

# **Overview of International Taxation including interplay between the Act and Double Taxation Avoidance Agreements and MLI**

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# Basis of charge

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- ▶ Section 4 of the Act is the charging section, which provides that:
  - ▶ income-tax is leviable on the total income
  - ▶ of a person
  - ▶ earned during the AY
  - ▶ at applicable rate of tax
- ▶ Total income – Defined u/s 2(45) – “total income” means the total amount of income referred to in section 5, computed in the manner laid down in this Act.
- ▶ Person – Defined u/s 2(31).
- ▶ Assessment year – Defined u/s 2(9).
- ▶ Tax – Defined u/s 2(43).

# Scope of total income

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- ▶ The scope of total income is provided by Section 5 of the Act
- ▶ The scope of total income depends on the tax residential status of the person liable to tax, which is tabulated below:

| Particulars   | OR | NOR | NR |
|---|----|-----|----|
| Income accrues or arises, or is deemed to accrue or <b><i>arise in India</i></b>      | √  | √   | √  |
| Income received or deemed to be <b><i>received in India</i></b>                       | √  | √   | √  |
| Income accrues or arises, or is deemed to accrue or <b><i>arise outside India</i></b> | √  | ×   | ×  |

- ▶ Amendments to the provisions of section 6 by Finance Act 2020
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# Section 9(1)(i)

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- ▶ Section 9(1)(i) – all income accruing or arising, whether directly or indirectly:
  - ▶ through or from any business connection in India or
  - ▶ through or from any property in India or
  - ▶ through or from any asset or source of income in India or
  - ▶ through the transfer of a capital asset situated in India

# Business Connection

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- ▶ Business connection involves a relation between:
  - ▶ A business carried on by a non-resident which yields profits or gains and
  - ▶ Some activity in India which contributes to the earning of these profits or gains.
- ▶ Business connection can take several forms. Its determination is based on facts and circumstances of each case.
- ▶ A stray or isolated transaction between a non-resident and resident in India without any element of continuity of dealings is not regarded as a business connection.
- ▶ Certain activities are specifically excluded from the scope of business connection by virtue of Explanation 1 to section 9(1)(i), such as, income from operations which are confined to the purchase of goods in India for the purpose of export; collection of news and views in India, etc

# Business Connection through Agent in India

## Explanation 2 to section 9(1)(i)

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- ▶ 'Business connection' includes any business activity carried out through a person who is acting on behalf of the non-resident. However, such person should fulfil any of the following three criteria:

### Conclusion of contracts

- ▶ The person has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, or
- ▶ He habitually concludes contracts, or
- ▶ He habitually plays the principal role leading to conclusion of contracts by that non-resident.

However, the contracts should be:

- ▶ In the name of the non-resident; or
- ▶ For the transfer of the ownership or granting of right to use, property owned by non-resident or that non-resident has the right to use; or
- ▶ For provision of services by the non-resident

# Significant economic presence (SEP)

## Explanation 2A to section 9(1)(i)

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- ▶ For taxation of a non-resident in India, physical presence based nexus has generally been the criteria. However, new business models, operating remotely through digital medium, avoid taxation in the source country, in absence of physical presence.
- ▶ The Act, therefore, now provides that a non-resident would create a taxable presence in India, if it has a Significant Economic Presence (SEP) on the basis of factors that have a purposeful and sustained interaction with the economy of India, with the aid of technology and other automated tools.
- ▶ It is provided that SEP of a non-resident in India shall constitute "business connection" in India, from the assessment year 2022-23.
- ▶ SEP shall mean either of the following:
  1. Transaction in respect of any goods, services or property carried out by a non-resident with any person in India, including provision of download of data or software in India, if the aggregate of payments arising therefrom during the previous year exceeds a threshold.
    - For example, online shopping services provided by Amazon or data download provided by Netflix.
  2. Systematic and continuous soliciting of business activities or engaging in interaction with prescribed number of users in India.
    - For example, Google Adsense or AWS cloud services.
- ▶ The threshold of payments and users will be prescribed in consultation with stakeholders.

# Scope of section 9(1)(i) extended by FA 2012

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- ▶ Prior to the amendment by FA 2012,
  - ▶ all income accruing or arising through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India
- ▶ Supreme Court in the case of [Vodafone International Holdings B.V. vs. Union of India & ANR [2012] 341 ITR 1 (SC)] held that income arising from indirect transfer of Indian business is not liable for tax in India
- ▶ Explanation 4 and 5 to Section 9(1)(i) of the Act was inserted by FA 2012
- ▶ Explanation 4 clarifies the meaning of the term “through”
- ▶ Explanation 5 clarifies that
  - ▶ an asset being a share in a company registered outside India is deemed to be situated in India if such asset derives value substantially from assets located in India
- ▶ Accordingly, income arising from indirect transfer of assets located in India are liable to tax in India



