The Chamber of Tax Consultants

SUMMARY OF CASE LAWS – INTERNATIONAL TAX

INTERNATIONAL TAX STUDY GROUP MEETING | NOVEMBER 7, 2020

RONAK G. DOSHI | BANSI S. MEHTA & CO.

INDIAN CASE LAWS

1 Beneficial DTAA rate on dividends prevails over DDT rate

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT [2020] 120 taxmann.com 338 (Delhi Trib)

FACTS:

- Assessee is a 100% subsidiary of a German company. In the course of appeal for AY 2013-14, it raised an **additional ground** challenging the rate of DDT u/s 115-O on the basis that a lower rate of tax (10%) on dividend is prescribed in Indo-Germany DTAA.

HELD:

- **Additional ground was admitted for adjudication**, following co-ordinates bench's interim order on similar grievance in case of Maruti Suzuki India Ltd 961/Del/2014 uphled by Del HC in W.P.(C) 13241/2019.
- The first critical issue is as to **whether DDT is tax on the company or the shareholders**. ITAT noted that in Godrej and Boyce [2010] 328 ITR 81, Bombay HC has unequivocally held that DDT is tax 'on the company' and not 'on the shareholder'.
- There is no dispute that the liability is on the 'payer company' to pay DDT, but at the same time, one must not loose sight that **dividend is tax on 'income'** and definition of income under the Income-tax Act includes 'dividend'.
- DDT imposed u/s 115O is subject to the charging provisions u/s 4 of the Act, which itself is subject to other provisions of the Income-tax Act, including S. 90 that provides for a beneficial treaty regime.
- ITAT relied upon rulings in Azadi Bachao Andolan (SC), Visakhapatnam Port Trust (AP HC) and Davi Ashmore (Calcutta HC) to observe that in case of inconsistency between the DTAA and the Income-tax Act, the DTAA shall prevail over the Act.

1 Beneficial DTAA rate on dividends prevails over DDT rate

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT [2020] 120 taxmann.com 338 (Delhi Trib)(cont'd…)

HELD:

- ITAT traced the legislative history of taxation of dividends in EM to Finance Bills of 1997 and 2003 and also referred to EM to Finance Bill, 2020 explaining rationale behind removal of section 115-O.
- ITAT concluded that **DDT was a product of administrative consideration over legal necessity** and weighed in the economic aspect of DDT and held "**the burden of DDT falls on the shareholders rather than on the company, as the amount of distributed profits available for shareholders stands reduced to the extent of DDT levied.**"
- ITAT found the flat rate of DDT across the board as "**iniquitous and regressive**".
- On a conjoint reading of the EMs to Finance Bills 1997, 2003 and 2020, ITAT observed that levy of DDT was merely for **administrative conveniences** and withdrawal of DDT is keeping in mind that revenue was across-the-board, irrespective of marginal rate, at which recipient is otherwise taxed.
- ITAT opined that generally accepted principles relating to interpretation of treaties in the light of object of eliminating double taxation, do not bar the application of tax treaties to DDT.
- ITAT observed that **Indo-Germany DTAA** which provides for the lower tax rate of 10% on dividend **predates the introduction of DDT** in 1997. ITAT relies New Skies Satellites (Delhi HC) to hold that the statutory amendment cannot override the treaty provisions.
- **ITAT expressed a considered view that tax rates specified in DTAA in respect of dividend must prevail over DDT**. Matter remitted back to AO for factual verification of beneficial ownership of dividends and existence of PE of the beneficial owner in India. In principle, additional ground allowed.

1 Beneficial DTAA rate on dividends prevails over DDT rate

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT [2020] 120 taxmann.com 338 (Delhi Trib) (cont'd…)

ADDITIONAL POINTS FOR CONSIDERATION:

- **UOI vs. Tata Tea Co. Ltd. [2017] 398 ITR 260 (SC)** – Assessee earned agricultural income from cultivation of tea. Amongst others, the plea before the Court was that DDT could be charged only on 40% of the agricultural income which was chargeable to tax under the Income-tax Act. Since, the balance 60% was exempt in the hands of the assessee, distribution of profits from that portion would not attract DDT. The Supreme Court held that when dividend is declared to be distributed and paid to the company's shareholder, it is not impressed with the character of source of its income. SC further held that imposition of additional tax on dividend (i.e. DDT) is covered by Entry 82 of the Union List and hence, a tax on income.

  Tata Tea's decision may imply that DDT is thus, a tax on dividend income of the shareholder and not on profits of the company.

- **SGS India (P.) Ltd. vs. ACIT [2017] 189 TTJ 398 (Mum Trib)** – Aditional ground was raised on the issue of DDT applying lower rate provided under the Indo-Switzerland DTAA. ITAT remanded the matter for re-adjudication observing that "though reading article 10 prima facie gives an impression that it will only apply to non-resident shareholder receiving the dividend, however, still it leaves a scope for examining the claim of the assessee that DDT being a tax on dividend, article 10 of the DTAA would be applicable even if such dividend is payable by the domestic company."

1 Beneficial DTAA rate on dividends prevails over DDT rate

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT [2020] 120 taxmann.com 338 (Delhi Trib) (cont'd…)

ADDITIONAL POINTS FOR CONSIDERATION:

- **Protocol under the Indo-Hungary DTAA:** "When the company paying the dividends is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend".

