Issues in International Taxation

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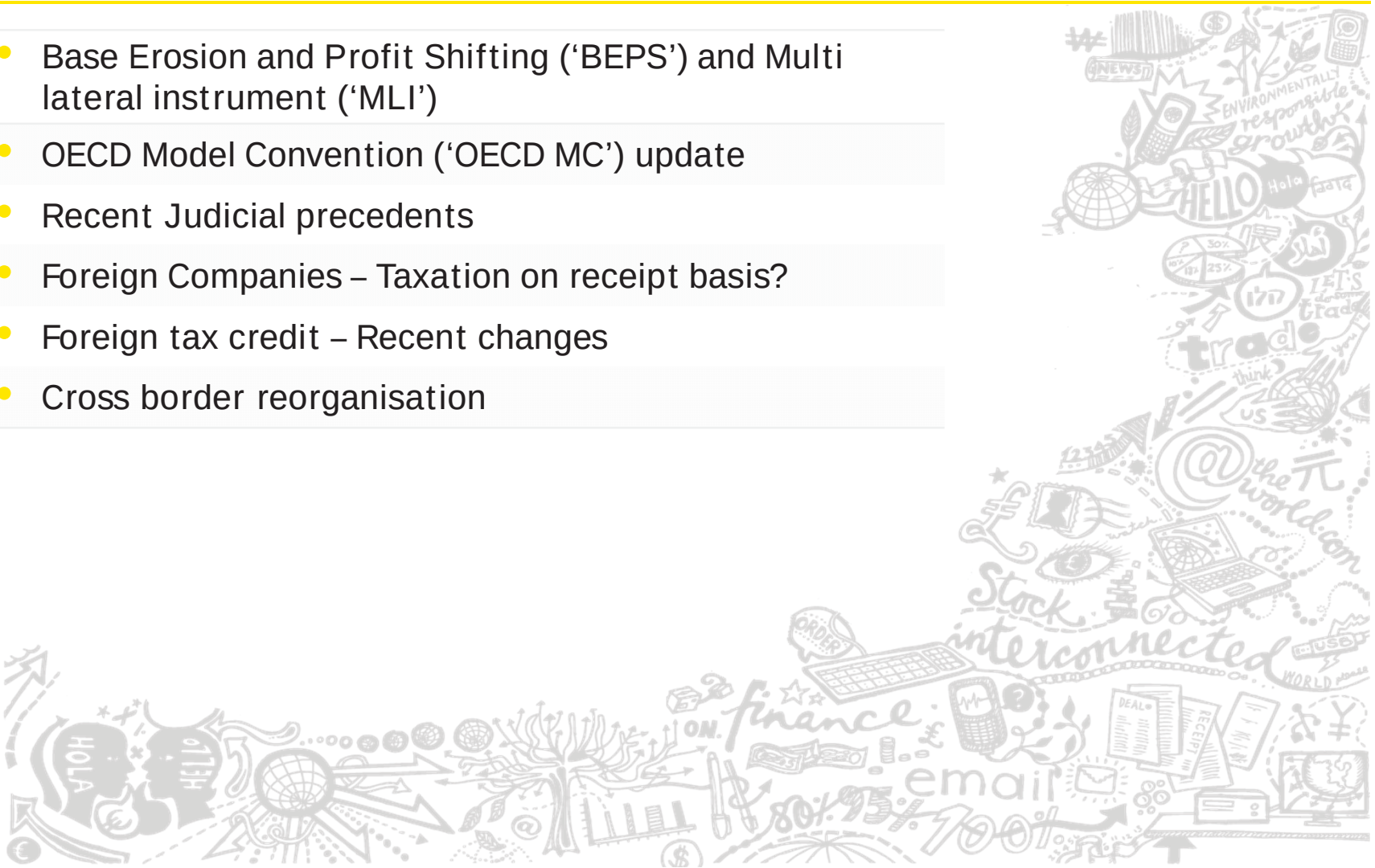
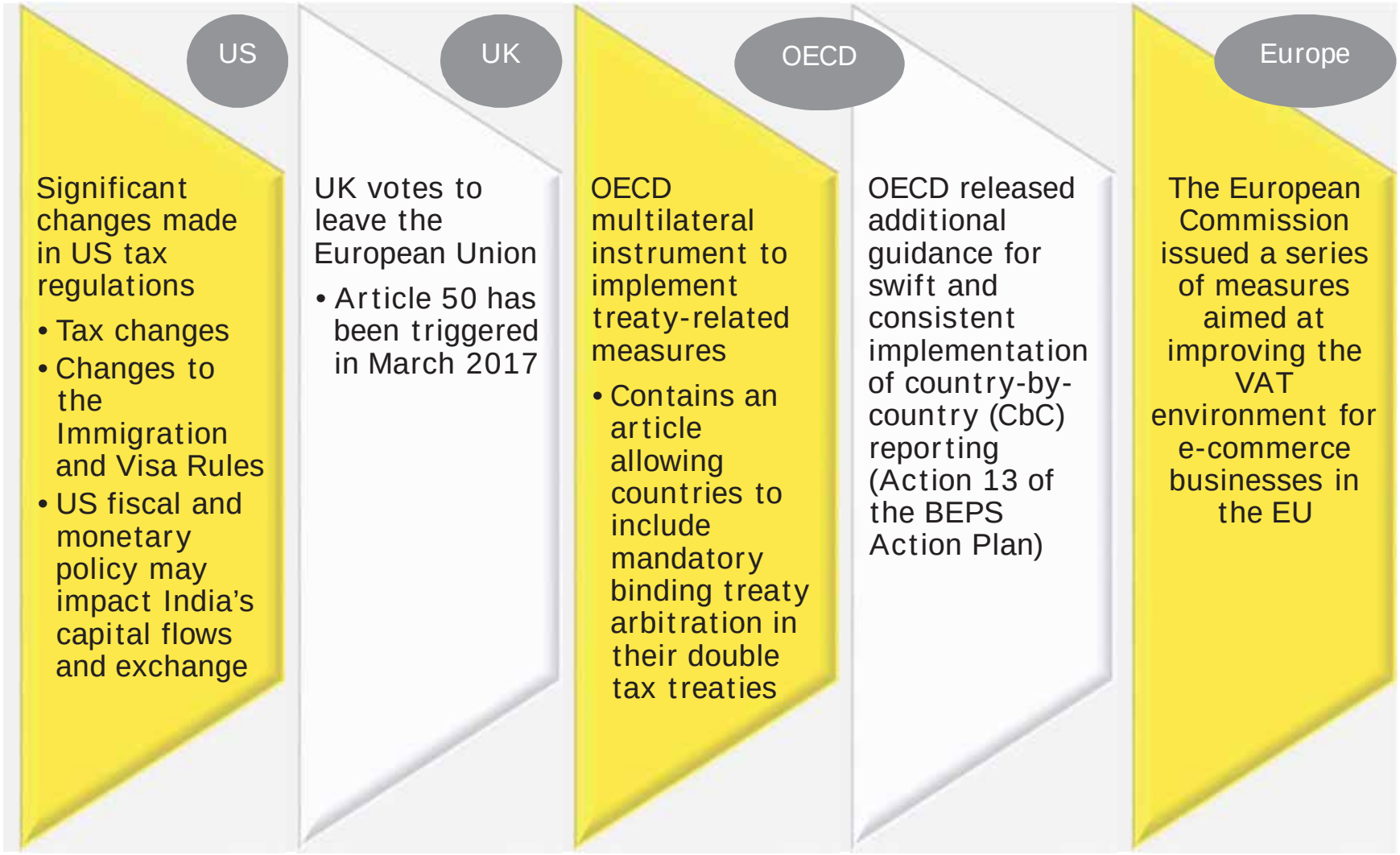
Agenda

- Base Erosion and Profit Shifting ('BEPS') and Multi lateral instrument ('MLI')
- OECD Model Convention ('OECD MC') update
- Recent Judicial precedents
- Foreign Companies – Taxation on receipt basis?
- Foreign tax credit – Recent changes
- Cross border reorganisation



