where the immovable property is held as stock in trade.

6. Recently, in case of *Vanenburg Facilities BV v Asst DIT (2013-TII-58-ITAT-HYD-INTL)* the Hyderabad Income Tax Appellate Tribunal has made the following observations as to the meaning of the term "immovable property" in tax treaty context:

- The term "immovable property" is synonymous with real property (Relying on UN Model Commentary 2011 Para 2 and Technical Explanation to the India-US Tax Treaty)
- Generally speaking, an "immovable property" is an immovable object, an item of property that cannot be removed.
- The definition of "immovable property" in section 269UA(d) of the Act cannot be considered to be the law of India and consequently "immovable property" for the purpose of Article 6(2) of India-Netherland tax treaty does not include shares of real estate company.
- In civil law system, "immovable property" means land or any permanent feature or structure above or below the surface.

7. In case of *Sanofi Pasteur Holdings SA v Department of Revenue, Ministry of Finance (2013)(30 taxmann.com 222)(AP)*, the Andhra Pradesh High Court held that Article 13(4) deals with alienation of shares of real estate companies. Further, it also held that if the following conditions are satisfied, Article 13(4) applies ie gains on alienation of shares, etc, may be taxed in source State:

- Shares of capital stock of a company, or interest in a partnership, trust or estate (shares, etc..) are alienated;
- The property of such company, partnership, trust or estate ('company, etc") consists, directly or indirectly, principally of immovable property situated in a contracting state(state S);
- Such company, etc, does not use immovable property in its business activities;
- Such company, etc, could be engaged in the business of management of immovable property.

This has also been supported in judicial rulings in case of *Punnika Parikh, in re (2012) (206 Taxman 372) (AAR)*; *Apollo Hospital Enterprise Limited Vs DCIT (2012-TII-131-ITAT-MAD-INTL) and Vanenburg Facilities BV v Asst DIT (2013-TII-58-ITAT-HYD-INTL).*

JAPAN

There are various laws each of which contains each own definition of “immovable property.” In the context of taxation concerning the alienation of shares of a company, partnership, trust etc. whose property consists principally of “immovable property,” the following definition of “immovable property”, which is stipulated in the Order for Enforcement of the Corporation Tax Act, applies.

(i) Land, etc. located in Japan (meaning land or the right on land, buildings and facilities attached thereto, or structures);
(ii) Shares of a corporation for which the rate of the sum of the values of land, etc. located in Japan accounts for 50 percent or more of the total amount of its gross assets;
(iii) Shares (excluding those falling under shares listed in the preceding item) of a corporation which owns shares listed in the preceding item or the following item (limited to a corporation for which the rate of the sum of the values of land, etc. located in Japan and shares listed in the preceding item, this item, and the following item among the total amount of its gross assets is 50 percent or more);
(iv) Shares (excluding those falling under shares listed in the preceding two items) of a corporation which owns shares listed in the preceding item (limited to a corporation for which the rate of the sum of the values of land, etc. located in Japan and shares listed in the preceding two items and this item among the total amount of its gross assets is 50 percent or more).

JAPAN (MIYATAKE & FUJITA)

The “immovable property” is well defined in Japanese internal law, which definition is used for Japanese tax law. Therefore, Japan does not have this problem.

MALAYSIA

Under the Laws of Malaysia – Interpretation Acts 1948 and 1967, “Immovable property” means land and any interest in, right over or benefit arising or to arise out of land.

MEXICO

There is no definition in our tax legislation. Then, based on the provisions of article 5 of our Tax Code regarding rules of supplementary application, we apply the definition referred to in the article 750 of our Federal Civil Code.

I. The soil and the buildings adhered to it;

II. The plants and trees, while in the land and their pending fruits, until they are separated from them by regular harvesting or cuts;

III. Everything united to a building in a fixed manner, so that it cannot be separated without damaging it or damaging the object adhered to it;

IV. The statues, reliefs, paintings or other objects of ornamentation, placed in buildings o inherited by the owner of the building in such a way that reveals the purpose of unite them to it in a permanent way;

V. The lofts, beehives, fish ponds or similar breeding, when the owner retains them in order to keep them united to the property and forming part of it in a permanent way;

VI. The machines, vessels, instruments or implements intended by the owner of the property, directly and exclusively to the industry or exploitation of that property;

VII. Fertilizers for the cultivation of an inheritance which are in the land where they are going to be used and the seeds necessary to the cultivation of the farm;

VIII. The electric devices and accessories attached to the soil or buildings by the owner thereof, unless otherwise agreed;

IX. The springs, ponds, wells and streams, as well as aqueducts and pipes of any kind that serve to drive liquids o gases to a property or to take them out of it;

X. The animals that are the breeding herd in rural land which are intended wholly or partly to livestock breeding; as well as the working beasts to the cultivation of a farm, while they are intended for that purpose;