- **Clarifications by Foreign Tax Authorities:**
  - **Singapore IRAS:** DDT is a tax paid by the Indian resident company on its distributed profits and is in addition to the income tax chargeable on its corporate profits, i.e., it is not a tax on the income of the Indian resident company. The DDT is also not a tax on the Singapore resident shareholder receiving the dividend.
  - **UK HRMC:** Additional taxes paid on distributed profits will be eligible for underlying tax on the grounds that it is an additional tax arising on distribution of profits by the company paying dividends.
  - **Mauritian revenue authority:** DDT, being tax paid out of the profits/reserves of the company declaring dividend, cannot be considered as a withholding tax suffered by the recipient of the dividend. In fact the liability to DDT rests with the paying company and not with the shareholder.

1 Beneficial DTAA rate on dividends prevails over DDT rate

Giesecke & Devrient [India] Pvt Ltd. vs. ACIT [2020] 120 taxmann.com 338 (Delhi Trib) (cont'd…)

ADDITIONAL POINTS FOR CONSIDERATION:

- **Application of Most Favoured Nation (MFN) Clause –** Indo-Slovenia DTAA and Indo-Lithuania DTAA provide lower rate of tax at 5% on dividend income, where the shareholder (being a beneficial owner) owns at least 10% of the capital of the company paying dividends.
- Slovenia and Lithuania were not OECD members when the respective treaties were entered into, but became OECD members on a later date.
- Recently, Columbia has become an OECD member on 28 April 2020. As per Indo-Columbia DTAA, dividend is taxable at the rate 5%, not subject to condition of any minimum shareholding in the company declaring dividend.
- Several treaties have an MFN clause which provides that if a lower rate or more restricted scope is provided in a treaty between India and a third State which is a member of the OECD, then as from the date on which such treaty enters into force, the favourable treatment shall be granted – Refer Indo-Swiss DTAA; Indo-Netherlands DTAA, Indo-France DTAA, etc.

- Question arises whether favourable benefits of Slovenia/Lithuania/Columbia tax treaties with India can be availed, even though such countries were not OECD members at the time of signing the tax treaty?

2 Special-Bench constitution to interpret the term 'paid' under DTAA

Ampacet Cyprus Ltd. vs. DCIT [2020] 184 ITD 743 (Mum Trib)

FACTS:

- Assessee, a company incorporated in Cyprus advanced loan to its Indian subsidiary (AE). During the year, the AE had not paid any interest on the loan because of the moratorium provided on interest payment in the loan agreement.
- The TPO disregarded the moratorium considering it to be influenced by intra-AE relations. TPO made TP adjustment and added notional interest to the Appellant's income.
- The Assessee challenged the TP adjustment on the ground that tax can only be levied under Indo-Cyprus DTAA (Article 11), if interest is actually 'paid', which was not the instant case. The question of TP adjustment would not arise as interest was not 'paid' by the Indian AE to the Assessee.

HELD:

- ITAT observed that the term **'paid' is not been defined in the treaty, hence, it should be assigned domestic law meaning under Article 3(2) of the treaty**. The term **'paid is defined u/s 43(2)** to mean "*actually paid or incurred according to the method of accounting…*".
- All the coordinate bench decisions on this issue and also Bom HC decision in case of DIT vs. Siemens AG are rendered without considering Article 3(2) & S. 43(2) and could possibly be *per incuriam*.

2 Special-Bench constitution to interpret the term 'paid' under DTAA

Ampacet Cyprus Ltd. vs. DCIT [2020] 184 ITD 743 (Mum Trib)(cont'd…)

HELD:

- ITAT referred to **Standard Triumph Motor Co. Ltd. [1993] 201 ITR 391** wherein the SC held that the **credit entry in the assessee's books does amount to receipt for the recipient in UK**.
- ITAT felt that it is indeed worth exploring as to whether the meaning assigned to the expression "received by an assessee", which essentially corresponds to and has to treated as equivalent to "paid to the payee", by SC in Standard Triumph is to be assigned to the treaty of the undefined treaty expression "paid".
- ITAT noted that **this aspect remained unexamined in co-ordinate bench and Bom HC decisions**.
- Recommendation has been made for constitution of a special bench. ITAT noted that in the event of a doubt about the correctness of the earlier decision or, extending that logic a little further, correctness of the path the earlier decisions have traversed to come to a conclusion, it is open to the bench to make a reference to for constituting a larger bench for considering the same.

POINTS TO PONDER:

- The decision has opened a Pandora's box, considering plethora of favourable rulings (including Jurisdictional High Court) – Gurgaon Investment Ltd. vs. DDIT [2020] 113 taxmann.com 79 (Mum Trib); **CIT v Pramerica ASPF 11 Cyprus Holding Ltd (ITA 1824 of 2016(Bom HC)**; DCIT vs. TMW ASPF I Cyprus Holding Co Ltd. [2019] 111 taxmann.com 212 (Delhi Trib); Saira Asia Interiors (P.) Ltd. vs. ITO (TDS) [2017] 185 TTJ 713 (Ahmd Trib); Pramerica ASPF 11 Cyprus Holding Ltd vs. DCIT [2016] 67 taxmann.com 368 (Mum Trib); Johnson & Johnson vs. ADIT [2013] 32 taxmann.com 102 (Mumb Trib); CSC Technology Singapore Pte. Ltd. vs. ADIT [2012] 50 SOT 399 (Delhi Trib); Pizza Hut International LLC vs. DDIT [2012] 22 taxmann.com 111 (Delhi Trib); **DIT (Intl. Tax) vs. Siemens Aktiengesellschaft (ITA No. 124 of 2010)(Bom HC)**
- Even if a Special Bench is constituted, can ITAT hold a position contrary to binding Jurisidictional HC?

