Asia Pacific YIN Seminar 2018: Taipei, Taiwan

Blossom Online Dating

The Blossom Group owns an online dating service called Blossom. The service is free for its users. Blossom earns revenue either selling user data to third parties in exchange for a fee or selling advertising space to third party advertisers.

The Blossom Group operates its business through a website and mobile application which is open to users in Country A and Country B. Ninety per cent of Blossom's users are located in Country B.

Country A is a low tax country and Country B is a high tax country.

Blossom's website and mobile application is developed in Country B through a third-party software development company ("SoftCo"). All user support is carried out in Country B through a third-party call centre ("CallCo"). The website and all data and software are hosted on servers located in Country A. Such servers are owned by Blossom.

Blossom was founded by Mr. Lee. Mr. Lee owns 100% of the Blossom Group through HoldCo, a company incorporated in Country A.

Mr. Lee is a national of Country B. Mr Lee moved to Country A shortly before founding Blossom and he is tax resident of Country A by virtue of holding an employment visa in Country A. Mr. Lee spends around 150 days in each of Countries A and B in a given year. The remaining 60 days are spent on holiday and travelling to conferences around the world outside of Countries A and B.

HoldCo owns two entities:

SalesCo, a company incorporated in Country A
MarketingCo, a company incorporated in Country B

Mr. Lee is the sole director of all three entities.

Both HoldCo and SalesCo hold tax residence certificates from the tax administration of Country A by virtue of the fact that Mr. Lee is a tax resident of Country A.

HoldCo owns the intellectual property of the business and licenses the use of such IP where appropriate to SalesCo.

HoldCo earns a 0% license fee for its license of IP to SalesCo.

SalesCo earns 100% of the revenue generated from the sale of data and advertising to customers in Country A and Country B, less fees paid to each of SoftCo (as a contractor), CallCo (as a contractor), MarketingCo and its operating expenses in Country A.

SalesCo has two employees (who are located in Country A) who manage the sales process. This includes communicating with customers who wish to buy data or advertise on the service on how the system works, inform them of the terms of pricing etc. Once these questions have been answered, the SalesCo employees assist with the process of concluding the contracts with these customer through their website from Country A.

MarketingCo has 50 employees who principle role is to advertise Blossom's service to users and advertise the benefits of Blossom's data and advertising space to customers. MarketingCo earns a cost plus 20% fee from SalesCo for the services rendered in Country B.

For more complicated or non-routine questions, or for the customisation of the service or price, SalesCo employees pass customers to the more experienced MarketingCo employees based in Country B. Once their queries are resolved, MarketingCo employees direct them back to SalesCo to finalise the sales process.

<u>Tax assumptions</u>

Country A's tax rate is 8.25% and it does not impose withholding tax.

Country B's tax rate is 25%. Country B imposes a 25% withholding tax on all payments made to non-resident persons.

Country A determines tax residence of companies based on the location of the residence of the directors.

Country B determines tax residence of companies based on the location of the place of effective management of the company.

The A-B double tax treaty is identical to the OECD Model Convention 2014.

Country A and Country B have all signed the Multilateral Convention on BEPS ("MLI"). The MLI has taken effect for all countries and the A-B treaty is a Covered Tax Agreement. Countries A and B have accepted most of the provisions; however, Country A has reserved on Article 4. Other provisions have been notified without reservation to the Depository for the Convention.

<u>The Dispute</u>

Country B's tax authorities have assessed all three entities of the Blossom Group as follows:

HoldCo

Country B has assessed HoldCo as a resident of Country B.

SalesCo

Country B has assessed SalesCo similarly as a resident of Country B.

If SalesCo is determined to be a non-resident of Country B, Country B reserves the right to deems that SalesCo has a PE in Country B (using Article 12 of the MLI through the activities of MarketingCo and CallCo).

MarketingCo

Where the above arguments are all unsuccessful, Country B wishes to impose a tax of the following on MarketingCo:

25% x 100% of the sales revenue less expenses of The Blossom Group

This is on the basis that in substance all of the activities of The Blossom Group are carried out in Country B.

<u>Resources</u>

OECD Model and Commentary (2014 edition)
- Article 4 (Resident)
- Article 5 (Permanent Establishment)
- Article 12 (Royalties)
- Article 7 (Business Profits)

International Case Law regarding place of effective management, abuse and agency PE

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Multilateral Convention"), and accompanying Explanatory Statement:
Article 4 (Dual Resident Entities) (nb. Country A reserved)
Article 6.1 (Purpose of a Covered Tax Agreement)
Article 7.1, 7.2 (Prevention of Treaty Abuse) (reserved on Limitation of Benefits)
Article 12.1 (Artificial Avoidance of Permanent Establishment Status)