XI. The dams and structures, even the floating ones, intended to stay in a fixed point of rivers, lakes or shores;

XII. Rights on rem ever properties;

XIII. The telephone and telegraphs lines and the fixed telegraphy stations.

NETHERLANDS

In my opinion, both an explicit reference to article 6 and, without that, a reference to art 3(2) would lead to the definition under domestic law.
Netherlands civil law defines ‘immovable property’ article3(1) of Book 3 of the Civil Law Code and reads (unofficial translation) *"Immovable [assets] are the land, unextracted minerals (etc), plants as well as buildings and projects joined to the land."* (Nederlandse B.W., boek 3, art. 3, lid 1)

NORWAY

It is very much up to the taxpayer to access relevant information. If he fails to make relevant analyses he would not know the relevant facts.

THE RUSSIAN FEDERATION

It is determined based on Civil Code of the Russian Federation (further – Civil Code), where Article 130 keeps a definition for Immovables and Movables.
Article 130 of Civil Code says:

1. To the immovables (the immovable property, realty) shall be referred the land plots, the land plots with mineral deposits, the set-apart water objects and everything else, which is closely connected with the land, i.e., such objects cannot be shifted without causing an enormous damage to their purpose, including the forests, the perennial green plantations, the buildings and all kind of structures. To the immovables shall also be referred the air-borne and sea-going vessels, the inland navigation ships and the space objects. The law may also refer to the immovables certain other property.

2. The things, which have not been referred to the immovable, including money and securities, shall be regarded as the movables. The registration of the rights to the movables shall not be required, with the exception of the cases, pointed out in the law.

SOUTH AFRICA

Under domestic tax law the capital gains provisions apply to assets of non-residents in the form of any interest in or right of whatever nature to immovable property situated in South Africa. Furthermore, an interest in immovable property situated in South Africa includes equity shares held by a non-resident in a company or the ownership or right to ownership in any other entity, or a vested interest in any assets of a trust, if–

- 80 per cent or more of the market value of those equity shares, ownership or right to ownership or vested interest, as the case may be, at the time of disposal thereof is attributable directly or indirectly to immovable property held otherwise than as trading stock; and
- in the case of a company or other entity, that person (whether alone or together with any connected person in relation to that person), directly or indirectly, holds at least 20 per cent of the equity shares in that company or ownership or right to ownership of that other entity.

Therefore, although the term ‘immovable property’ has not been dealt with by way of definition, it has been sufficiently described in the capital gains tax charging provisions to have the effect that the shareholding and interests referred to above are within the scope of ‘immovable property’ envisaged in article 6.

THE UNITED STATES

The term immovable property, or a USRPI, includes any interest, other than an interest solely as creditor, in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the U.S. Virgin Islands. The term “real property” includes: (1) land and unsevered natural products of the land; (2) improvements; and (3) a limited category of personal property associated with the use of real property. Generally, an interest in real property includes not only direct interests but also fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

Improvements on the land generally include buildings or any inherently permanent structure, or the structural component of either. The term "building" encompasses factories, office buildings, warehouses, garages, and stores. The term "inherently permanent structure" refers to an asset that is attached to real property and that will ordinarily remain attached for an indefinite period.

Personal property associated with the use of real property includes movable walls, furnishings, and other personal property associated with the use of the real property. Personal property is treated as real property when (i) the personal property is used in mining, farming and forestry; (ii) the personal property is used in the improvement of real property (e.g., construction equipment); (iii) the personal property is used in the operation of a lodging facility; or (iv) the personal property is used by a lessor in the leasing of furnished office or other work space to lessees. Unless personal property is within any of the above four categories, it is not considered associated with the use of real property.

In addition to a direct interest in U.S. real property, as mentioned above, the definition of a USRPI includes an interest in a domestic corporation if, at any time the shorter of (1) the period after June 18, 1980, during which the taxpayer held the interest, or (2) the 5-year period ending on the date of the disposition of the interest in the corporation the domestic corporation was a USRPHC. See our response to Question 1 for the details.

ZAMBIA

The term 'immovable property' is not defined under our domestic law.

However, under the Property Transfer Tax Act, Cap 340, the term property is defined as:

"property" means-

(a) any land in the Republic
(b) any share issued by a company incorporated in the republic; or
(c) a mining right issued under the Mines and Minerals Development Act, 2008, or an interest therein.

The Income Tax Act, Cap 323 does not have a separate definition for property but only makes reference to the definition provided in the Property Transfer Act.

From the definition above, our interpretation is that property does not include movable properties such as:

- motor vehicles
- aircraft; or
- ships and boats

b) “Principally” in relation to ownership of ‘immovable property’ has been defined to mean the value of such ‘immovable property’ exceeding 50% of the aggregate value of all assets.

i. What is the date taken by your tax administration for determining such value?

AUSTRALIA

The date of alienation.

In the case of CGT, this is taken as the date when the CGT event occurs.