3 Carve outs to 'indirect transfer' provision, retrospective

Augustus Capital PTE Ltd vs. DCIT [ITA No. 8084/DEL/2018] (Del Trib)

FACTS:

- Assessee, a Singaporean Co. engaged in the business of incubation of companies, transferred its entire shareholding in Accelyst [another Singaporean start-up that held investment in India] to an Indian company, Jasper Infotech Private Limited [Owner of Snapdeal].
- For AY 2015-16, the Assessee, as per Exp. 5, 6 and 7 to Sec. 9(1)(i) contended that the transaction involving transfer of shares of a foreign company that held investment in India was not taxable.
- Disregarding assessee's submissions, the Revenue held that Exp. 7 to section 9(1)(i) was inserted by the Finance Act, 2015 w.e.f. 01.04.2016 was prospective in nature and not applicable to AY under consideration. Thus, the capital gains were held as taxable in India.

HELD:

- ITAT noted that S. 9(1)(i) was amended and Exp. 5 was inserted by the Finance Act, 2012 with retrospective effect from 01.04.1962. Because of apprehensions and ambiguities in the said Explanation, Shome Committee was constituted. Based on the recommendations of Shome Committee and pursuant to Delhi HC ruling in Copal Market Research Limited, Exps. 6 and 7 were inserted by the Finance Act, 2015 w.e.f. 01-04-2016.
- ITAT further noted that both **Exps 6 and 7 start with "For the purposes of this clause"** (i.e. 9(1)(i)) and **Exp. 5 starts with "For removal of doubts".** Thus, Exp 6 and 7 have to be read with Exp 5 to understand the provisions of S. 9(1)(i) of the Act and **cannot be read in isolation**.
- ITAT held that **both explanations have to be given retrospective effect**.

4 Business Connection in India - Payment to foreign celebrity for appearance outside India

Volkswagen Finance (P.) Ltd. vs. ITO (Intl. Tax) 2020] 184 ITD 872 (Mum Trib)

FACTS:

- The assessee, an Indian company jointly with its group entity, Audi India, planned an event in Dubai for launch of Audi A-8L facelift model in the Indian market.
- Around 150 people, mostly prospective Indian customers and journalists were flown to Dubai for their participation in the event.
- Consideration was paid to a US resident celebrity for making an appearance at the event.
- The assessee and Audi India, received full rights to use free & non-exclusive promotional usage of all the event footage/material, films/stills/interviews, etc. of the launch.
- The assessee did not withhold any taxes on payments made to celebrity for the appearance on the grounds that the event was not held in India, and hence, the income did not accrue or arise in India.
- The AO held that the payment was taxable in India as royalty u/s 9(1)(vi) as well as under Article 12 of the Indo-USA DTAA. Accordingly, the taxpayer was required to withhold tax.
- On appeal, the CIT(A), confirmed the action of the AO and also held that the whole purpose of organizing an India-centric event at Dubai was to avoid "attraction of clause regarding income accruing or arising in India", referring to S. 9(1)(i).

4 Business Connection in India - Payment to foreign celebrity for appearance outside India

Volkswagen Finance (P.) Ltd. vs. ITO (Intl. Tax) [2020] 184 ITD 872 (Mum Trib) (cont'd…)

HELD:

- It needs to be examined whether the income from appearance fee accrued or arose in India or was deemed to accrue or arise in India under S. 5 r.w.s 9(1)(i).
- ITAT observed that in strict legal sense of the expression 'accrues or arises' in India, the event resulting in accrual of income must take place in India. But, given the broader scheme of the Income-tax Act, even first limb of S. 5(2)(b) needs to be read with, *inter alia* S. 9(1)(i), which extends the scope of income by including a deeming fiction,
- ITAT took note of the following **key facts**:
  - The Audi A8L facelift launch **event in Dubai was India-centric**.
  - The **event was for the purpose of promoting business in India** which generates enquiry of potential customers in India who in turn would like to purchase Audi cars in India and finance the same from the Assessee. It was for this reason that the Assessee was a part of this event.
  - While the event physically took place in Dubai (UAE), the predominant benefits was by way of below-the-line publicity on internet, press releases, news reports, social media of Audi 8L facelift in India.
  - The **target audience was in India, the potential customers were in India, the intended benefits were in India, and yet the event was in Dubai UAE**.
  - The use of this event, as **a tool of marketing, was only in India**.
  - The **entire expenses of the event were treated as business expenses and claimed as deduction**.