# Scope of section 9(1)(i) extended by FA 2015

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- ▶ Explanation 6 and 7 to Section 9(1)(i) of the Act was inserted by FA 2015 in relation to taxation of indirect transfer of asset
- ▶ Explanation 6 explains the meaning of the term “substantial” as mentioned in Explanation 5:
  - ▶ If the value of assets located in India on a specified date exceeds Rs 10 crore and represents at least 50% of the value of all the assets owned by the foreign company, then such asset shall be deemed to be situated in India.
- ▶ Explanation 7(a) provides exemption to small shareholder (‘SSE’) from applicability of indirect transfer provisions. Small shareholder would mean an investor who:
  - ▶ does not hold right of Control or management in foreign company;
  - ▶ does not hold voting power/ share capital/ interest > 5% of total voting power/ share capital of foreign company.
- ▶ Explanation 7(b) provides for proportionate basis of taxation of income from transfer of share/ interest as is reasonably attributable to assets located in India
- ▶ CBDT has issued Circular No. 41/2016 to clarify the scope of indirect transfer provisions

# Royalty income – Section 9(1)(vi)

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- ▶ Royalty means consideration payable for:
  - ▶ Transfer of all or any right in respect of a patent, model, design, secret formula or process or trade mark or similar property
  - ▶ Imparting of any information concerning the working of or use of patent, model, design, secret formula or process or trade mark or similar property
  - ▶ Use of any patent, model, design, secret formula or process or trademark or similar property
- ▶ Exclusions from royalty
  - ▶ Consideration chargeable under the head 'Capital gains'
  - ▶ Consideration for the sale, distribution or exhibition of cinematographic films
  - ▶ Consideration for use/ right to use ICS equipment referred to in Section 44BB

# Fees for Technical Services – Section 9(1)(vii)

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- ▶ FTS means consideration payable for:
  - ▶ Rendering of any managerial, technical or consultancy services
  - ▶ Includes provision of services of technical or other personnel
- ▶ FTS does not include:
  - ▶ consideration for any construction, assembly, mining etc
  - ▶ income of recipient chargeable under the head "Salaries"

# Tax treaties



# What is “Treaty”

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- ▶ Oxford Companion to Law : “Treaty”

*“an international agreement, normally in written form, passing under various titles (treaty, convention, protocol, covenant, charter, pact, statute, act, declaration, Concord, exchange of notes, agreed minute, memorandum of agreement) concluded between two or more States, on subjects of international law intended to create rights and obligations between them and governed by international law.*

- ▶ Vienna Convention on law of Treaties 1969 defines “treaty” as :

*“An international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”.*

# Principles of interpretation of treaty

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- ▶ Tax Treaty is an agreement between countries
- ▶ Drafted by diplomats, and not lawyers
  - ▶ Leads to sloppiness in drafting; implies that care has to be taken so as to not render any word, phrase, or sentence redundant
  - ▶ Need to be given a general meaning, general to layman and lawyer alike (SC in Ram Jethmalani & Ors)
- ▶ The provisions of Treaty should be interpreted in accordance with the ordinary principle of treaty interpretation as per Article 31(1) of the Vienna Convention on the law of treaties which are:
  - ▶ Interpretation in good faith and
  - ▶ In accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose

Treaty does not create any additional tax burden; it can only relieve tax **[Principle of non-aggravation]**

# Texture of Tax Treaty

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- ▶ Model Convention of tax treaties:
  - ▶ UN Model – Gives right to tax based on source principle (preferred generally by developing countries)
  - ▶ OECD Model- Gives right to tax based on residence principle (preferred generally by developed countries)
  - ▶ US Model- Model followed by USA
- ▶ Parties may, at discretion, adopt a set draft called UN Model, OECD Model
  - ▶ Parties have an option to adopt a materially different text

# Texture of Tax Treaty

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- ▶ Treaty is an agreement between countries
  - ▶ Bilateral arrangement
  - ▶ Multilateral arrangement
- ▶ Limited Treaty v/s. Exhaustive Treaty
- ▶ There are no strings to originality
- ▶ There are no constraints on terms of agreement (Example, absence of clause related to technical services in some treaties)
- ▶ Conditions need not be uniform in all treaties (Example, absence of LOB clause in Mauritius treaty upto March 2017 vis-à-vis Singapore treaty upto March 2017)



# Influence of MFN Clause in Treaty

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- ▶ MFN clause
  - ▶ Example: India – Netherlands Tax Treaty

*“If after signature of this convention under any Convention or Agreement between India and a **third State which is a member of the OECD, India, should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then, as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.**”*