In other situations involving income being on revenue account, the relevant date is determined according to ordinary concepts.

AZERBAIJAN

Date of alienation of the shares, or if no such evaluation is available for that date, the closest date before or after the alienation, when such evaluation is made.

BRAZIL

This case is not relevant for tax purposes under Brazilian Law (see item 1(a) and 4).

CHINA

In the domestic law of China, a period of time rather than a specific date is taken to determine the taxpayer’s obligations. If a taxpayer alienates shares of a company more than 50% of whose property is composed of immovable property during any time in three years before the alienation, the taxpayer is liable to tax in China.

Mr. Nilesh Kapadia (on India)

In the context of section 56(2), the date has been defined to mean the date of transfer.
In the absence of any other clarity on the issue, the revenue will in all probability take the value as on the date of transfer.

Mr. T.P. Ostwal (on India)

In India, there are no set guidelines in this respect. Typically, it would be based on the latest audited balance sheet of the entity owning immovable property. Where broken period balance sheet have been prepared for management accounting purpose, value as per such balance sheet could also be taken.

JAPAN

The value of immovable property in the aggregate value of all assets is determined at the date of the transaction (i.e., the alienation of the shares).

JAPAN (MIYATAKE & FUJITA)

The date of the alienation of the shares.

MALAYSIA

The market value of immovable property as at the date of acquisition of shares in the relevant controlled company, if the market value of shares in a RPC and/or the acquisition price of shares in a RPC is at least 75% of the value of its total tangible assets, the company is a RPC. If as at the date of acquisition of shares, the relevant company is not an RPC, the determination of the company status (whether it is an RPC or not) need to be done when the company acquire additional real property/immovable property. In such cases, the market value at date of acquisition of the real property is required

MEXICO

The date of the alienation that triggers the tax and therefore the obligation to pay it.

NETHERLANDS

The date of the sale of the shares.

NORWAY

It would be the date of the transaction.

THE RUSSIAN FEDERATION

In order to determine such value tax administration uses the value on the last reporting date.

SOUTH AFRICA

The date is the time of disposal which would be the date on which the suspensive conditions in the agreement have been fulfilled or the date of the agreement in the case of an unconditional agreement.

THE UNITED STATES

The value of the assets is determined on each Determination Date as defined in 1(b) during the Testing Period (five-year lookback rule) and on the date of disposition by the foreign taxpayer.

Dr. Stephen R. Crow (on the US)

In most cases, the financial information used in tax calculations is the date of sale, however, there are other provisions in the tax law where average values for a defined period are used.

ZAMBIA
[Not Answered]

ii. Is the value taken by your tax administration the book value, cost or fair market value?

AUSTRALIA

Fair Market value is the value to be taken for CGT purposes (Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No.4) Bill at paragraph 4.79).

AZERBAIJAN

It is book value, but when tax authorities have strong basis to believe that that value significantly deviates from the market value they may recalculate taxes based on the mechanisms for calculation of the market value prescribed in the Tax Code.

BRAZIL

This case is not relevant for tax purposes under Brazilian Law (see item 1(a) and 4).

CHINA

The book value calculated according to the accounting system of China is taken by our tax administration. At the same time, it is stipulated that the value calculated this way should be no less than the fair market value.

Mr. Nilesh Kapadia (on India)

There is no clarity on the value to be adopted. Perhaps the Article read in conjunction with Article 31 of the Vienna convention would mean that the value should be the fair market value.

There is no clarity on the inclusion of assets like goodwill and other intangible property. Perhaps the Article read in conjunction with Article 31 of the Vienna convention would mean that the value should include that of such assets as well. However, one could rely on Rule 11UA in the context of Section 56(2)(viib) and go by the book value alone, i.e. exclude such assets.

Mr. T.P. Ostwal (on India)

In India, there are no set guidelines in this respect. Typically, it would be based on the book value as per the latest audited balance sheet of the entity owning immovable property.

JAPAN

Fair market value.

JAPAN (MIYATAKE & FUJITA)

Fair market value.

MALAYSIA

The Market Value.

MEXICO

According to our income tax law, we take the book value of assets.

NETHERLANDS

Fair market value.

NORWAY

Fair market value.

THE RUSSIAN FEDERATION

The value taken by tax administration is book value on the last reporting date.

SOUTH AFRICA

The market value of the property is used which is the price that could have been obtained between a willing buyer and a willing seller dealing at arm's length in an open market.

THE UNITED STATES

USRPHC status is determined based on a fair market value approach (the "FMV Test"). As mentioned above, any U.S. corporation in which the FMV of its USRPIs equals or exceeds 50 percent of all of its USRPIs, foreign real property and other trade or business assets is a USRPHC. For purposes of the FMV Test, the FMV of the property is its gross value reduced by the outstanding balance of certain debt secured by the property. Gross value is the exchange price that would exist between an unrelated willing buyer and willing seller, when neither is under any compulsion to buy or sell and both have reasonable knowledge of all relevant facts.