4 Business Connection in India - Payment to foreign celebrity for appearance outside India

Volkswagen Finance (P.) Ltd. vs. ITO (Intl. Tax) [2020] 184 ITD 872 (Mum Trib) (cont'd…)

HELD:

- In light of above, ITAT held that **all the benefits accrued to the taxpayer in India, and it was on account of these benefits that the international celebrity was paid for his participation in the Dubai event**.
- ITAT held that the **business connection is intangible**, as it is a relationship rather than an object, but it is significant business connection which has resulted in income accruing and arising to the non-resident. The income thus, based on facts, accrued and arose by reason of business connection in India.
- ITAT also noted that **none of the judicial precedents had an occasion to examine an intangible business connection, and, there is thus, no guidance available on this issue**.
- Assessee emphasised on S. 115BBA which provides for taxation of an entertainer where income is received/receivable from his performance in India and submitted that this implies thereby that performance outside India is outside the ambit of taxation in India. The ITAT held that the same deals with mode and rate of taxation in hands of non-resident entertainer. Such modalities cannot be treated as restrictions on chargeability to tax u/s 5(2)(b). Hence, if an income is not covered under the said provisions, then the same was taxable at normal tax rates.
- ITAT also rebutted the claim on treaty protection. Article 18 dealing with income of entertainers was not applicable as event was held outside India. Under Article 23 on Other Income also treaty protection from source taxation is not available.
- In light of the above discussion, it is viewed that the income embedded in payment to the international celebrity, for participation in Dubai A8L launch event, was taxable in India.

4 Business Connection in India - Payment to foreign celebrity for appearance outside India

Volkswagen Finance (P.) Ltd. vs. ITO (Intl. Tax) [2020] 184 ITD 872 (Mum Trib) (cont'd…)

POINTS TO PONDER:

- The 'Event' in Dubai, is whose business connection in India – the non-resident celebrity or the Assessee?
- For the purpose of S. 9(1)(i), whose business connection needs to be determined – the non-resident or the Payer?
- Would the conclusion be different if Exp.1(a) to S. 9(1)(i) was examined?

  The said Exp. read as "*For the purposes of this clause— (a) in the case of a business… of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India*".

- The decision seems to be influenced by India's post-BEPS developments. Leads to expansion of scope of Business connection targeting Indian market/customers.

5 FTS taxability for IT services income linked to 'royalty'; 'Make available' test inapplicable

Aktiebolaget SKF vs. DCIT (Intl. Tax) 2020] 181 ITD 695 (Mum Trib)

FACTS:

- In the preceding year, the Assessee had only two agreements with SKF India and SKF Techhnologies i.e. the technology collaboration and technical assistance agreement.
- In the concerned AY, these were broken down into three agreements, i.e. License Agreement; Trademark License agreement and IT service delivery agreement.
- Originally, income arising from all three agreemens was offered to tax as royalty income. However, in the revised return, fees charged for IT services was not offered to tax claiming that the same was reimbursement of expense and hence, not liable to tax in India.
- AO & DRP held the IT service income were in the nature of FTS both under the Income-tax Act and Indo-Sweden DTAA.

HELD:

- ITAT noted that **three agreements are meant to function together and the royalty agreement cannot be effectively implemented, unless it is integrated with the IT support agreement**.
- ITAT remarks that the Assessee has bifurcated the agreements into separate IT services agreement, so that it can be taken out of the ambit of definition of royalty.
- In light of scope and nature of IT services, it was held to be 'FTS' u/s 9(1)(vii) of the Income-tax Act, 1961, as well under Indo-Sweden DTAA.

5 FTS taxability for IT services income linked to 'royalty'; 'Make available' test inapplicable

Aktiebolaget SKF vs. DCIT (Intl. Tax) 2020] 181 ITD 695 (Mum Trib) (cont'd…)

HELD:

- With regard to applicability of MFN benefit without a separate notification, ITAT ruled that there is no doubt whatsoever on benefit of MFN status, if the other country, where the third state with which India has DTAA is a member of OECD. Even if there is no separate notification from the Government, the benefit of MFN has to be given to the assessee.
- With respect to Assessee's claim on extending the 'make available' clause benefit under Indo- Portugal DTAA to instant Sweden treaty in view of the MFN clause, ITAT examines Article 12(4) of the Portugal DTAA and elucidates that **in order to apply the second limb** (providing for the 'make-available' requirement), the **Assessee has to first exhaust the first limb** (covering services that are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a royalty payment is received).
- ITAT observed that **IT services rendered by the assessee were subservient to the royalty agreement and were ancillary and subsidiary to the main frame royalty agreement** entered into by both the parties.
- ITAT clarifies that **when the services rendered come under first limb of FTS, then the Assesee is not correct in moving to the second limb of FTS, to argue that the services do not make available** any technical knowledge, skill, process etc.

KEY TAKEAWAYS:

- Restructuring of intra-group services need to be done vigilantly with adequate documentation. Tax authorities do examine the substance and conduct rather than restricting to the form of the transaction;
- If the services are ancillary to the main royalty agreement, make available clause does not apply.