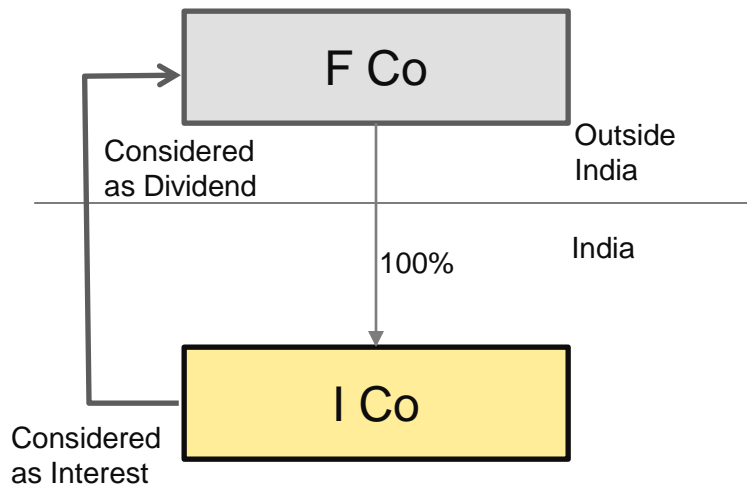
# What is purpose of Treaty?

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- ▶ Preamble to treaty indicates the objective of entering into treaty:
  - ▶ Avoidance of Double taxation;
  - ▶ Prevention of Tax Evasion;
  - ▶ Exchange of information and Mutual assistance between taxing jurisdictions
  - ▶ Encouragement of mutual trade and investment
- ▶ Preamble in Multilateral Convention (BEPS Action 15)
  - ▶ *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)*
- ▶ Under BEPS, purpose of Treaty is both to eliminate double taxation and prevent double non-taxation

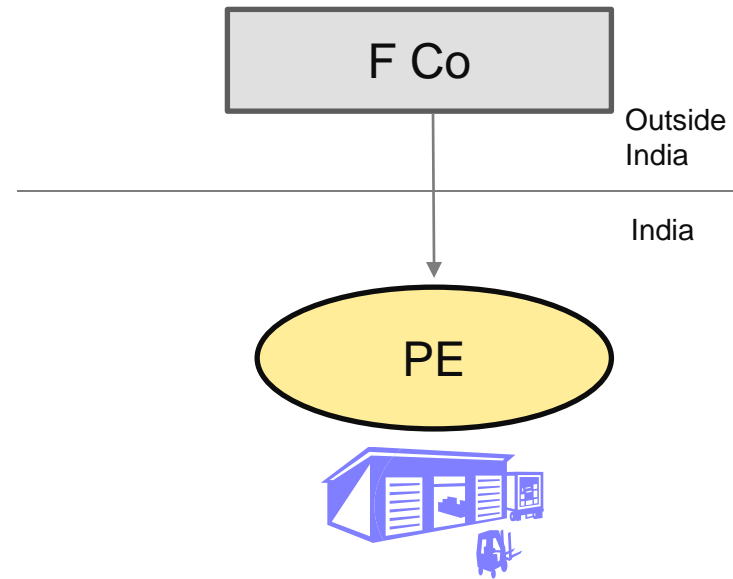
# Double taxation v/s Double Non-taxation

## Double Non-taxation



- I Co issues a hybrid instrument to F Co which qualifies as debt in India and as equity in COR of F Co
- India considers payment made by I Co as interest and provides deduction
- COR of F Co in its domestic law provides participation exemption in case of dividend
- Hence, dividend not taxable in COR of F Co