Backdrop


US
Significant changes made in US tax regulations
• Tax changes
• Changes to the Immigration and Visa Rules
• US fiscal and monetary policy may impact India's capital flows and exchange
UK
UK votes to leave the European Union
• Article 50 has been triggered in March 2017
OECD
OECD multilateral instrument to implement treaty-related measures
• Contains an article allowing countries to include mandatory binding treaty arbitration in their double tax treaties
OECD released additional guidance for swift and consistent implementation of country-by-country (CbC) reporting (Action 13 of the BEPS Action Plan)
Europe
The European Commission issued a series of measures aimed at improving the VAT environment for e-commerce businesses in the EU

BEPS and MLI

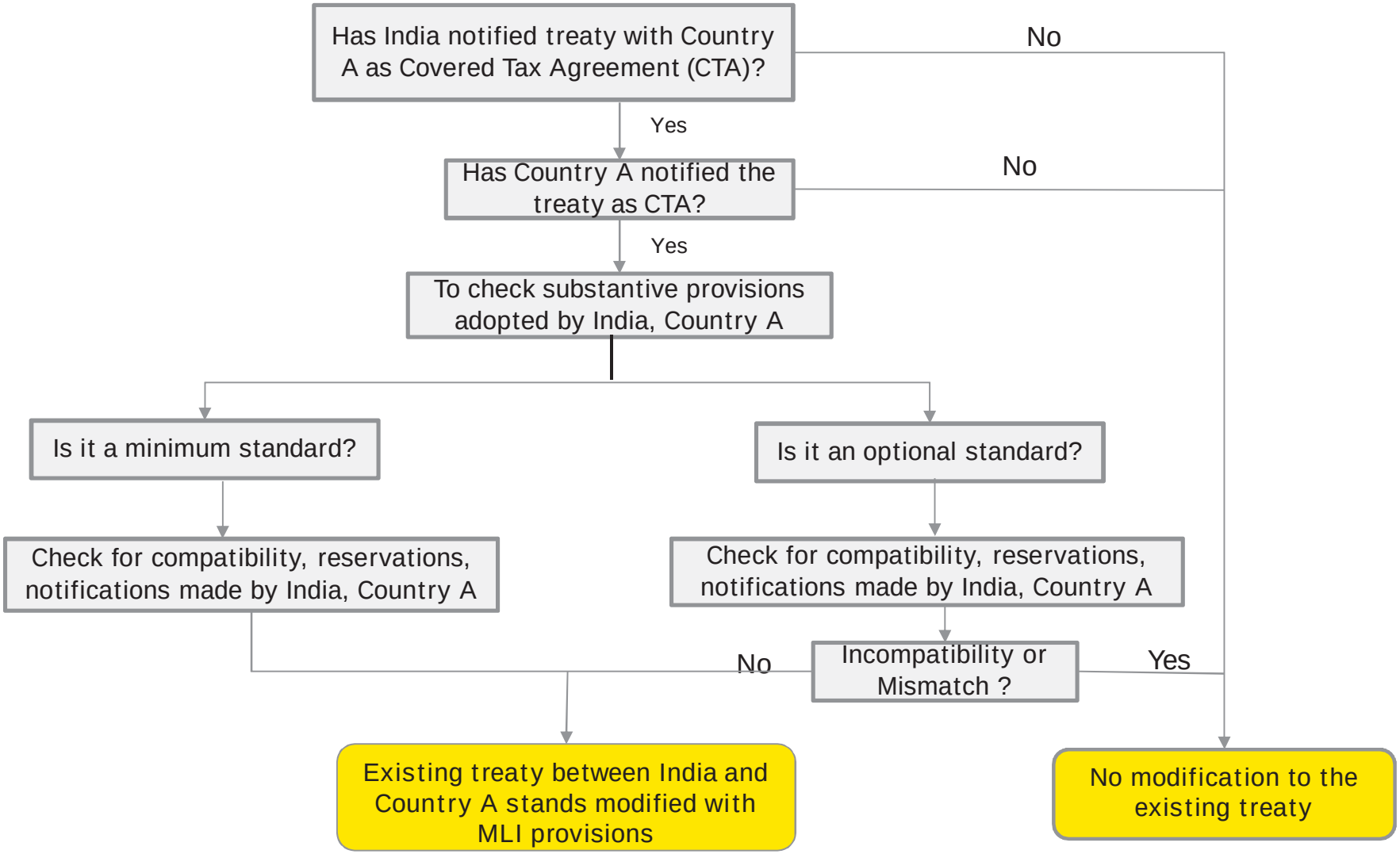
Implementation of BEPS Action Plan in India

Action 1 Measures impacting digital economy	• Introduction of Equalization Levy on certain digital advertising transactions • Introduction of 'significant economic presence'	Action 8-10 Aligning Transfer Pricing (TP)	Tax administration and taxpayers expected to give consideration while applying arm's length principles
Action 4 Limiting Interest Deductions	Introduction of the interest deduction limitation rule	Action 13 TP documentation	Introduction of Country by Country Reporting (CbCR) and Master File TP documentation
Action 6 Treaty Abuse	Minimum standard in MIL- India has adopted PPT + Simplified LOB	Action 14 Dispute Resolution	Committed to minimum standards for improving effectiveness on Mutual Agreement Procedures (MAP)
Action 7 Preventing the artificial avoidance of PE status	Extended agency definition included in business connection	Action 15 MLI	On 7 June 2017, India along with 67 other countries signed the Multilateral Instrument (MLI) to modify existing tax treaties.

MLI
Features

What is MLI, its objective	• Single instrument that modifies bilateral tax treaties in a synchronised, fast and consistent manner • One negotiation, one signature, one ratification
Impact	• To modify 1200+ tax treaties in first signing; intended to cover 3000+ tax treaties
Actions implemented	• Action 2 (Hybrid mismatches) • Action 6 (Treaty abuse) *Minimum standard* • Action 7 (Permanent Establishment) • Action 14 (Dispute resolution) *Minimum standard*
Legal status	• MLI does not function as protocol, needs to be read with existing tax treaties • Does not replace existing tax treaties but modifies them

How to apply MLI to check impact of India-Country A treaty?



Entry into force and Entry into effect

Entry into force ('EiF') for MLI:

Particulars	Entry into force
For first 5 jurisdictions who deposit their ratified copy of MLI with OECD	MLI to come into force on the first day of the month following the expiry of 3 calendar months from date on which 5th Signatory has deposited its instrument for ratification From this date, all 5 signatories become 'parties' to the MLI and shall be bound by it
For other jurisdictions	First day of the month after the expiry of 3 months from the date of deposit of its instrument of ratification

Entry into effect ('EiE') for the respective CTA:

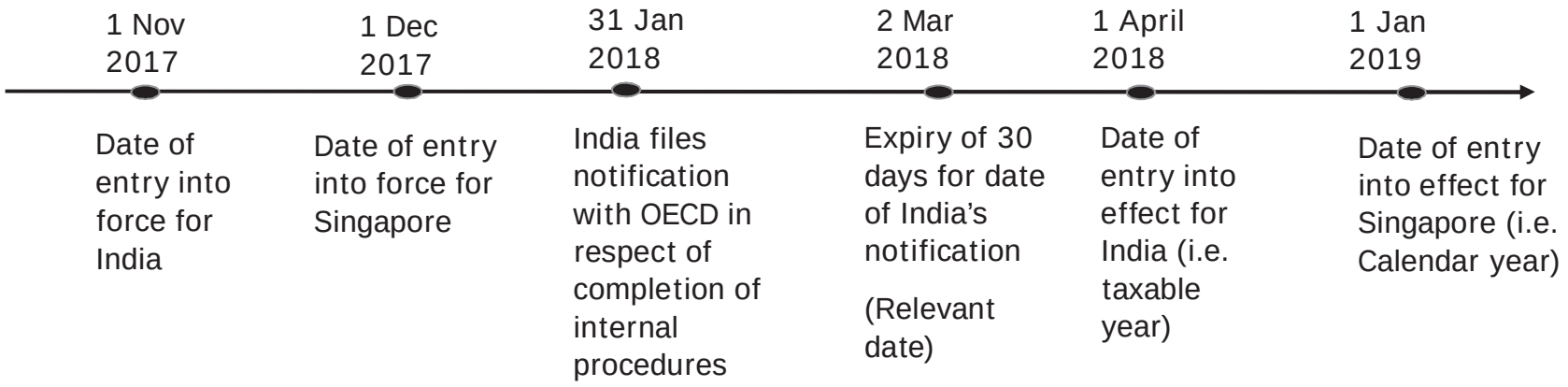
- Computed from the latest date of EiF for each of the treaty partners of a CTA – referred as "relevant date"