As a matter of administrative convenience, a U.S. corporation may presume it is not a USRPHC if the book values of its USRPIs on all relevant Determination Dates during the testing period is 25 percent or less of the aggregate book values of its USRPIs, its interests in foreign real property, and any other assets used or held for use in a trade or business (the "Book Value Test"). However, the Book Value Test may not be relied upon if the taxpayer knew at the time it performed the Book Value Test that the book value of relevant assets was substantially higher or lower than the FMV of those assets. If the IRS determines, on the basis of information as to the fair market values of a corporation's assets, that the Book Value Test may not accurately reflect the status of the corporation, the IRS will notify the corporation that it may not rely upon the presumption. The term "book value" refers to the amount at which an asset is carried on financial accounting records kept consistently with generally accepted accounting principles as applied in the United States.

ZAMBIA

[Not Answered]

iii. Which are the assets to be reckoned, i.e. whether all assets as per books or even the assets not in the books such as goodwill and other intangible property etc.?

AUSTRALIA

Assets to be reckoned are anything recognised in commerce and business as having economic value for which a purchaser would be willing to pay (ATO ID 2012/14).

AZERBAIJAN

All assets, including those, which are not in the books.

BRAZIL

This case is not relevant for tax purposes under Brazilian Law (see item 1(a) and 4).

CHINA

Assets per books are reckoned without those not in the books.

Mr. Nilesh Kapadia (on India)

There is no clarity on the inclusion of assets like goodwill and other intangible property. Perhaps the Article read in conjunction with Article 31 of the Vienna convention would mean that the value should include that of such assets as well. However, one could rely on Rule 11UA in the context of Section 56(2)(viib) and go by the book value alone, i.e. exclude such assets.

Mr. T.P. Ostwal (on India)

In India, there are no set guidelines in this respect. Typically, only assets as per the books would be considered. Assets like goodwill, other intangible property, etc not recognised in the books of accounts are not considered.

JAPAN

Exactly speaking, all assets should be valued at fair market value, e.g., if there is any off-balance asset, it should also be valued at fair market value.

JAPAN (MIYATAKE & FUJITA)

All assets are of fair market value.
The assets not in the financial statements would not be taken into consideration.

MALAYSIA

The value of total tangible assets (TTA) is taken into consideration in determining the RPC status of the company.

Under Para 34A (6) section 2 of the Real Property Gains Tax Act 1976, value of TTA means the aggregate of the defined value of real property or RPC shares or both and the value of other tangible assets. 'Defined Value' means market value of real property or the acquisition price of RPC shares as determined.

MEXICO

In this regard, article 161 of the Mexican income tax law and its precedents, the articles 190 and 151 of the income tax law in force until 2012 and 2001, respectively, as well as other provisions embedded in the current income tax law title named "Foreign residents with income arising from source located in national territory", were established by the legislator in accordance with the trends that have governed the international concert in which Mexico belongs from several years ago, especially since the Mexico's accession to the OECD.

So, it should be highlighted the great similarity between the Article 13, paragraph 4 of the Model Tax Convention on Income and on Capital issued by the OECD and the article 161, first paragraph, of the Mexican income tax law.

On this basis and taking into account the Supreme Court recognition about the Commentaries to the Model Tax Convention as a source to interpret the Model itself, as well as an explanation of its text, the paragraph 28.4 of the Commentary to Article 13 of the Model Tax Convention says:

28.4 Paragraph 4 allows the taxation of the entire gain attributable to the shares to which it applies even where part of the value of the share is derived from property other than immovable property located in the source State. The determination of whether shares of a company derive more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property).

According to this Comments, the value of all the assets of the company will be compared through the comparison between the book value of all the assets of the company and the book value of all the immovable property of the company.

NETHERLANDS

All assets that influence the value of the shares. That would include goodwill and other intangible assets.

NORWAY

All assets, including off balance ones.

THE RUSSIAN FEDERATION

In accordance with Russian legislation such intangible assets as goodwill are not reckoned.

SOUTH AFRICA

The assets will be all those taken into account in determining the market value of the interest which will be all assets whether or not they have been included for accounting purposes (i.e. goodwill and other intangible property are included).

THE UNITED STATES

This generally depends on whether the company is performing a FMV Test or a Book Value Test. If the company is using the Book Value Test, it generally would only consider the assets on its balance sheet. However, since the Book Value Test is a rebuttable presumption, if there is an asset that is not reflected on the balance sheet that could impact whether the company is a USRPHC, such asset should be taken into account.

ZAMBIA
[Not answered]

c) In a case where the 'immovable property' is situated in your country and the company is a resident of the other country and the share transaction takes place between the residents of the other country, your tax administration may not have access to information regarding such transactions to assert the taxation right, because the company whose shares are alienated is not in your territory. How does your tax administration tackle such a situation?