6 Company that becomes AE during the year, not valid comparable; Average ALP to be compared with each controlled transaction separately

Lonsen Kiri Chemical Industries Ltd. vs. DCIT [2020] 120 taxmann.com 396 (Ahmd Trib)

FACTS:

- The Dyestar Group of companies (DG) became the AE of the Assessee w.e.f. 4th Feb, 2010.
- In order to determine the ALP for the export of the goods to DG, Assessee compared the average price charged post 4th Feb with the average price for the export of goods prior to said date as uncontrolled transaction.
- TPO was of the view that each invoice should be compared separately with ALP arrived at based on average prices and made an upward adjustment.
- In export transaction with another AE, Well Prospering Ltd. (WP), the Assessee considered average price of exports only to non-AEs only. TPO was of the view that Assessee should have also considered export to DG prior to 4th Feb, to arrive at the ALP.

HELD:

- Issue for adjudication before ITAT *inter alia was* whether the TPO was right in comparing the average price of the comparable with the individual invoices raised by the Assessee on the AEs for determining the ALP.
- ITAT **referred to Rule 10B(1) and held that the provisions of the rule permits to aggregate the comparable uncontrolled transactions for determining the ALP, but does not permit to aggregate the international transactions carried out by the assessee to work out the average price for the purpose of the comparison**.

6 Company that becomes AE during the year, not valid comparable; Average ALP to be compared with each controlled transaction separately

Lonsen Kiri Chemical Industries Ltd. vs. DCIT [2020] 120 taxmann.com 396 (Ahmd Trib) (cont'd…)

HELD:

- Relevant extract of Rule 10B(1) reads as under:

  (a)comparable uncontrolled price method, by which,—

  (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or **a number of such transactions**, is identified;

  .....

  (iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided **in the international transaction** or the specified domestic transaction;

- ITAT relied on **Tilda Riceland (P) Ltd [TS-47-ITAT-2014(DEL)-TP]** wherein it has been held that while averaging is permissible for the uncontrolled transactions, each international transaction is to be taken on standalone basis. It is not open to the assessee to compare the average price in his transactions with AEs with average price in uncontrolled transactions.

- On the issue of whether, DG can be taken as a comparable prior to 4th Feb, ITAT referred to the provisions of S. 92A(2) and noted that a company shall become the AE of another company if at **any time during the relevant previous year** such company meets the criteria specified under the provisions of S. 92A of the Act.

6 Company that becomes AE during the year, not valid comparable; Average ALP to be compared with each controlled transaction separately

Lonsen Kiri Chemical Industries Ltd. vs. DCIT [2020] 120 taxmann.com 396 (Ahmd Trib) (cont'd…)

HELD:

- Observing that the DG became Assessee's AE in the year under consideration ITAT held that such company cannot be taken as comparable company for the purpose of determining the ALP.
- DG taken as comparable by Assessee was not disputed either by the TPO or CIT(A). Thus, a question arose as to whether such an issue could be raised by the assessee before ITAT. In this regard ITAT opined that if the assessee has made mistake in the interpretation of the provisions of the Act, then it is the duty of the authorities to rectify such mistake.

POINTS TO PONDER:

- Most logical approach for determining ALP of sales to AE is comparing aggregation of AEs and non-AEs transactions by taking its arithmetical mean –
  - PCIT vs. Audco India Ltd. [2019] 264 Taxman 237 (Bom HC);
  - Bilag Industries (P.) Ltd. vs. ACIT [2020] 113 taxmann.com 122 (Surat Trib);
  - Godrej Sara Lee Ltd. vs. ACIT [2015] 58 taxmann.com 109 (Mum Trib)

6 Company that becomes AE during the year, not valid comparable; Average ALP to be compared with each controlled transaction separately

Lonsen Kiri Chemical Industries Ltd. vs. DCIT [2020] 120 taxmann.com 396 (Ahmd Trib) (cont'd…)

POINTS TO PONDER:

- In order to arrive at ALP, comparison is between 'AE and no-AE transactions' or 'controlled and uncontrolled transactions'?