Particulars	Date of entry into effect
Provisions related to withholding taxes	1st day of next calendar year that begins on or after the relevant date
Provisions related to other taxes	Taxable period that begins on or after expiry of 6 calendar months from the relevant date

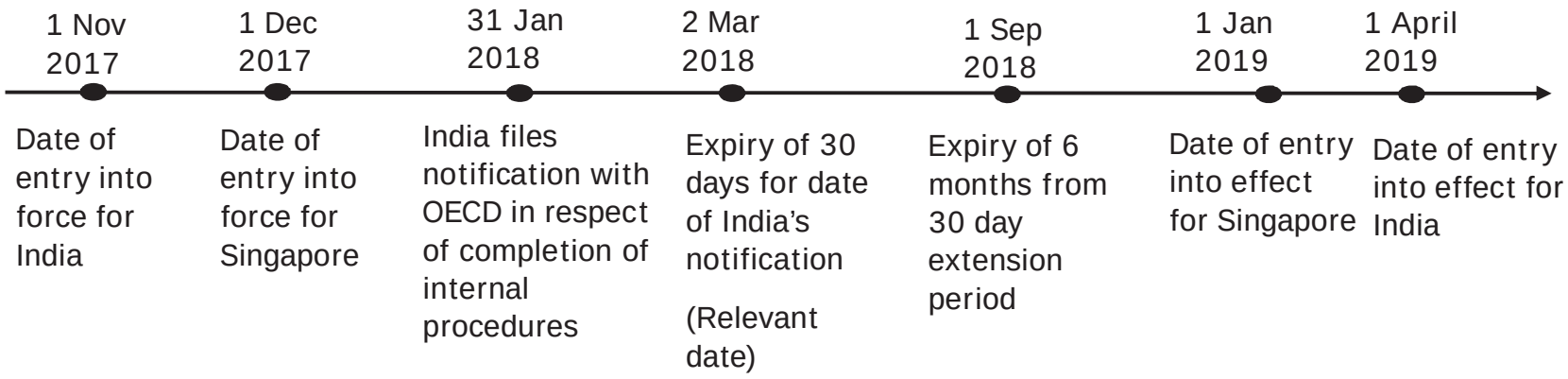
- Option to replace "calendar year" with "taxable period" for purpose of its own application- India has opted for such replacement.
- Option for delay until such country has completed its internal procedures for this purpose- India opted for such extension

Entry into effect – Illustration
India-Singapore treaty

Withholding taxes



Other taxes



MLI – snapshot of India's major trading and investment partner countries

Key India tax treaty partners that have not signed the MLI yet – existing treaties remain unaffected	Key India tax treaty partners that have signed the MLI – existing treaties to be modified based on matching of MLI position of both countries	Treaty partners that have signed the MLI but have not included India in their provisional lists – existing treaties remain unaffected
US, Brazil, Saudi Arabia, Thailand	Australia, Canada, Cyprus, France, Japan, Netherlands, UK, Luxembourg, Ireland, Italy, Russia, South Africa, Singapore, Malaysia	Mauritius, China, Germany

Article 6 - Preamble of a CTA

Title & Preamble

"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),"

Additional optional language:
"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,"

India's position

India has been silent on its position on Article 6

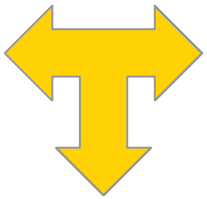
Being a minimum standard, MLI Preamble will be added to the existing preamble text for all CTAs whether or not other treaty partner notifies India's treaty for the purpose

Optional language not inserted in the absence of opting for such language

Article 7- Prevention of treaty abuse
Minimum standard

PPT Rule

Notwithstanding any provisions of a CTA, a benefit under the CTA shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the CTA."



LOB Rule

Rules based on objective criteria such as legal nature, ownership in, and general activities of residents of Contracting States (i) simplified or (ii) Detailed

India's Position

India has opted for PPT with Simplified LOB ('SLOB')

- PPT
  - ✓ Being a default test, it should apply to all CTAs irrespective of the position adopted by other countries.
  - ✓ PPT wider in scope compared to Indian General Anti-avoidance Rule ('GAAR')
  - ✓ Further, India has not opted for the Competent Authority Rule.
- SLOB- Applied if treaty partner adopts it or allows India to apply it asymmetrically

GAAR
Welcome clarifications

1. GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction

2. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction.

3. No GAAR if tax avoidance is sufficiently addressed by LOB clause in treaty

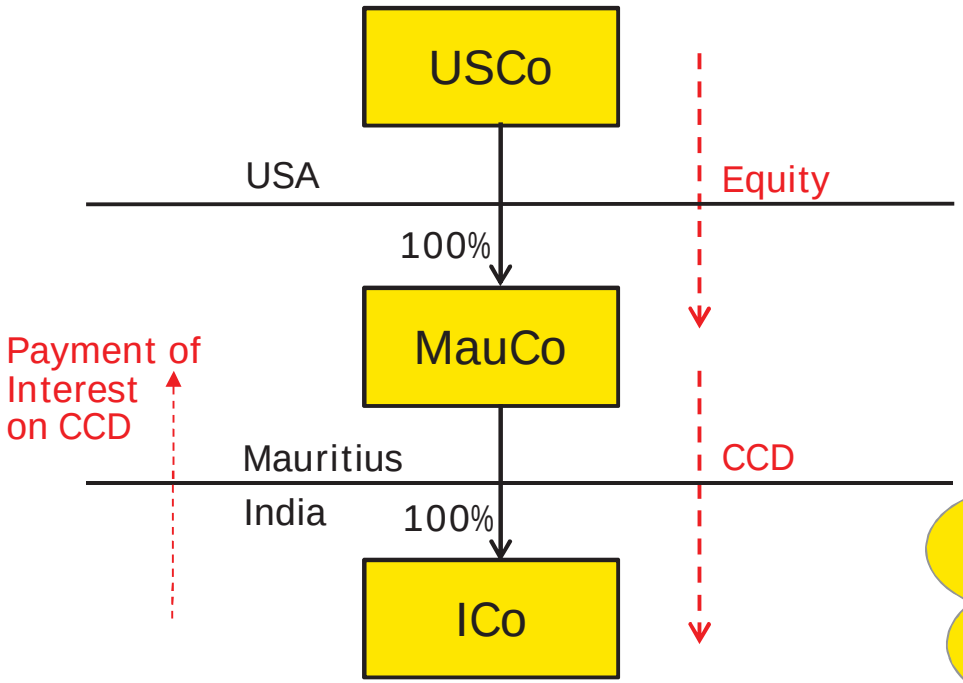
4. GAAR not to apply in case the arrangement held permissible by AAR

5. GAAR not to apply if arrangement is sanctioned by court if the tax implications are explicitly and adequately addressed

6. GAAR and SAAR to co-exist

   Eg Implication of limitation on interest benefit under section 94B

GAAR/PPT
Case Study



I-M Interest WHT	7.5%
I-US Interest WHT	15%
Domestic law WHT	40% + SC

What could be the possible implications if the said transactions are treated as 'Impermissible avoidance agreement' under GAAR/PPT?