AUSTRALIA

Primarily we become aware of such transactions via media reports, the stock exchange and other notifications, commercial databases, etc. We monitor them regularly looking for large potential transactions which might require further investigation, taking action where appropriate to assess liability to tax in Australia and ensure collection.

Any proposed acquisitions of certain interests in Australia businesses by 'foreign companies' and 'persons' that are subject to the Foreign Acquisitions and Takeovers Act1975 require approval from Australia's Foreign Investment Review Board (FIRB).When such interests are proposed to be disposed of between foreign entities, the acquirer would also require approval from FIRB. The Australian Taxation Office is consulted by FIRB in relation to some of these proposed transactions.

AZERBAIJAN

That may be identified only through exchange of information with other countries and unfortunately, only incidentally.

BRAZIL

If a non-resident company has an immovable property in Brazil, the foreign company must be get a taxpayer identification number of the Secretariat of the Federal Revenue of Brazil (RFB) called Cadastro Nacional das Pessoas Jurídicas (CNPJ). In this case the company is identified by a number (for example: 01.234.567/8901-23) and it must keep the board of administrators and shareholders in CNPJ updated.

CHINA

It is indeed very difficult for the tax administration to tackle such a situation. Tax officials can only take the initiative to get information of such transactions. They pay close attention to news reports, announcements of listed companies and so on in order to learn about such transactions.

Mr. Nilesh Kapadia (on India)

Such transactions need to be reported to the Reserve Bank of India and the tax administration may be able to access the information from the said bank. However, whether such data exchange takes place or not is not known in public forum.

Mr. T.P. Ostwal (on India)

In domestic income tax laws of India (Section 195 of the Act), the non-resident purchaser / has obligation to withhold Indian taxes and deposit the same with Indian revenue authorities, if the relevant transaction taking place outside India between two or more foreign entities is chargeable to tax in India. Thus, such withholding tax procedure is the first source of information for Indian tax administrators. Secondly, Indian tax administration have powers under the domestic income tax laws to make enquiries and seek further information from resident or non-resident entities on the aspect relevant for tax purpose (Section 133 of the Act). Exercising such powers, Indian tax administration can collect the necessary information from the transacting parties if the transaction, prima facie, involves Indian tax implications. For this purpose, initial source of information is those available in public domain (websites, internet, filings with regulatory authorities in India or outside India, etc).

In case of Indian companies, the tax department can call for the details of change in shareholding at the time of assessment of return of income. Basis this, they may call for information regarding sale of shares during the respective tax year. However, in case of multi layered sale of shares there is no way that the tax department can get these details. Similarly in case of foreign companies, who do not file return of income in India, these details cannot be tapped by the tax department.

JAPAN

In such a situation, it is difficult to obtain necessary information to identify such transactions, unless, for example, such information is provided by a treaty partner through an exchange of information, e.g., spontaneous exchange of information, under the relevant tax treaty.

JAPAN (MIYATAKE & FUJITA)

The Japanese tax administration may not be aware of such transaction unless somebody brings it to their attention. In such event, the exchange of information under the relevant tax treaty is the only way of access.

This problem has not been discussed openly in Japan.

MALAYSIA

Under the RPGT Act, a foreign company is also required to notify the acquisition of real property or RPC shares. However, there's no effective enforcement on the case mentioned.

MEXICO

In this case, we shall determine if the source of the income is located in national territory. According to article 161 of the Mexican income tax law, the source of income is located in national territory, when:

a) the book value of the shares comes directly or indirectly in more than 50% from immovable property located in the national territory

b) when the issuer is a resident in Mexico.

So, in the event of the materialization of any of the previous assumptions, the resident abroad will be obliged to pay the tax derived from the alienation of such shares.

Regarding the question posed, if the immovable property is intended to productive activities (i.e. manufacture, storage, delivering) it could be a permanent establishment, and then the tax administration will have access to information related to that immovable property used by the foreign company. If the immovable property is intended to passive activities (i.e. letting) the information could be obtained from the lessee because of his obligation to withhold the tax.

In the case of listed companies, its financial statements are public, and then the tax administration has access to them.

Nevertheless, the secure way to assure certainty consists on the analysis of the accounting information. The tax administration could get the relevant information by exchange of information with tax administrations abroad.

NETHERLANDS

The Netherlands does not have domestic regulation that includes the transfer of shares in land-rich companies in the taxable base.
The issue does not arise in the Netherlands.

NORWAY

They probably don't know of the facts and would not consider the tax issues.

THE RUSSIAN FEDERATION

Tax administration tackles such a situation through the collaboration between foreign countries' competent authorities.

SOUTH AFRICA

It mainly relies on disclosure by the seller, who is required to file an income tax return.

THE UNITED STATES

The United States does not impose tax on indirect transfers of USRPIs where the USRPI is held by a foreign company. The USRPI will not be subject to tax until it is disposed of by the foreign company that owns the USRPI.