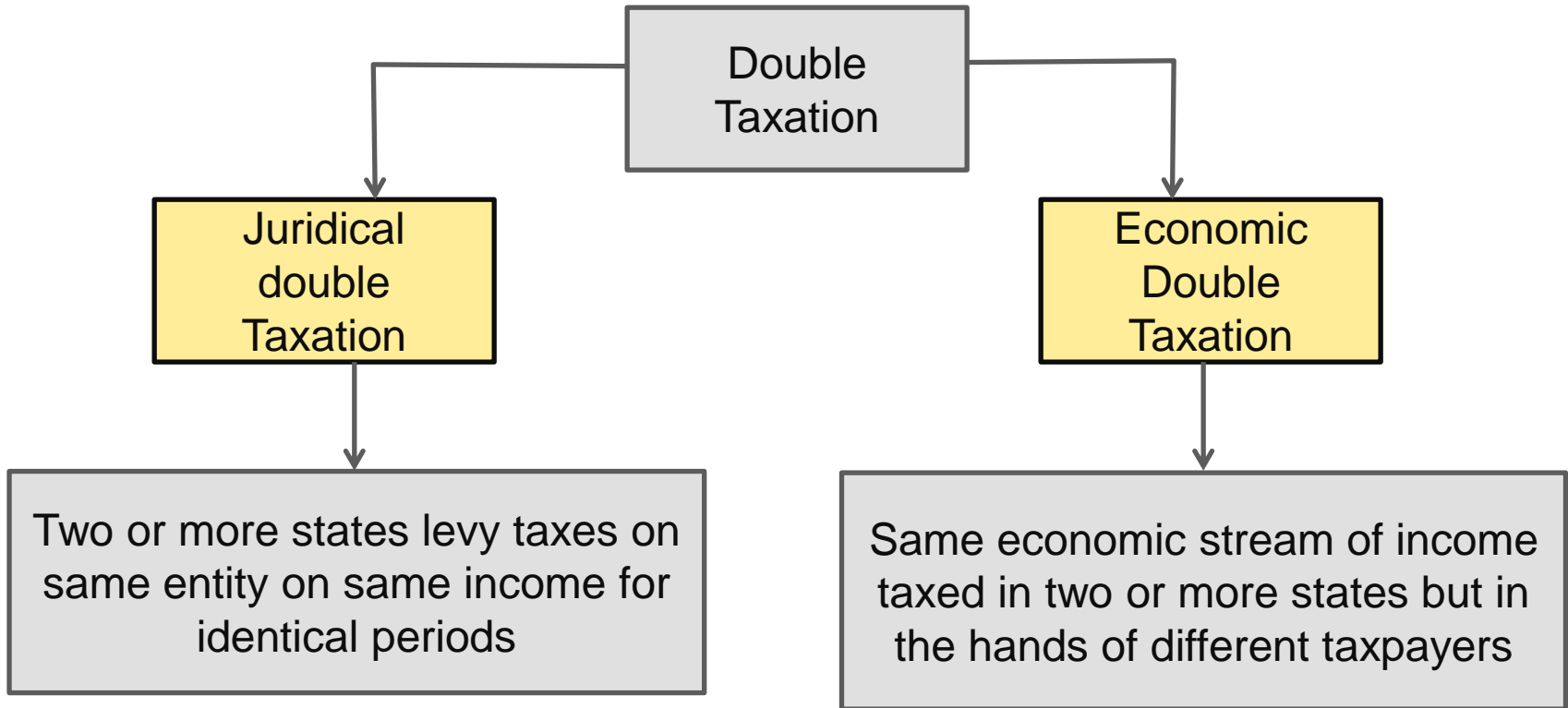
## Double taxation



- F Co has a branch in India. Income from branch forms part of its global income
- Income of branch is taxable in India
- Income of branch in India is taxable both in India and COR of F Co

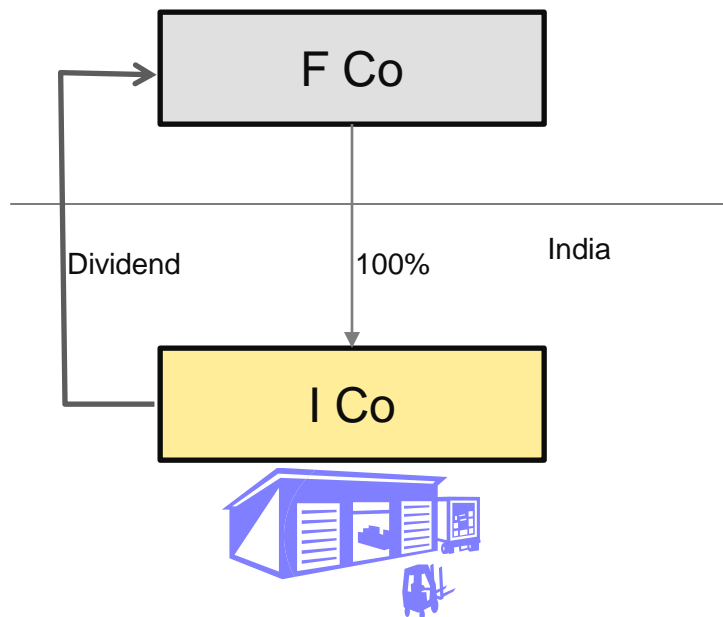
# Types of Double Taxation

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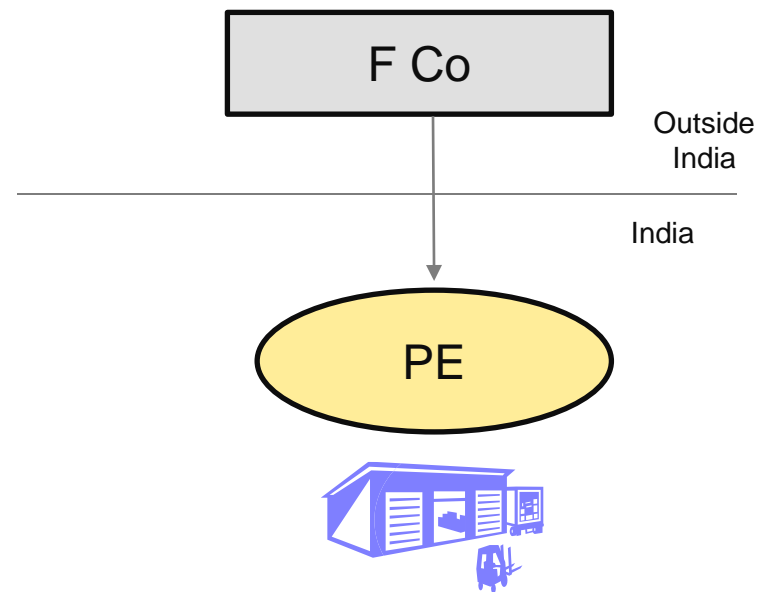
# Economic V/s Juridical Double taxation