GAAR/PPT
Case study

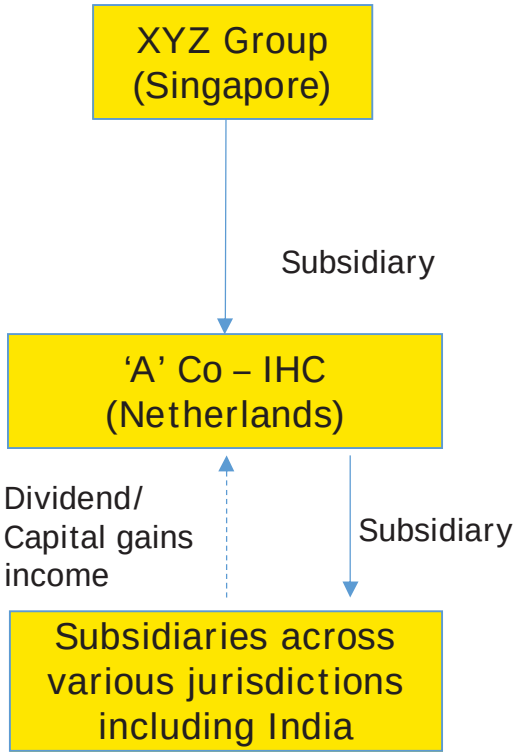
Consequences	Tax impact
Treating IAA as not entered into or carried out	Taxing USCo as if it had directly invested in ICo - WHT @ 15%
Disregarding MauCo as an accommodating party	
Treat MauCo and USCo as one and same person	
Reallocate interest income from MauCo to USCo	
Treating the place of residence of MauCo to be in USA by concluding that MauCo's location of residence in Mauritius is without any substantial commercial purpose	Taxing MauCo as if it is a company incorporated in USA and effective denial of treaty benefit in absence of TRC - WHT @ 40% on a net basis (as s.115A does not apply to CCD)

Simplified LOB

SLOB grants benefits to a resident of a CJ on satisfaction of any of the following conditions:

Conditions	Description
Resident should be a Qualified person (Para 9)	Qualified persons to include Individuals, Government and Government bodies, publicly traded companies/ entities, not-for profit organizations, persons satisfying certain ownership tests, etc.)
Resident should be carrying on active trade or business in the CoR (Para 10)	• Income is derived by person engaged in active conduct of trade or business in CoR • Income derived from emanates from or is incidental to such business • Exceptions provided as to when person is not engaged in active conduct of business (illustratively- holding company, providing group financing, providing overall supervision/ management of a group)
Derivative Benefits Rule (Para 11)	If, on at least half of the days of any 12 month period, atleast 75% of beneficial interest in resident enterprise is directly or indirectly owned by certain persons entitled to equivalent benefits (Equivalent Beneficiaries defined as a person entitled to equivalent/ more favourable benefit under domestic law, CTA or any other instrument)

Case Study
Facts



- 'XYZ' is a technology group ('Group') – HQ in Singapore and has subsidiaries across 30 jurisdictions including India. It provides ITES services
- The Group has established 'A' Co as an intermediate holding company ('IHC') in the Netherlands,
- 'A' Co, established in the Netherlands, was acquired by the group 20 years ago, through acquisition of shares of the 'ABC' group which held various entities (including 'A' Co) across various jurisdictions
- At the time of acquisition, 'A' Co held the shares of various operating entities in various jurisdictions, Hence, 'A' Co acted as the IHC for these entities
- The number of subsidiaries under 'A' Co have increased over the years in various jurisdictions.
- The role of 'A' Co is to primarily act as IHC of the various subsidiaries of the Group and it undertakes minimal business/operating activities
- At the time of acquisition, 'A' Co had 3 personnel for managing the general day to day affairs of the company, which has now increased marginally to 5 personnel
- The Board of 'A' Co comprises of certain independent and common directors No documentation available to substantiate substance

Case Study
Issues for consideration

- Is the onus to demonstrate satisfaction of Principal Purpose Test ('PPT') and/ or Simplified Limitation on Benefits ('SLOB') as per Multilateral Instrument ('MLI') on 'A' Co or the tax authorities?
- Will treaty benefits be available to 'A' Co as per MLI/ BEPS Action 6 where:
  - Dividend is received from the subsidiaries; or
  - Capital gains arises on exit of investment in subsidiaries
- If assuming that going forward 'A' Co increases the level of activities to be undertaken in its capacity as an IHC, will it make any difference to availability of treaty benefits?
- Assuming that 'A' Co was established by the Group itself to act as the IHC of various operating entities in various jurisdictions (other things being the same) would treaty benefits have been available?

Article 12 - Broader Agency PE rules

MLI provision

Wider scope of Agency PE

- Dependent agency PE (DAPE) rule extended to cover persons who habitually play a principal role leading to conclusion of contracts that are routinely concluded without material changes
- Excludes Independent Agent

Stringent condition for independent agent exclusion

- Not available to agents acting exclusively or almost exclusively on behalf of foreign enterprise, its closely related enterprises (CREs)
- CRE defined with respect to control/ beneficial holding with threshold of 50% of voting/beneficial/equity interest

India's stand

- India has opted for broader agency PE rule for all its treaties
- Applicable where the treaty partner has also notified India's treaty in this respect
- Replaces DAPE provision only to the extent refers to agents having authority to conclude contracts - other activities triggering agency PE like maintenance of stock or securing of orders remain unaffected by MLI

Amendment in FA 18- Business Connection

Deviation from MLI provisions

MLI Provision	Explanation 2a to section 9(1)(i)
Notwithstanding provisions of para 1 and 2 and subject to provisions of para 6, where a person is acting in a Contracting Jurisdiction on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are: a) in the name of the enterprise; or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or c) for the provision of services by that enterprise, That enterprise shall be deemed to have a permanent establishment in that state	For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident *a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are–* *(i) in the name of the non-resident; or* *(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or* *(iii) for the provision of services by the non-resident; or* ; b) C)

Blue- Identical language

Red- divergent language

Amendment in FA 18- Business Connection
Impact

Scenario	Impact of amendment	Treaties
Countries with which India does not have tax treaty	Highest Impact	NA
Treaties which will be amended after MLI enters into force	• Low/Medium impact • Treaty and ITA provisions would be almost similar • Treaty benefit available, subject to PPT, wherever ITA provisions have broader coverage	France, Netherlands, Japan, Russia
Treaties which will be based in pre-BEPS article 5(5) of OECD MC	• Low impact • Treaty language would be more beneficial	Existing treaties like Brazil, China, South Africa, Germany

Article 16 - Dispute resolution measures

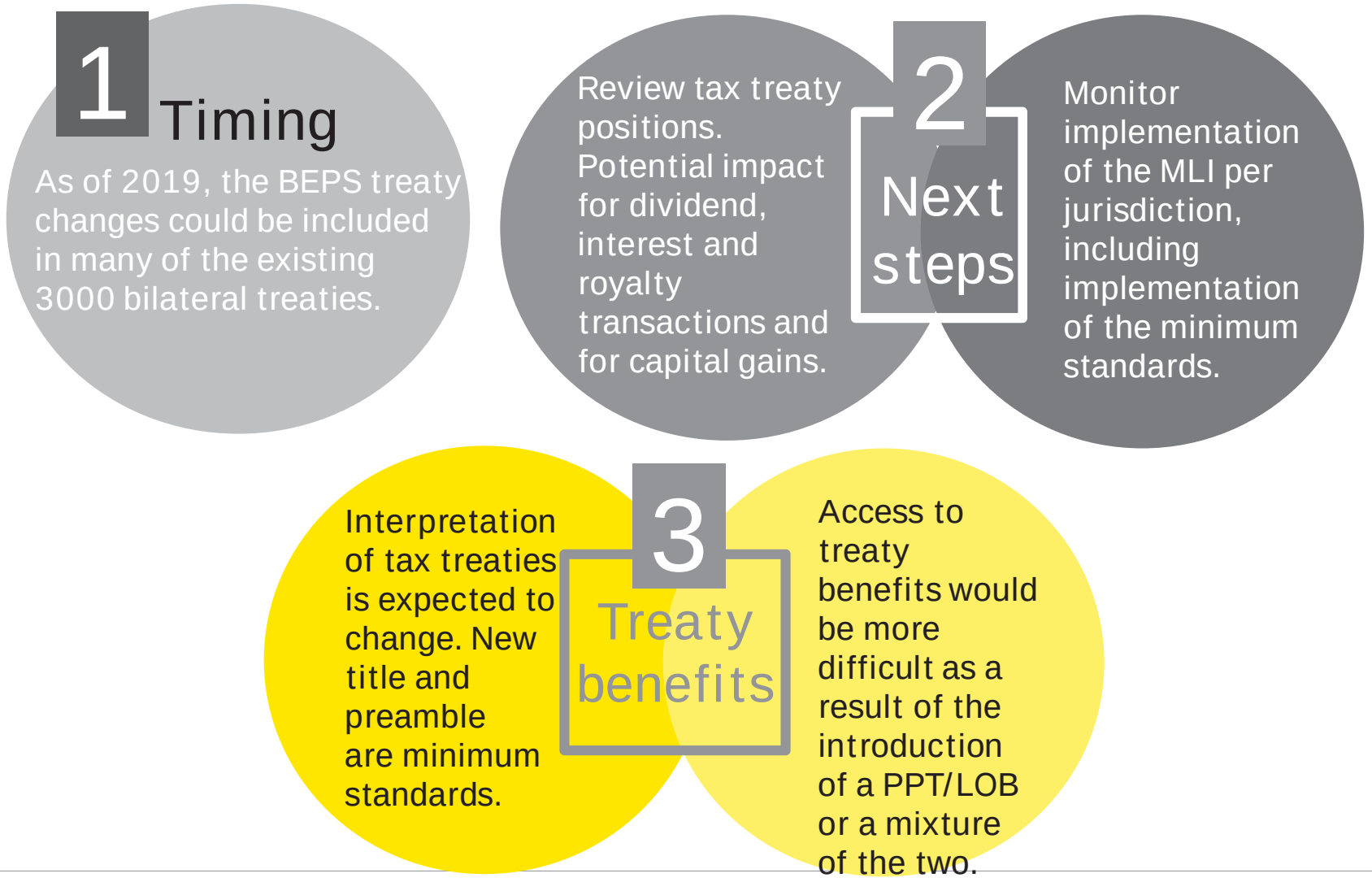
MLI provisions and India positions :