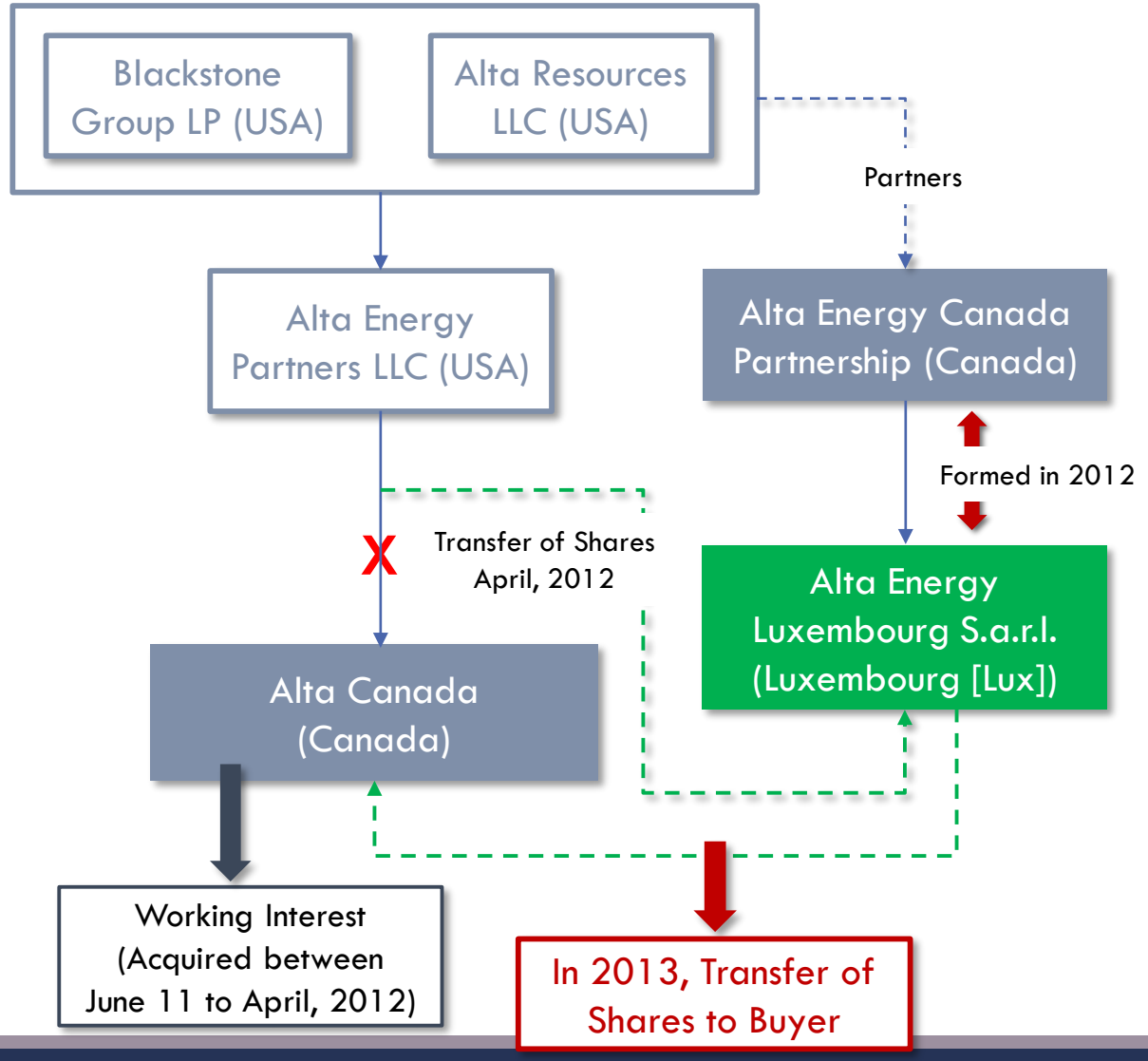
  Relevant provisions:

  - S. 92F(ii) – "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions;
  - Rule 10A(ab) – "uncontrolled transaction" means a transaction between enterprises other than associated enterprises, whether resident or non-resident;
  - S. 92A(2) - For the purposes of sub-section (1), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—
  - Objective behind introduction of TP provisions (EM to FB, 2001) – MNEs have an ability to allocate profits in different jurisdictions by controlling prices in intra-group transaction. TP provisions introduced for computation of reasonable, fair and equitable profits and tax in India

- If an enterprise becomes an AE at any time during the year, what will be the value of international transaction which has to be benchmarked?
  - Value of all transactions during the year; or
  - Value of transactions after enterprise becomes AE