## Economic DT



- I Co earns business income in India
- I Co pays dividend to F Co out of its profits.
- Such dividend income is also taxable
  - In hands of I Co – DDT
  - In hands of F Co- In its COS

## Juridical DT



- F Co has a branch in India. Income from branch forms part of its global income
- Income of branch is taxable in India

# Practical approach to taxability

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- ▶ Foreign company (NR in India) liable to tax in country of residence (COR)
- ▶ India “may” tax India sourced income as per India domestic law
- ▶ Liability in India may be relieved
  - ▶ If there is exemption or relief under domestic law
  - ▶ If there is exemption or relief under Treaty
- ▶ In case of double taxation
  - ▶ Tax relief, usually by country of residence
  - ▶ COR will not give refund of excess tax in COS

**Tax credit may be in a different year: basis of charge of ESOP as salary**

# Interplay of Treaty and Domestic Law

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- ▶ Taxpayer can opt for taxation in accordance with tax treaty or domestic tax laws, whichever is more beneficial [S.90(2)]
- ▶ Subject thereto, domestic law has full force
- ▶ Domestic law provisions can, at times, be more beneficial to NR:
  - ▶ Tax rate on interest income S.194LC
- ▶ Interplay with international laws such as: The United Nations (Privileges And Immunities) Act, 1947

Treaty does not create any additional tax burden; it can only relieve tax [**Principle of non-aggravation**]

# Meaning of terms used in Tax Treaty

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- ▶ Article 3(2) of OECD/ UN MC:

*“As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, **any meaning under the applicable tax laws of that State** prevailing over a meaning given to the term under other laws of that State.”*

- ▶ Term ‘immoveable property’ is defined in the Treaty
- ▶ Term ‘interest’ is defined in a Tax Treaty; excludes processing fees
- ▶ Term ‘income’ is not defined in Tax Treaty
  - ▶ Adopt the meaning as per Indian Law
  - ▶ Ambulatory/Dynamic Approach !!!



# Aids to interpretation of treaty

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- ▶ Aids to interpretation
  - ▶ Language of the treaty (text of the treaty)
  - ▶ Protocol to the treaty
    - ▶ India and Mauritius signed protocol in May 2016 amending tax treaty
  - ▶ Model commentaries: OECD as also UN
  - ▶ Collateral or supporting documents
    - ▶ Technical Explanations to Treaty
    - ▶ Memorandum of Understanding
    - ▶ Minutes/Notes of discussion
    - ▶ Extensive Commentaries by Authors like Klaus Vogel, Philip Baker
    - ▶ Judicial precedents

# Articles of a Treaty (OECD Model, 2010)

## SCOPE PROVISIONS

1. Article 1 - Personal Scope
2. Article 2 - Taxes covered
3. Article 30 - Entry into force
4. Article 31 - Termination

## DEFINITION PROVISIONS

1. Article 3 - General definitions
2. Article 4 - Residence
3. Article 5 - Permanent Establishment

## MISCELLANEOUS PROVISIONS

1. Article 24 - Non-discrimination
2. Article 27 – Assistance in collection of taxes
3. Article 28 - Diplomats
4. Article 29 - Territorial Extension

## ELIMINATION OF DOUBLE TAXATION

1. Article 23 - Elimination of double taxation
2. Article 25 - Mutual Agreement

## ANTI-AVOIDANCE

1. Art 9 - Associated Enterprise
2. Art 26 - Exch of Info

## SUBSTANTIVE PROVISIONS

1. Article 6 - Immovable property
2. Article 7 - Business Profits
3. Article 8 - Shipping, etc
4. Article 10 - Dividends
5. Article 11 - Interest
6. Article 12 - Royalties & FTS
7. Article 13 - Capital gains
8. Article 15 – Income from employment
9. Article 16 – Directors fees
10. Article 17 - Artistes & Sportsmen
11. Article 18 - Pensions
12. Article 19 - Government service
13. Article 20 - Students
14. Article 21 - Other income
15. Article 22 - Capital

- Specific overrides General.
- Technical fees earned is part of business income

# Article 1 – Scope of Convention - India- USA Treaty

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## ARTICLE 1 - *Scope of the Convention* –

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention.

How to read?



2. This Convention shall apply to persons who are residents of ***one or both of the Contracting States*** [ **either USA or India or both**], except as otherwise provided in the Convention.