MAP access in "either" state (Article 16 Para 1) Minimum Standard	Reserved its right not to include MLI provision • Adopted allowing MAP access to Resident State, implement bilateral notification to other CJ • Largely all India treaties allow MAP access in resident State. Bilateral notification process to be set up
Minimum period of 3 years for MAP access (Article 16 Para 1) Minimum Standard	Agreed to insert a 3 year condition in its treaties • Notified 4 treaties which provide a lesser time threshold – It will be modified to provide a period of 3 years • Notified 80+ treaties already having a minimum of 3 year period – Will not be impacted by MLI.
Bilateral resolution of MAP cases where unilateral MAP fails (Article 16 Para 2)	Accepted to include bilateral resolution of MAP cases • Notified treaties which do not have comparable provision • Hence all treaties to now contain parallel MLI provision (subject to other State's position)

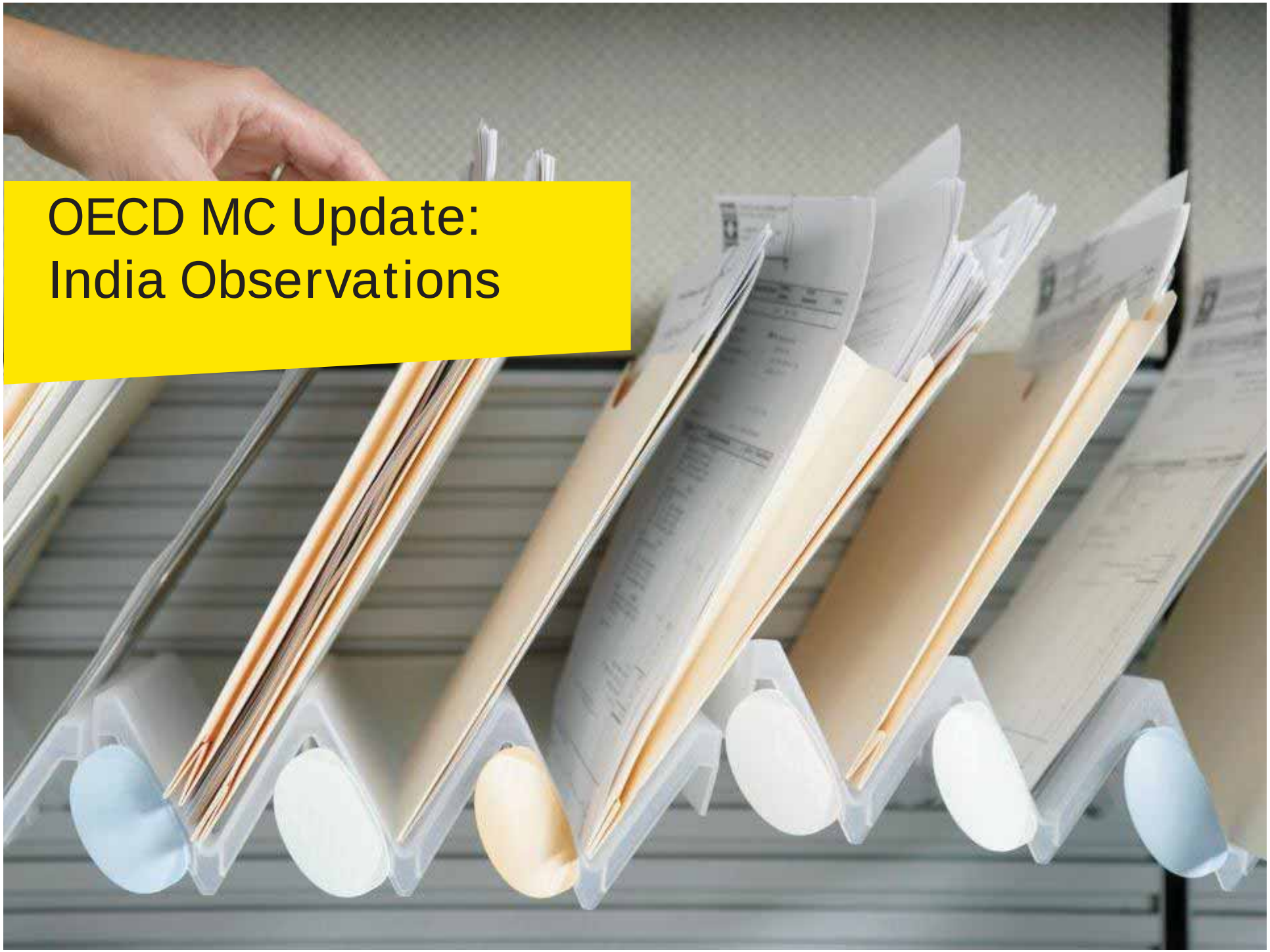
Article 16 - Dispute resolution measures

MAP implementation irrespective of domestic time limits (Article 16 Para 2)	Agreed to allow MAP implementation irrespective of domestic law time limits • Notified 7 treaties which do not have this language • Not opted for optional provision of making domestic law change to allow MAP implementation and limit the time period of making primary adjustments
Suo moto resolution of issues related to treaty interpretation and double taxation in consultation with CA of other State (Article 16 Para 3)	Accepted to include • Notified treaties which do not contain comparable provision • Hence all treaties to now contain parallel MLI provision (subject to other State's position)

Key takeaways



OECD MC Update: India Observations



OECD MC Update
India positions

In November 2017, OECD approved the contents of the 2017 Update to the OECD MC. India's positions to the 2017 Update are mainly on Permanent Establishment (PE), Mutual Agreement Procedure (MAP) and on certain other miscellaneous provisions such as the tie-breaker rule for residence of non-individuals, and tax treaty eligibility for transparent entities, among others.

Issue	MC provision	India observation
Deemed PE due to "significant economic presence"	Considering the challenges due to digital economy, a new nexus test in the form of "significant economic presence" has been introduced to determine the taxable presence in a state - Refer Annexure 1 for amendment in FA 2018	• Reserves right to deem a PE in case of significant economic presence (SEP) in India – *ITA amended to that effect* • *A website may lead to SEP* • *Downloading cookies, automated software on an equipment by opening a website, which uses the equipment to collect data may result in SEP*
Agency PE		
Routine conclusion of contracts	For DAPE – routine conclusion of contracts necessary	India has reserved a right on non-inclusion of the term "routinely."