ZAMBIA

Currently we are studying how to handle such scenarios.

d) Tax administrations may or may not know of abusive escape from the ambit of legislation/ the treaty provision, particularly by shareholders with controlling interest as the company can borrow short term to make the value of 'immovable property' at the relevant time less than 50%. What are the safeguards in your law to tackle such an abusive situation?

AUSTRALIA

The Australian legislation disregards the market value of an asset acquired by the test entity, or by another entity, if the acquisition was done for a purpose (other than an incidental purpose) that included ensuring that a membership interest in any entity would not pass the principal asset test (Subsection 855-30(5) ITAA 1997).

The Australian Government has recently announced amendments to the legislation (i.e. Division 855) to improve the integrity of the CGT foreign residents' regime by preventing the creation and duplication of assets in certain circumstances which would otherwise lead to the principal asset test (which measures whether 'real property assets' exceed 50% of the aggregate value of all assets) being failed.

The general anti avoidance provisions may be applied as a matter of last resort.

AZERBAIJAN

None.

BRAZIL

No, there are no such rules and they are not relevant for tax purposes under Brazilian Law (see item 1(a) and 4).

CHINA

In our law, it is stipulated that liabilities are not considered in calculating the value of total assets and that of immovable property of a company. With this provision, borrowing short term will not increase the value of a company's total assets and make the value of immovable property less than 50%.

Mr. Nilesh Kapadia (on India)

There is no SAAR to tackle such cases. Once GAAR is implemented, such a situation can be taken care of by the revenue.

Mr. T.P. Ostwal (on India)

In India, there are no safeguards provided under the law to tackle such a situation.

JAPAN

There are not such safeguards in the Japanese tax law. However, in the case of abusive escape, application of anti-abuse provision of a relevant tax law may be considered.

JAPAN (MIYATAKE & FUJITA)

Such abusive situation has not been discussed openly in Japan.

MALAYSIA

Although a taxpayer can inject tangible assets other than real property/ RPC shares (short term borrowings will not contribute to the value of total tangible asset for determining RPC status), he is not likely to resort to such arrangement. Further, when a company is determined to be RPC, the shares remain as RPC shares even though the value of real property/RPC shares may fall below the 75% threshold.
Thus, it is not easy to avoid becoming RPC or RPC shares.

MEXICO

As we said before, the paragraph 28.4 of the Commentary on the Article 13 of the Model Tax Convention says:

28.4 Paragraph 4 allows the taxation of the entire gain attributable to the shares to which it applies even where part of the value of the share is derived from property other than immovable property located in the source State. The determination of whether shares of a company derive more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property).

According to this Comments, the value of shares shall be determined from a comparison between the value of the immovable property located in the source State and the total value of the assets of the Company, with no consideration of debts or passives.

Then, taking into consideration the similarity between the texts of the Mexican income tax law and the Model Tax Convention, by interpreting the article 161 of the mentioned law, debts and other passives are not taking into consideration, regardless whether or not secured by mortgages on real property.

NETHERLANDS

Refer to answer to Q 1(b).

NORWAY

The GAAR.

THE RUSSIAN FEDERATION

In order to tackle such an abusive situation tax administration in frames of pre-audit analysis performs monitoring and other tax control activities.

SOUTH AFRICA

The risk is real from a tax treaty perspective because cash in the bank derived from borrowing would increase the gross assets. South Africa does not have a specific counter to this, except possibly the general anti-avoidance rules which may be difficult to apply to such a situation.

However, under domestic tax law the value of immovable property in relation to the value of the shares / interest in the property owning entity is measured. The effect is that additional borrowing by the entity to acquire assets other than immovable property will not change the value of the shares or interest in the entity.

THE UNITED STATES

1. The five-year lookback Testing Period may prevent this type of planning. Also, the testing fraction is based on the gross value of the company's assets, limiting the ability of the company to use debt to alter the numbers. Only certain types of debt can reduce

the value of a USRPI held by the company. The FMV of a USRPI can only be reduced by debt to the extent that the debt is a mortgage or other valid security interest in the property that is valid and enforceable where the property is located. The debts must be (1) incurred to acquire the property (including long-term financing obtained to replace construction loans or other short-term debt), or (2) otherwise incurred in direct connection with the property (such as property tax liens or debts incurred to maintain or improve the property).

2. The regulations also contain an anti-abuse rule providing that the gross value of assets in the denominator of the testing fraction (*i.e.,* trade or business assets and non-US real property interests) shall be reduced by the outstanding balance of any debt that was entered into for the principal purpose of avoiding USRPHC status.

3. The fact that the fraction must be met multiple times (*i.e.,* on each Determination Date over the Testing Period described in response to Q. 1,) also reduces the opportunity for abusive transaction.

ZAMBIA

[Not answered]

3. Interests covered

Does your country's legislation and treaty provisions cover alienations of shares in companies only, or do they extend to other interests such as in partnerships or trusts?