- ▶ Citizenship is not a relevant criteria (e.g. US Citizen can be a resident of India)
- ▶ Unless a tax resident of either state, taxpayer cannot access this treaty

# Article 1 - India- USA Treaty

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## ARTICLE 1 - *Scope of the Convention* –

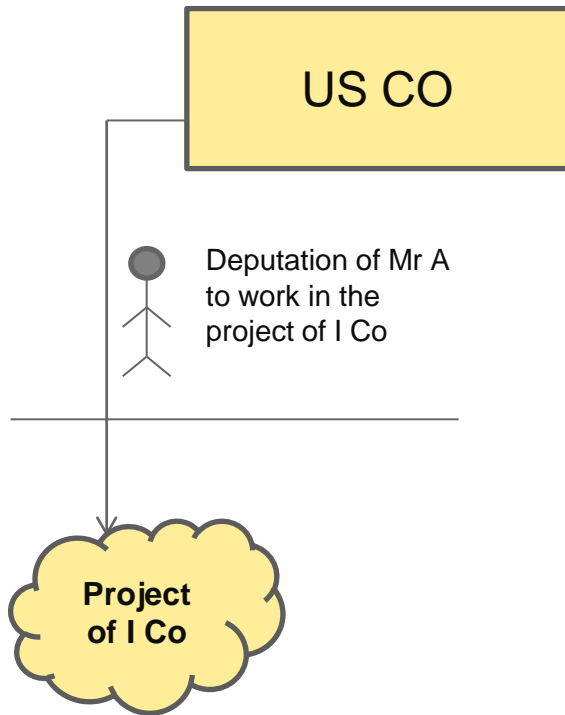
3. Notwithstanding any provision of the Convention ....., a Contracting State may tax its residents [as determined under Article 4 (Residence)], and by reason of citizenship may tax its citizens, as if the Convention had not come into effect .....

How to read?



4. Notwithstanding any provision of the Convention ....., a Contracting State **(USA)** may tax its **(USA's)** residents [as determined under Article 4 (Residence)], and **by reason of citizenship** may tax its **(USA's) citizens**, as if the Convention had not come into effect

# Triangular (Multiangular) cases

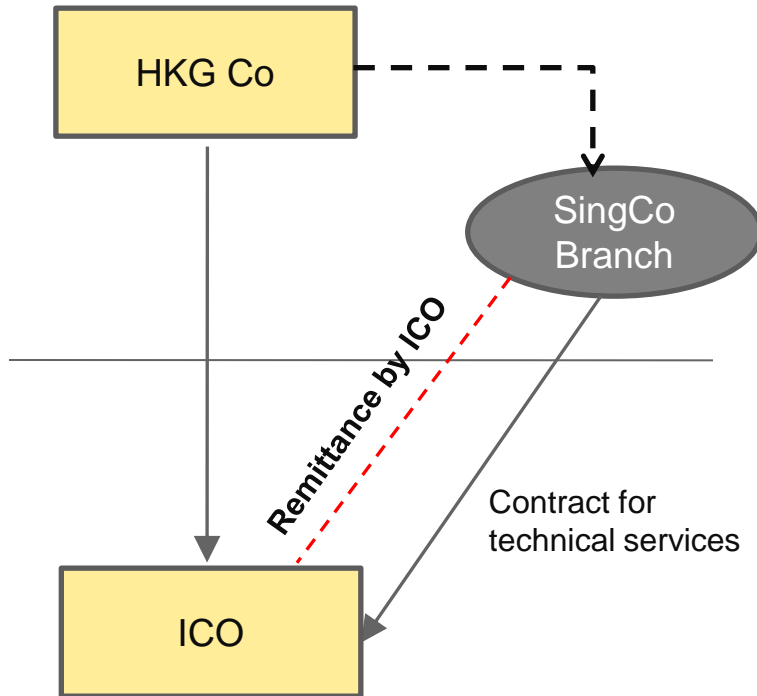


- Fact pattern of Mr A who is deputed by US Co to work in a project of I Co for six months

|                   |             |
|-------------------|-------------|
| Tax Resident      | Sweden      |
| Citizenship       | UK          |
| Employer          | US Company  |
| Project of US Co  | India       |
| Receipt of salary | Netherlands |

Which treaty benefit is available to Mr. A or US Co in respect of India income?

# Triangular case & Treaty applicability



- ▶ Triangular cases : Treaty applicability
  - ▶ Hong Kong Company has branch in Singapore
  - ▶ Singapore branch enters into contract for rendering technical services to ICO
  - ▶ Services are rendered from Singapore
  - ▶ ICO takes benefit of India Singapore treaty
  - ▶ ICO remits service charges to Singapore branch without deducting tax at source

## Issue

- ▶ Is benefit of India Singapore treaty available?