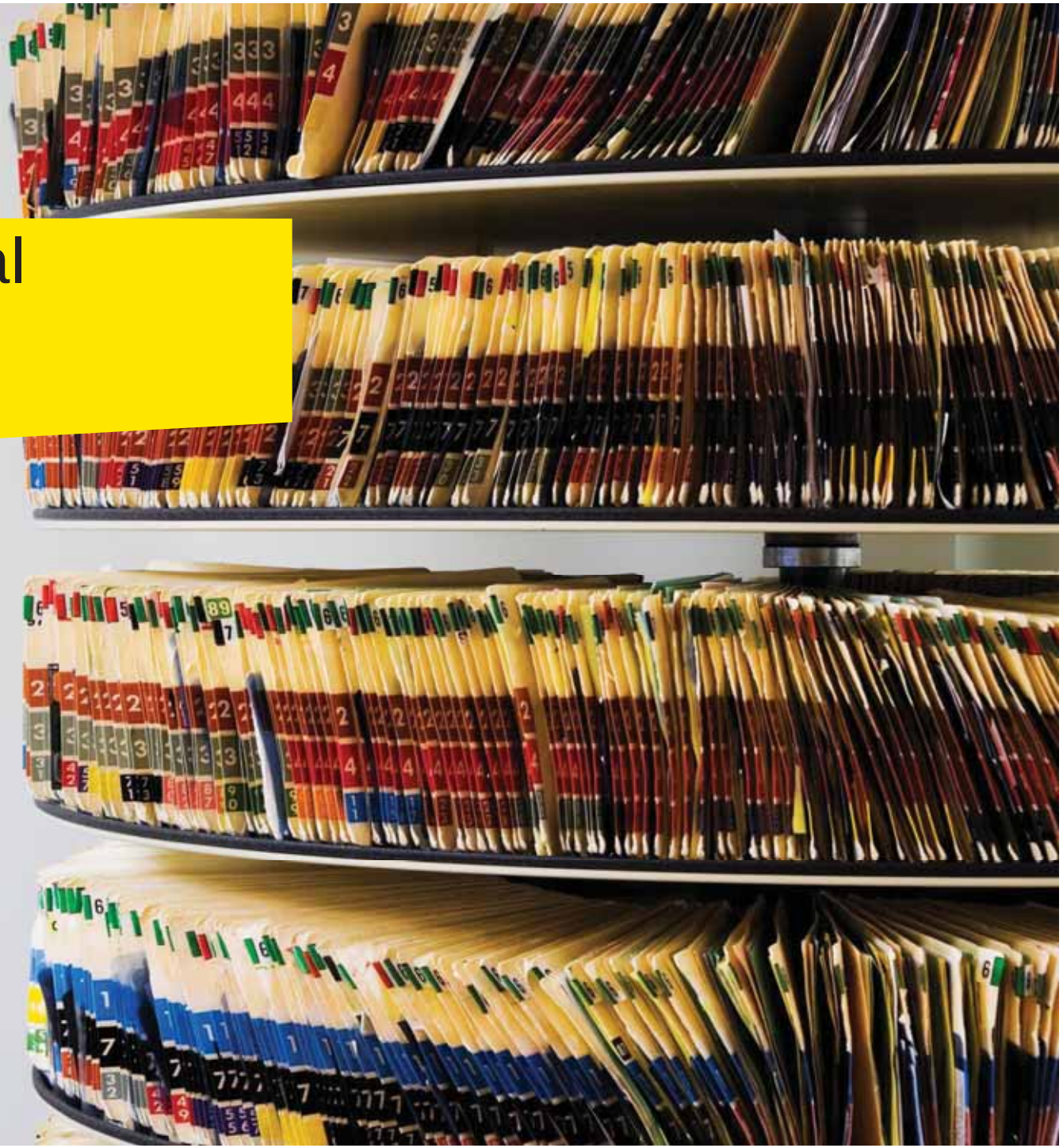
OECD MC Update
India positions

Issue	MC provision	India observation
Close relation	For dependency, close relation between principal and agent necessary	India has reserved a right on non-inclusion of the term "to which it is closely related."
Anti fragmentation	New anti fragmentation rule has been introduced for Preparatory and auxiliary activities only upon satisfaction of certain conditions.	Even when the anti-fragmentation provision does not apply, an enterprise cannot fragment a cohesive operating business into several small operations to take benefit of exemption for preparatory or auxiliary activity
Low-risk distributor	A buy-sell distributor (irrespective of whether it is an AE or not) not to be considered as a DAPE since it is neither acting on behalf of a non-resident enterprise nor is it selling goods that are owned by such enterprise.	India does not agree with the above interpretation because it considers that distribution of goods owned by an enterprise (by an associated or related enterprise) may create PE, particularly in a case where the risks are not borne by such distributor.

OECD MC Update
India positions

Issue	MC provision	India observation
Fixed Place PE		
Disposal test	Place not at disposal if no right to use the same or be present there	India does not agree with this interpretation
Permanence test	Permanence of six months recommended for satisfying the test of permanence, unless due to nature of business shorter duration may satisfy the condition	India has reserved a right to conclude satisfaction of permanence test even if the business, which is otherwise carried out in state A, is temporarily carried out in State B.
Repair work post completion of construction contract	The time spent on repairs after the completion of construction contract not to be included in original construction period for determining the duration for construction PE	According to India, any work undertaken on a site shortly after the construction work has been completed, including repair works, may be taken into account as part of the original construction period.
Treatment of GST/VAT	Not relevant	Can be relevant factor for determining PE

Recent Judicial Precedents



Recent judicial precedents
International taxation

Formula One World Championship Ltd (Supreme Court ['SC'])	
Facts	▸ F-1 World Championship Ltd. (FOWC) entered into "Race Promotion Contract"(RPC) with Jaypee Sports ('Jaypee'), an Indian company on 13/09/2011, wherein:- ▸ it granted Jaypee the right to host, stage and promote the F-1 Grand Prix of India (event) for a consideration of USD 40 million. ▸ Factually the event was held only in 2011-2013 for 3 days each year at the racing circuit owned by Jaypee. ▸ Circuit was to be constructed by Jaypee per approval from FOWC ▸ FOWC and its affiliates had access to the circuit beginning 14 days prior and 7 days post the event ▸ As conditions precedent, Jaypee had granted certain commercial rights (such as advertising, hospitality, etc.) to fellow group companies of FOWC to be exploited at the racing circuit during the period of the event.
Issue under consideration	Whether FOWC constitutes Permanent Establishment ('PE') in India?

Recent judicial precedents
International taxation

Formula One World Championship Ltd (SC)..... *continued*	
SC Ruling	▸ PE entails two requirements – fixed place of business at disposal and business carried out through that place; ▸ International circuit is a fixed place and since races are conducted from this circuit, it is an economic/business activity. Further, the circuit was at the disposal of FOWC as it had control over it; ▸ The number of days for which the access was there would not make any difference and FOWC constituted a fixed place PE in India and was liable to pay tax on the income; ▸ The entire arrangement demonstrated that the entire event was taken over and controlled by FOWC and its affiliates. The commercial rights were with FOWC which were exploited with actual conduct of race in India; ▸ Omnipresence of the FOWC and its stamp over the event is loud, clear and firm. One could clearly discern that it was a virtual projection of FOWC on the soil of India; ▸ SC held that the circuit where the F-1 event was held is a fixed place PE of FOWC in India.

Recent judicial precedents
International taxation

A.P. Moller Maersk (SC)	
Facts	▸ The Taxpayer, a Danish resident company, was engaged in shipping, chartering and related business. ▸ The Taxpayer had set up a centralized telecommunication facility called Maersk Net System ('System'), which enabled the agents (including Indian agents) to access information like tracking of cargo of a customer, transportation schedule, etc. ▸ Such System was an integral part of the international shipping business of the Taxpayer, which ran on servers located in Denmark.
Issue under consideration	▸ Whether income received from Indian agents for the use of global telecommunication facility can be classified as fees for technical services ('FTS') under the India-Denmark Tax Treaty ('Treaty').
SC Ruling	▸ A 'common facility' by way of the System is provided to all the agents across the countries to carry out their work using the said System and cost in relation to this is shared by all the agents. ▸ There was no element of technical services involved in relation to the payments made by the agents in India and, hence, cannot be treated as FTS. It is merely a cost to cost reimbursement and the same is not chargeable to tax.

Recent judicial precedents
International taxation

E-Funds IT Solutions Inc (SC)	
Facts	• E-Funds India performed back office operations in respect of ATM management, electronic payments, decision support, etc to two of its group companies based out of United States • Revenue authorities opined that E-Funds India constituted PE of its group companies.
Issue under consideration	▸ Whether E-Funds constitute PE in India for providing back office services to its group companies in US?
SC Ruling	▸ SC ruled that there exists no PE in India on facts either by way of Fixed place PE, Service PE or Agency PE under the DTAA. ▸ The SC held that there was no fixed place in India that was at the disposal of the Taxpayers to trigger Fixed place PE. ▸ No part of the main business and revenue-earning activity of the Taxpayers was carried on through E-Fund, hence, no Service PE was constituted as no services were rendered by the Taxpayers to any customers in India. ▸ The SC held there was no Agency PE as Indian affiliate was never authorized to nor exercised any authority to conclude contracts on behalf of the Taxpayers.