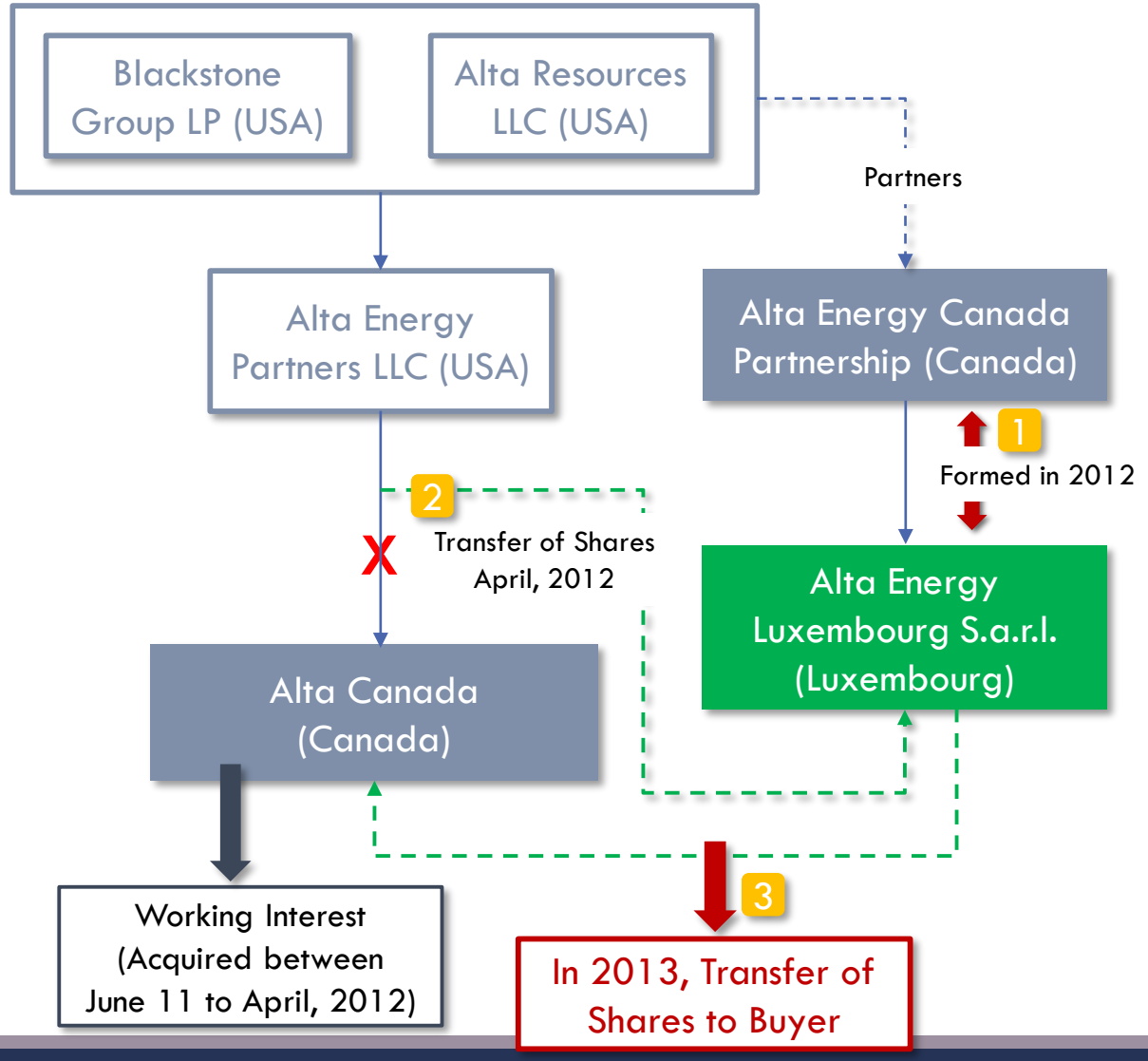
FOREIGN CASE LAWS

7 Her Majesty The Queen vs. Alta Energy Luxembourg S.A.R.L. [2020] 116 taxmann.com 856 (FC - Canada)



- Alta Canada was a WOS of Alta Energy Partners, LLC (US), which in turn was owned by two groups. One bearing expertise for oil and natural gas and other funding capital needed for conduct of such exploration.
- In 2011, the said two groups were informed that the structure is not ideal from tax perspective because the exploration work was being done on properties in Canada. By late 2011, it was expected that the value of Alta Canada could increase substantially in the next few years.
- A restructuring was undertaken in 2012.
- As part of the restructuring, Alta Energy Luxembourg (Lux) was formed under the laws of Luxembourg and the shares of Alta Canada were transferred to it. Since, the FMV of Alta Canada at that time of transfer was equal to the adjusted cost base of these shares, no capital gain was realized.
- Alta Energy Canada Partnership was formed under the laws of Alberta, Canada. The partners were the shareholders of Alta Energy Partners, LLC. All of the shares of Alta Luxembourg were held by this entity
- In effect, the result of the restructuring was to replace Alta Energy Partners, LLC with Alta Lux and Alta Energy Canada Partnership.

7 Her Majesty The Queen vs. Alta Energy Luxembourg S.A.R.L. [2020] 116 taxmann.com 856 (FC - Canada) (cont'd...)



- In 2013, the shares of Alta Canada were sold for approximately $680 million.
- Alta Lux claimed capital gains tax exemption under Lux - Canada DTAA
- The Minister of National Revenue (Minister) did not agree that the provisions of the Lux DTAA applied. In the alternative, the Minister invoked the provisions of GAAR to tax that taxable capital gain in Canada and made assessment.
- On appeal by Alta Lux, the Tax Court found that the provisions of the Lux Convention did apply and that the GAAR did not apply. Therefore, the appeal of Alta Lux was allowed.
- The question before Federal Court was whether GAAR can apply to override the application of the Treaty?

7 Her Majesty The Queen vs. Alta Energy Luxembourg S.A.R.L. [2020] 116 taxmann.com 856 (FC - Canada) (cont'd...)

RELEVANT PROVISIONS:

- ***Article 1*** **-** This Convention shall apply to persons who are residents of one or both of the Contracting States.
- ***Article 13(4) of the Treaty.*** Under Article 13(4), Canada has the right to tax capital gains arising from the disposition of shares that derive their value principally from immovable property ("**Immovable Property**") situated in Canada. The application of Article 13(4) is subject to an important exception – property that would otherwise qualify as Immovable Property is deemed not to be such property in the circumstances *where the business of the corporation is carried on in the property* (the "**Excluded Property**" exception).
- ***Article 13(5) of the Treaty.*** Article 13(5) is a distributive rule of last application. It applies only in cases where capital gains are not otherwise taxable under paragraphs (1) to (4) of Article 13 of the Treaty.
- ***Section 245(2) of the Canadian Income-tax Act (CITA).*** Section 245(2) provides that "*Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction*."
- ***Section 245(4) of the CITA.*** Section 245(4) provides that section 245(2) applies to a transaction only where it may reasonably be considered that the transaction would result directly or indirectly in misuse of the provisions of *inter alia* the CITA or a tax treaty.