# Article 2 : Taxes covered - India- USA Treaty

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**ARTICLE 2 - *Taxes covered*** - 1. The existing taxes to which this Convention shall apply are :

- (a) in the United States, the Federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes)....
  - (b) in India :
    - (i) the income-tax including any surcharge thereon, but excluding income tax on undistributed income of companies, imposed under the Income-tax Act ; and
    - (ii) the surtax
- ▶ *State taxes levied by US not covered under India –US tax treaty*

# Article 7 - Business Profits – India-UK treaty

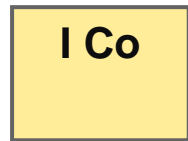
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1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise **may be taxed** in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment.



# Expression “may be taxed”

I Co



India  
UK

UK PE

- ▶ As per Article 7(1), if the enterprise (I Co) carries on business as aforesaid, the profits of the enterprise “**may be taxed**” in the other State (UK)
- ▶ The term 'may be taxed' would accord right to tax to source country (i.e. UK)
- ▶ May be taxed permits source taxation as well and does not exclude residence taxation (Delhi ITAT in case of Telecommunications Consultants India Ltd)
  - ▶ Decision of SC in CIT v. P.V.A.L Kulandagan Chettiar (267 ITR 654) (SC) proceeds on the basis that treaty residence was in Malaysia
- ▶ Notification No. 90 and 91 of 2008 clarifies when a treaty provides that any income of a resident of India “may be taxed” in the other country, such income shall be included in his total income chargeable to tax in India

‘May be taxed’ coupled with source country right restricted to a specified rate

# Article 13- Royalties and Fees for Technical Services [Para 1 & 2 ] (India-UK treaty)

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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.
2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed 15 per cent of the gross amount of such royalties or fees for technical services

# Article 13- Royalties and Fees for Technical Services [Para 1 & 2 ] (India-UK treaty)

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## UK Company as recipient of Income

1. Royalties and fees for technical services arising **in India** and paid to a **resident of UK** may be taxed in **UK**.
2. However, such royalties and fees for technical services may also be taxed **in India** in which they arise and according to the law **of India**; but if the **beneficial owner** of the royalties or fees for technical services **is a resident of UK**, the tax so charged shall not exceed 15<sup>1</sup> <sup>2</sup> per cent of the gross amount of such royalties or fees for technical services

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<sup>1</sup> Rate of tax as per S. 115A(1)(b) of Income Tax Act is 10%. Hence, the domestic tax law may be more beneficial in this case as compared to the treaty rate

<sup>2</sup> 15% rate is all inclusive of surcharge, education and secondary education cess [DIC Asia Pacific Pte Ltd v. ADIT (2012) 22 taxmann.com 310 (Kol)]

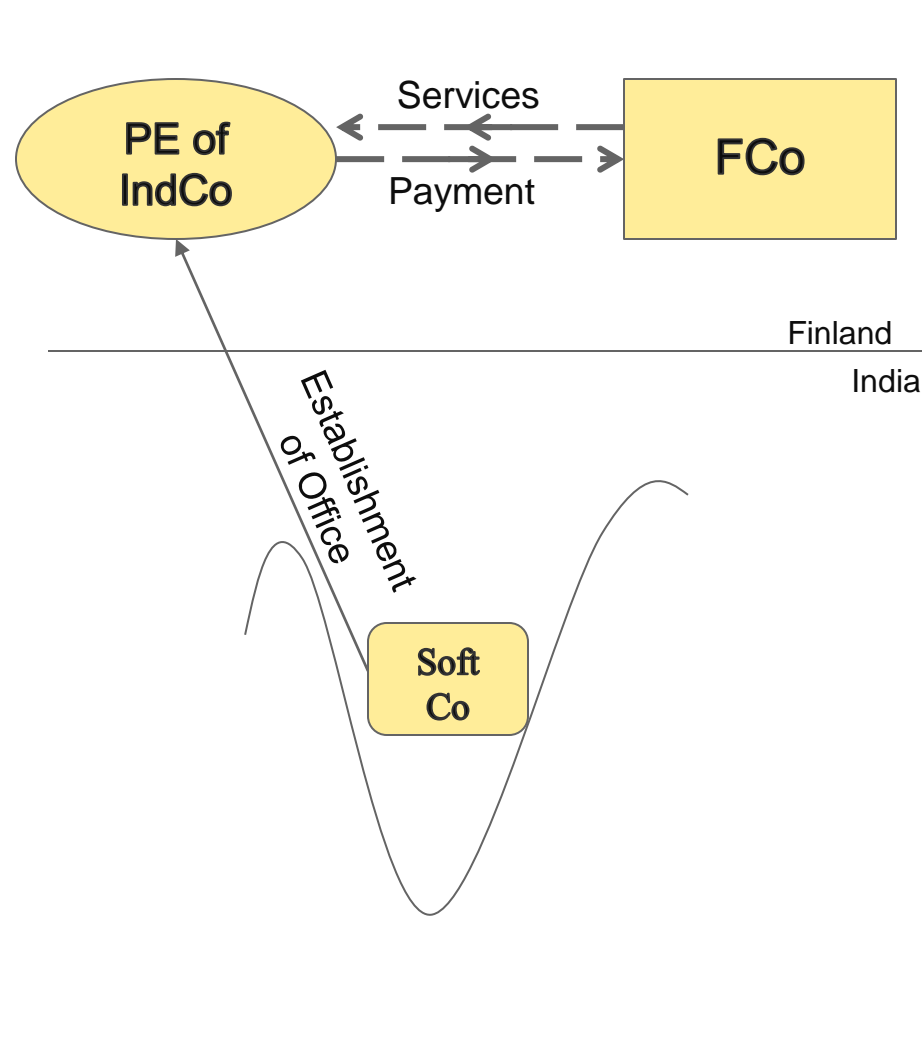
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# Source rule - Treaty