Recent judicial precedents
International taxation

Electrical Material Center Co Ltd (Bangalore Tribunal)	
Facts	• The Taxpayer, a company resident of Saudi Arabia, received income from an Indian company by rendering certain services through four engineers sent to India. The engineers spent more than 360 man days individually, but their collective stay in India was 90 days only. • While filing the return of income in India, the Taxpayer claimed that income from services to the Indian company were in the nature of FTS and, in the absence of a provision on FTS under the DTAA, such income is not taxable in India.
Issue under consideration	▸ Whether the tax payer constitutes PE in India, if not, whether the income received by the tax payer has to be offered to tax under clause "other income" in absence of FTS clause in the DTAA?
Bangalore Tribunal	▸ The Bangalore Tribunal held that only solar days are to be considered, and not man days. As the presence of the Taxpayer in India, through its engineers, was less than 182 days (as required by the India-Saudi Arabia DTAA to constitute Service PE) i.e., only 90 solar days, there was no service PE. ▸ In the absence of the FTS Article, income shall be considered as "other income" under India-Saudi Arabia DTAA, taxable only in the country of residence of the taxpayer i.e., Saudi Arabia.

Recent judicial precedents
International taxation

Google India Private Ltd vs. ACIT (Bangalore Tribunal)	
Facts	• Taxpayer, an Indian Company, entered into contract with one of its Group company based out of Ireland ('G Co'), pursuant to which it was given non-exclusive distribution and marketing rights in respect of online space for advertisement in India.
Issue under consideration	► Whether the payment made by Taxpayer to G Co for granting of distribution and marketing rights in respect of online space for advertisement can be considered as 'royalty' under the ITA as well as the India-Ireland DTAA
Bangalore Tribunal	► The Tribunal, basis its analysis and understanding of facts of the arrangement, held that the distribution agreement is not merely an agreement to provide the advertisement space but is a continuous targeted advertisement campaign to focused consumer in a particular language to a particular region with the help of digital data and other information with respect to the person browsing the search engine or visiting the website. ► Such campaign involved use and access to IP of G Co like patented technology, software, trademark, brand, secret process, confidential information etc. by the taxpayer. Hence, payment made by taxpayer to G Co qualified as 'Royalty' under the Act as well as the DTAA.

Recent judicial precedents
International taxation

AB Mauritius (AAR No. 1128 of 2011)	
Facts	• AB Mauritius (Mau Co) is a company incorporated in Mauritius in 2003 with an objective of investing in AB India (I Co) and 'S' sector in other Asian markets • Mau Co acquired shares I Co from sellers in US. The consideration was discharged by taking over a loan, which sellers owed to C Group in December 2003 • Mau Co ratified the acquisition along with the loan payable by resolution passed in Dec 2004 in its books for the year ended 2004. SPA in 2003 was signed by the chairman and managing partner of C Group, who was authorized by the Board to enter into SPA (but no specific resolution was passed). This is subsequently ratified • I Co recorded Mau Co as shareholder immediately and same is reflected in the financial statements for the year ended 2004. Entries were recorded in the books of Mau Co for the year ended June 2004 • The loan availed/taken over was repaid by Mau Co over a period of time • Mau Co held a valid TRC throughout 2003 – 2012 • BOD of Mau Co was independent and met in Mauritius to take its business decisions

Recent judicial precedents
International taxation

AB Mauritius (AAR No. 1128 of 2011)	
AAR Ruling	► Board minutes, FIPB and Mauritius approvals, signing of SPA by Mr A, show the intent of the C Group and not any decision taken by Mau Co, making it a mere spectator ► BOD of Mau Co was neither controlling nor managing the crucial investment decisions for the purpose of which it was set up ► Mau Co is only a benami or a name lender for the C Group ► The acquisition was a colorable device and an impermissible tax avoidance arrangement for deriving treaty benefit ► While TRC is presumptive evidence of ownership, subsequent conduct of the company casts a shadow on beneficial ownership of shares ► In the present case, it can hardly be said that they are separate entities in substance. Mere accounting entry without actual flow of money/other consideration must be made subservient to the actual transaction ► Basis the above, the AAR ruled that ► Since parent (C Group) acquired the shares of I Co from sellers, the gain arising in the hands of C Group, on sale to Sing Co was taxable as per the India-US DTAA and not as per India-Mauritius DTAA ► Withholding tax provisions (section 195) would be applicable; Transfer pricing provisions would apply to the transaction; MAT provisions (section 115JB) are not applicable


FTS taxation:
Receipt basis?

Taxing FTS
Receipt basis?

ITA	• Section 145 of ITA provides that the income from PGBP and Other sources can be computed on cash or mercantile basis, subject to provisions of ICDS • FA 2018 has introduced section 43CB which makes it mandatory to offer to tax income from services on percentage completion method in accordance with the provisions of ICDS
Treaties	Generally, Article 12 of tax treaties has a language: *"1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State."*
Judicial Precedents	Supreme Court has admitted SLP of tax department against order of Bombay High Court (HC) in DIT v Siemens Aktiengesellschaft (ITA 124 of 2010) (Bombay HC), *wherein HC* was dealing with the Royalty/ FTS article of India – Germany DTAA and held that the assessment of Royalty/ FTS should be made in the year in which the amounts are "received" and not otherwise. Thus, the HC accepted that under the said DTAA, "receipt" was the basis of taxation.

Taxing FTS
Receipt basis?

Klaus Vogel Commentary

While the earlier edition of Klaus Vogel commentary on Article 10 and 12 supported receipt basis taxation, in the recent edition of Klaus Vogel, there seems to be a change in opinion, wherein to indicate that the timing of taxation of a source of income can be determined only by the domestic laws and the DTAA provisions may not be able to impact such timing. Refer Annexure 3 for the extract.

Considering the recent amendment in section 43CB and update in the commentary of Klaus Vogel, it seems difficult to take a position to offer to tax FTS on receipt basis in India, especially when the F Co follows mercantile system of accounting for its global accounts

Foreign Tax credit

Foreign Tax credit (FTC) rules
Overview

In June 2016, CBDT notified foreign tax credit rules (Rule 128) for grant of foreign tax credit.

1. FTC available to residents of India
2. FTC allowed in the year in which respective income is offered to tax.
3. FTC allowed also allowed against cess and surcharge, but not against interest or penalty
4. Restricted to lower of foreign tax or tax payable in India on respective income
5. FTC to be computed separately for each source of income
6. Prescribed documents (self declarations) and forms to be filed before the filing ROI

While most of the provisions of the FTC rules are in line with the approach previously followed, there are few additional peculiar provisions:

Foreign Tax credit (FTC) rules
Key challenges

FTC against Minimum Alternate Tax (MAT)

- In case where taxes are payable under MAT, FTC shall be allowed against such MAT in the same manner as allowable against normal tax payable under the ITA.
- However, where the amount of FTC available against MAT is in excess of FTC credit available against taxes payable under the normal tax provision, FTC credit would be reduced to the extent of such excess. Refer Annexure 1 for an illustration
- This provision introduced to curb an earlier practice wherein the Tax payer used to claim entire FTC against MAT and also used to claim the entire MAT credit arising on payment of MAT, leading to double tax benefit.
- Corresponding amendment made in MAT provisions in ITA through FA 2017 with effect from AY 2018-19. However, the FTC rules which first prescribed the said limitation, are applicable from AY 2017-18 only