AUSTRALIA

The legislation and treaty provisions extend to other interests such as in partnerships and trusts.

Note: The domestic legislation covering trusts applies to fixed trusts only (ATO ID 2007/60).

AZERBAIJAN

In legal persons only.

BRAZIL

Brazilian legislation and treaty provisions cover alienations of any kind of interest including shares and other rights.

CHINA

Our legislation and treaty provisions cover alienations of shares in companies only.

Mr. Nilesh Kapadia (on India)

Generally restricted to companies only.

Mr. T.P. Ostwal (on India)

(a) Typically, the text of Article 13(4) in Indian Treaties is based on UN Model with modifications. In Indian treaties, only alienation of shares in a company is typically covered barring following exceptions:

- In India-Australia treaty, shares or comparable interest in a company are covered.

- In India-Netherland treaty, shares (other than shares quoted on approved stock exchange) forming part of a substantial interest (25% or more) in the capital stock of a company is covered.

(b) Typically, such other interests – in partnership firms, trusts, etc are not covered in Indian tax treaties.

(c) In its domestic income tax laws, any transaction by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of person, which has the effect of transferring or enabling the enjoyment of, any immovable property, is also covered.

JAPAN

In many tax treaties Japan has ever concluded, each relevant provision covers not only the alienation of interests in companies but also that of others such as partnerships or trusts.

Under the domestic laws, the definition of "share" does not necessarily mean shares of company, but it also includes other interests.

JAPAN (MIYATAKE & FUJITA):
A considerable number of Japan's tax treaties also provide for partnerships and trusts.

MALAYSIA

It covers a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia.

MEXICO

In our domestic legislation, specifically the Mexican income tax law contains the provisions applicable to the alienation of parts of joint ventures as well as of trusts. Then the law does not provide only about the selling of shares of a Company.

The Mexican income tax law provides that references to shares shall be deemed to include certificates of patrimonial contribution issued by a national credit society, corporate participations, participations in civil associations, ordinary certificates of participation issued with basis on shareholding trust authorized under the applicable legislation in matters of foreign investment.

NETHERLANDS

The Netherlands does not have domestic regulation that includes the transfer of shares in land-rich companies in the taxable base.
The issue does not arise in the Netherlands.

NORWAY

There is no such tax liability for non-resident shareholders under domestic law, unless the assets are connected to a business activity carried on within the country – in which case also interests in partnerships would be covered. Treaty provisions would normally adopt the OECD Model provision being limited to share transactions, but could in other cases adopt the UN Model including interests in partnerships.

THE RUSSIAN FEDERATION

There are no exceptions for companies only or exceptions for partnerships or trusts.

SOUTH AFRICA

Legislation covers vested interests in trusts and ownership or the right to ownership in any entity other than a company.

THE UNITED STATES

There are a separate set of rules that apply to partnerships, trusts, and estates to the extent these entities own any USRPIs. If a foreign person sells an interest in a partnership, trust, or estate, the foreign person must determine what portion of the gain is attributable to any USRPI held by the partnership, trust, or estate. We note however that there is limited guidance with respect to these entities and there are many interpretive issues when determining how to best to comply with FIRPTA. For example, there is currently no guidance for determining what portion of the gain is attributable to a USRPI.

No withholding is required on the disposition of an interest in a partnership holding USRPIs unless: (1) fifty percent or more of the value of the gross value of the gross assets of the partnership consist of USRPIs and (2) ninety percent or more of the value of the gross assets of the partnership consist of USRPIs plus any cash or cash equivalent. This is a safe harbor for withholding purposes only; a partner disposing of an interest in a partnership holding USRPIs remains liable for the substantive tax on any gain attributable to the USRPIs held by the partnership without regard for the safe harbour.

ZAMBIA

Our legislation covers alienation of shares in companies only.

However, partnerships and trusts are allowed to make investments in companies by purchasing shares. When such shares are finally sold, they will be liable to property transfer tax.

4. Other Comments

<u>Do you have any other comments on country practice in this area?</u>

AUSTRALIA

To further improve the integrity of the foreign residents' regime in relation to the disposal of Australian real property interests, the government has announced the introduction of a 10% non-final withholding tax to apply to the disposal by foreign residents of certain taxable Australian property from 1 July 2016. This will apply to both capital and revenue transactions and the withholding obligation will rest with the purchaser. This measure will not apply to residential property transactions under $2.5 million or to disposals by Australian residents (2013-14 Budget announcement).

AZERBAIJAN

[Not addressed]

BRAZIL

As regards the Brazilian taxation of capital gains from the alienation of shares, it is necessary to clarify that non-residents are taxed under the same rules applicable to individuals resident in Brazil.