7 Her Majesty The Queen vs. Alta Energy Luxembourg S.A.R.L. [2020] 116 taxmann.com 856 (FC - Canada) (cont'd...)

HELD:

- On 'object, spirit & purpose' test, **Revenue argued** that Articles 1, 4 & 13(4) of Lux. DTAA, together, are **intended to grant benefit to Lux 'investor'** whose investments in specific taxable Canadian property gives rise to gains for them, in Lux. Those provisions **are not intended to benefit entities who did not have the 'potential to realize income in Lux, nor have 'any commercial or economic ties therewith'**

- FCA identified three key aspects and addressed them as under:
  - a) **Resident versus Investor** – Perusing Article 13(4) & Article 1 of the DTAA, FCA states that **the exemption is provided to Luxembourg 'residents', not 'investors'**.

    FCA clarifies that the requirements of the Luxembourg Convention are simply that the person claiming the exemption (who holds a substantial interest) is a resident of Luxembourg, and that the company (whose shares were sold) satisfies the asset test as set out in Article 13(4) and there are no further requirements;
  - b) **Potential to Realize Income in Luxembourg** – FCA found that **any issue with respect to taxable income earned by the Luxembourg entity was ultimately a matter for the Luxembourg authorities**. The entity is certainly liable to tax in Luxembourg by virtue of being a resident. The quantum of tax payable was not considered to be an appropriate argument for the Crown to raise on Appeal
  - c) **Commercial or Economic Ties** – The Revenue's argument was that the underlying purpose of the exemption in Article 13(4) was to benefit persons with some economic or commercial ties with Luxembourg. FCA dismissed this argument stating that **there is no distinction in the Lux DTAA between residents with strong economic or commercial ties and those with weak or no commercial or economic ties.**

- FCA concluded that the object, spirit and purpose of the relevant provisions of the Lux DTAA is reflected in the words as chosen by Canada and Lux and since the provisions operated as they were intended to operate, there was no abuse.

7 Her Majesty The Queen vs. Alta Energy Luxembourg S.A.R.L. [2020] 116 taxmann.com 856 (FC - Canada) (cont'd...)

HELD: FCA's remarks on GAAR:

- The proper focus for the GAAR analysis, is on the provisions of the Lux DTAA**. If there is no abuse of the said DTAA, there would be no abuse of relevant CITA provisions**.
- The taxpayer, once has shown compliance with the wording of a provision, he or she should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision. **It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner**.
- Even if one of the objectives for the exemption was to encourage investment in Canada, it does not seem that this should be elevated to the status of a requirement that must be met to claim the exemption from tax in Canada. **While the GAAR can change the tax consequences from what they would otherwise be, the GAAR cannot be used**, in this case, **to justify adding a requirement for investment that is not present in the Luxembourg Convention**.
- **No abuse can arise from the choice of the most beneficial treaty**. There is nothing inherently proper or improper with selecting one foreign regime over another. The selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the **shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined**.

KEY TAKEAWAY: This decision would aid in challenging treaty shopping under the GAAR moving forward and also, under the MLI regime, more particularly PPT.

8 Fowler vs. HRMC [2020] 116 taxmann.com 713 (SC-UK)

FACTS:

- The taxpayer was a deep-sea diver resident in South Africa. He was engaged in diving operations on the UK Continental Shelf.
- The UK-South Africa DTAA provided for self-employed persons to be taxed only where they were resident, but for employment income to be taxed where it was earned.
- The term 'employment' is not defined in the tax treaty. But, S.15(2) of the UK Income-tax Act (ITTOIA) provides that where persons carried out certain diving operations as employees 'the performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the UK'.
- HMRC claimed that the taxpayer's income was employment income liable to tax in the UK.
- The taxpayer denied liability to tax on the basis of the combination of S.15 of ITTOIA & Article 7 (Business Profits).
- The First-tier Tribunal ruled in Fowler's favour. The Upper Tribunal reversed that decision. The Court of Appeals reinstated the decision of the First-tier Tribunal. HMRC appealed to SC.

HELD:

- On the assumption that the taxpayer was an employee, his remuneration constituted employment income. Section 15(2) of the ITTOIA did not alter the meanings of the terms of the treaty nor of the word 'trade'. The section took the usual meanings of those terms and erected a fiction not for the purpose of deciding whether qualifying divers were to be taxed in the UK on their employment income but for the purpose of adjusting how that income was to be taxed.

8 Fowler vs. HRMC [2020] 116 taxmann.com 713 (SC-UK)(cont'd…)

HELD: **Interpretation of tax treaty (more specifically Article 3(2) of the DTAA)**

- **Article 3(2) provides an "always speaking"** means of ascertaining the meaning of terms in the Treaty which are undefined therein. In the sense that it requires ascertaining the 'at that time', i.e. when the Treaty is to be applied.
- Nothing in the Treaty requires articles 7 and 14 to be applied to the fictional, deemed world which may be created by UK income tax legislation. **Rather they are to be applied to the real world, unless the effect of article 3(2) is that a deeming provision alters the meaning which relevant terms of the Treaty would otherwise have**.
- A deeming provision (in S. 15(2)) should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language. But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real.
- Nor should article 3(2) of the Treaty be construed so as to bring a qualifying diver within article 7 rather than article 14. To do so would be contrary to the purposes of the Treaty. This is because, as is recognised by article 2(1), the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied.

KEY TAKEAWAY: Undefined words in the tax treaty must be given an autonomous international meaning.

THANK YOU!