Foreign Tax credit (FTC) rules
Key challenges

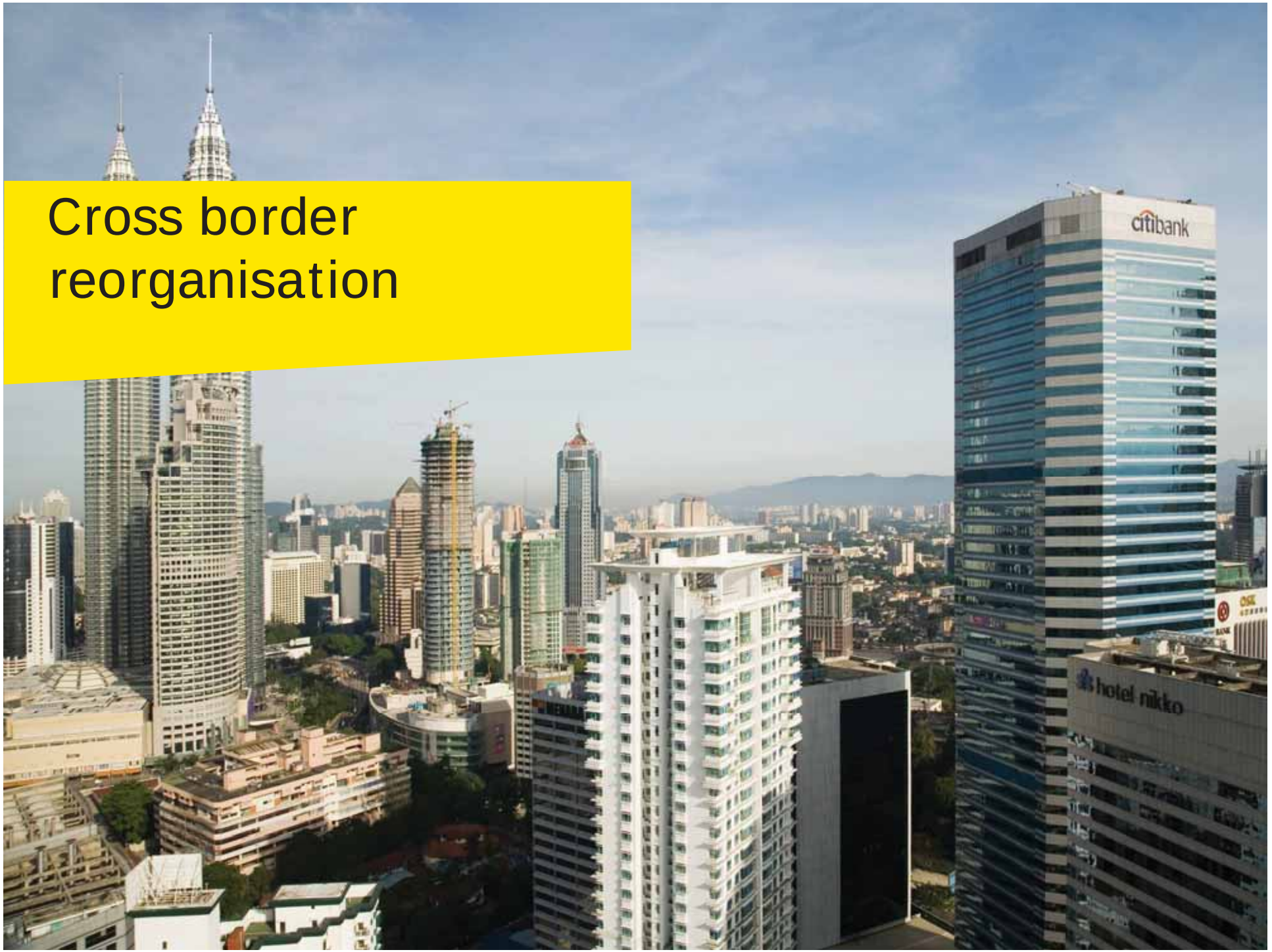
Disputed foreign tax

- Where the foreign tax paid or any part of it has been disputed in any manner by the taxpayer, such foreign tax credit would not be allowed
- Such disputed foreign taxes would be allowed as credit only in the year in which such income has been offered to tax, if taxpayer submits prescribed documents as a proof of settlement of dispute within 6 months from such settlement.

Clarity needed on following aspects

- Claim of underlying tax credit
- FTC applying tax sparing clauses
- FTC in case of mismatch accounting period, characterisation of income etc
- Also FTC rules fall short of industry expectation on allowing claim of FTC on aggregate basis (pooling of credit method) instead of source by source approach, as allowed now.
- Allowability of foreign taxes which are not creditable
- Carry forward or carry back of FTC

Cross border reorganisation



Cross border reorganisation
Recent updates

Companies Act, 2013

Section 234 was notified in April 2017 allowing inbound and outbound mergers, amalgamations and arrangements between Indian and foreign companies

RBI regulations

Subsequently, RBI issued draft regulations to govern cross border mergers.

The same are now notified as Foreign Exchange Management (Cross border mergers) Regulations, 2018

Income tax

Currently, merger of foreign enterprise into Indian company or demerger of foreign enterprise into Indian resulting company is exempt under the provisions of ITA, subject to satisfaction of other specified conditions.

No exemption provisions have been introduced in the ITA for reverse scenarios

The views and opinions expressed in this article are those of the authors and do not necessarily reflect the positions adopted by revenue authorities.

Also, the information provided is not intended to be an advice on any matter and should not be relied on as such. Professional advice should be sought before taking action on any of the information contained in it.

Thank You!

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Annexures

Annexure 1- Significant Economic Presence

Another step towards taxing digital economy

Definition of 'Business connection' expanded to include non-residents having "significant economic presence" (SEP) in India through digitized businesses and includes:

a. Revenue based condition: Provision for download of data or software in India; OR

b. User based condition: Systematic and continuous soliciting of business activities or engaging in interaction with user base in India

Revenue and users threshold to be determined in consultation with stakeholders

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,–

(i) the agreement for such transactions or activities is entered in India; or
(ii) the non-resident has a residence or place of business in India; or
(iii) the non-resident renders services in India:

This amendment has enabled India to negotiate for inclusion of clause on SEP in tax treaties

Annexure 2

Restriction on MAT credit when FTC is availed

Particulars	Reference	Example 1 (INR)	Example 2 (INR)
Foreign taxes on foreign income of 100	A	20	10
Normal tax liability in respect of foreign income	B	5	15
MAT liability in respect of foreign income	C	20	20
FTC available against MAT / normal computation	D	20	10
FTC against MAT in excess of normal tax liability	E=D-B	15	NIL
MAT credit *without limitation of new provision (ie under earlier MAT provisions)*	F=C-B	15	5
Available MAT credit under the limitations of new provisions	G=F-E	NIL	5

Annexure 3
Klaus Vogel extract – Recent Edition

M No 39 of Article 12

"*The term 'paid to' is not defined in the MCs. It is given a broad interpretation as all of the various forms of satisfying the shareholder's or creditor's claim to receiving the royalty.*"

M No 29 -31 of Article 11

"*To the extent that this indicates a requirement of payment in money, it is difficult to justify, as the settlement of a debt by other means should equally fall under Article 11 OECD and UN MC. 'Payment' may thus be defined as 'the fulfilment of the claim to receive interest in whatever form it may occur'. The US Tax Court has come to the same conclusion, holding that the recording of interest payments via book entries, rather than a transfer of cash, constitutes actual payment. It required, however, such a transfer to give the recipient the ability to dispose of or use the 'funds' as he wishes in order to qualifies a payment. By this definition, which would require an actual settlement of an actual debt, notional or deemed interest would fall outside the scope of Article 11 OECD and UN MC."*

Following the more stringent View that requires 'actual payment', a problem could occur with respect to different rules applied in the source and residence State regarding accrued interest. The taxation of accrued interest (i.e., interest clue but not yet paid) that is actually paid at a later time (e.g., at the same time as the principal is repaid) is dependent on the domestic rules of the State applying the treaty. Where a recipient is taxed on an accrual basis on such interest (e.g., interest inherent in a discount on issuance of the debt or 'original issue discount'), Article 11(1) OECD and UN MC would not prevent the application of such rules leading to taxation before actual payment, which can be based on the argument that the rule does not control the timing of taxation ." .....

An alternative and, practically, less problematic view would be to leave the determination of timing of the 'payment' to the domestic law provisions of the source State. Under this approach, interest would be 'paid' whenever the source State attributes the 'income' it represents to the recipient. An alternative interpretation of the term 'paid' is more convincing in light of the need for internal consistency of the distributive norms and the objective of the OECD MC (further supra Preface to Articles 10-12 at m. nos 9-13)....."