All Brazilian DTCs allow the taxation of the capital gains by the source country without any threshold and it is not related to the percentage of the immovable property in the aggregate value of all assets of the shares alienated. Therefore the aggregate value of immovable property (new art. 13(4) or the percentage of the shares alienated (new art. 13(5)) have never been considered to be relevant to the taxation of the capital gains at source.

The Brazilian Law enables the shareholder to request and verify the accounting records of the company and ask for clarifications.

> Additionally, all Brazilian DTCs have a paragraph similar to this: "*3. Gains from the alienation of any property other than those mentioned in paragraphs 1 and 2, may be taxed in both Contracting States*." It is worth to mention that Brazil has presented a position to OECD Model Tax Convention as follows: *"1. […] Brazil reserve the right to tax at source gains from the alienation of property situated in a Contracting State other than property mentioned in paragraphs 1,2, 3 and 4".*

CHINA

Interested in practices of other countries, it will be appreciated if you share them with us through email.

Mr. T.P. Ostwal (on India)

In India, there is not much guidance on the interpretation of the terms used in Article 13(4). However, wherever required India relies on the UN Model Convention and UN Model Commentary.

JAPAN

[Not addressed]

JAPAN (MIYATAKE & FUJITA)

See the short memo (which follows) for general information on capital gains from the alienation of shares in the real property rich entities.

MALAYSIA

No further comments.

MEXICO

[Not addressed]

NETHERLANDS

In order to respect the principle of resident state taxation on capital gains, it is in our view essential to restrict the application of article 13(4) to abusive situations. In that light treaty partners must be realistic in accepting exceptions to the 13(4) rule for cases where (abusive) influence by shareholders is unlikely, such as

- Regularly trade on stock exchanges;
- Mergers
- Less than 50% shareholding
- Business
- Pension funds

NORWAY

[Not addressed]

THE RUSSIAN FEDERATION

There are no comments.

SOUTH AFRICA

[Not Addressed]

THE UNITED STATES

1. FIRPTA was enacted as an exception to the general rule that the United States does not subject a foreign person to tax on gain derived from the sale of assets unless that gain is with respect to an asset used by the taxpayer in a U.S. trade or business. The goal of FIRPTA is to assure that a foreign investor in U.S. real estate is subject to tax, either directly or indirectly, on any gain realized on the disposition of that U.S. real estate interest. The concept of treating shares of a company predominately holding U.S. real estate was included because, at the time of enactment of FIRPTA, it would have otherwise been possible for a foreign investor to avoid the FIRPTA tax by placing the U.S. real estate in a U.S. company. Under the law applicable at that time, this structure could have avoided U.S. taxation because a company could sell its assets in the course of liquidation free from U.S. tax. However, this ability of a foreign investor to avoid tax disappeared when the tax law allowing the tax-free sale in the course of liquidation was repealed. At that point, the concept of a USRPHC was no longer needed since the inherent gain on the real estate would remain taxable at the corporate level. Thus, the goal of assuring one level of U.S. tax on the appreciation in the real estate could have been achieved without the considerable complexity that comes with treating shares of a U.S. company as USRPIs and, in fact, as discussed above, if the U.S. company disposes of all of its USRPIs in taxable transactions, the shares of the company are no longer considered USRPIs in recognition of the fact that the gain has been subject to U.S. tax and FIRPTA was never intended to impose two levels of tax. We mention this because the questionnaire assumes that it is good policy to treat the shares of a company holding real estate as a real property interest and that premise may be questioned when the company itself will be taxable on any dispositions of its real estate holdings.

2. We note that there is a common misconception in the United States that the USRPHC rules only apply to companies in the real estate business or operated predominately for the purpose of holding U.S. real estate. However, the mechanical 50 percent test results in many companies being treated as USRPHCs even though their business is not real estate oriented. A manufacturing company can be a USRPHC simply because it has a heavy investment in plant and equipment. Similarly, a services business that does not require a high capital investment can be a USRPHC by virtue of owning the office building from which it operates. Because taxpayers do not think in terms of a manufacturing company or services company being a USRPHC, there are frequent occurrences of accidental compliance failures which leads to considerable need for remedial action, often time-consuming to both taxpayers and tax administrators.

3. Given the above two considerations and the complexity added by treating shares as real estate interests, we suggest the propriety of treating shares of companies that predominately hold real estate the same as directly holding real estate interests should be carefully considered as there are competing policy considerations, particularly where the company holding the underlying real estate cannot avoid local taxation on the gain inherent in the real estate. If a decision is

made to treat shares as real estate interests, we suggest the circumstances when it is appropriate to do so be carefully circumscribed. For example, there might be an exception where most of the company's income is from non-real estate activities or the percentage threshold be increased from 50 percent to, for example, 80 percent.

ZAMBIA

We do not administer the capital gains tax under our tax legislation.

However, some of our tax treaties have Articles on capital gains. This is mainly done in anticipation of future enactment of legislation on capital gains.

Under the Share Option Schemes, the gain realised from the sale or exercise of a share is taxable.

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