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- ▶ General Source rule :
  - ▶ Payer rule: deemed to arise in India when the payer is
    - a) Indian State itself, a political sub-division, a local authority of India
    - b) or a resident of India.
  - ▶ PE rule: Country of Permanent establishment/ fixed base
    - a) in connection with which the liability to pay FTS is incurred
    - b) Such fees are borne by such PE/ FB
  - ▶ PE can be of enterprises of treaty resident or any person

# Significance of PE linked Source Rule



- ▶ Soft Co, an Indian company is in the business of development of software
- ▶ Soft Co established an overseas office for onsite support
- ▶ Overseas branch of I Co appoints F Co for designing interiors of branch
- ▶ Payer to F Co is an Indian resident
- ▶ F Co sources income where PE of ICO is i.e. Finland

# Restricted source rule

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▶ Article 12(5) of India Finland Treaty

Fees for technical services shall be **deemed to arise in a Contracting State (India) when the payer is that (India) State** itself, a political sub-division, a local authority, or a resident of that State (India). Where, **however**, ..... when the fees for technical services relate to **services performed, within a Contracting State (Finland), then such fees for technical services shall be deemed to arise in the State in which the services are performed (Finland).**

# Interplay of section 9(1)(vi) vs. Article 12

| Particulars                | Royalty as per Section 9(1)(vi)   | Royalty as per Article 12   |
|----------------------------|---|---|
| Definition of Royalty      | The term Royalty is defined very broadly in the Act   | The term Royalty is defined in an exhaustive manner in the Treaty   |
| Scope                      | Wide  | Narrow  |
| Impact of Finance Act 2012 | Explanation 4 to 6 inserted into Section 9(1)(vi) of the Act vide the Finance Act 2012 has broadened the meaning of the term Royalty  | The meaning of the term Royalty as per Treaty has remained unaffected by the amendment introduced by the Finance Act 2012. Thus, benefit under Treaty still available |
| Rate of taxation           | 10%<br><br>The tax-rate in the Act has been amended to keep it at par with the rate in tax-treaties                                   | Varies for different countries<br>India – USA Tax Treaty – 15% to 20%<br>Usually below the rate mentioned in the Act  |
| Example                    | Royalty paid by a US company in respect of a property utilized for the purpose of earning income in India is deemed to arise in India | Royalty taxed in the state in which the recipient is a resident   |

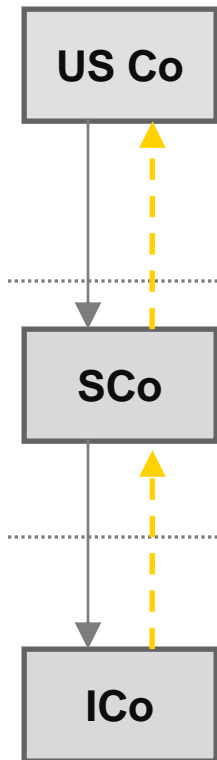
# Section 9(1)(vii) vs. Article 12

| Particulars | FTS as per Section 9(1)(vii)   | FTS/ FIS as per Article 12  |
|-------------|--|---|
| Scope       | The scope of FTS is wide as per the Act  | The scope of FTS/ FIS may be narrow as per Treaty on account of requirement of 'make available'. Eg. India-US Treaty  |
| Example     | <p>Fees received by a US company for providing technical service to an Indian company may be liable for tax in India</p> <p><b>Impact:</b> Fees received for provision of service may be liable for tax in India on account of application of section 9(1)(vii) of the Act</p> | <p>Fees received by a US company for providing technical service shall not be liable for tax in India unless the services rendered are made available to the service recipient in India</p> <p><b>Impact:</b> Fees received for provision of service may not be liable for tax in India on account of application of section 90(2) of the Act read with Article 12 of India-US treaty</p> |



# Interest – Beneficial owner

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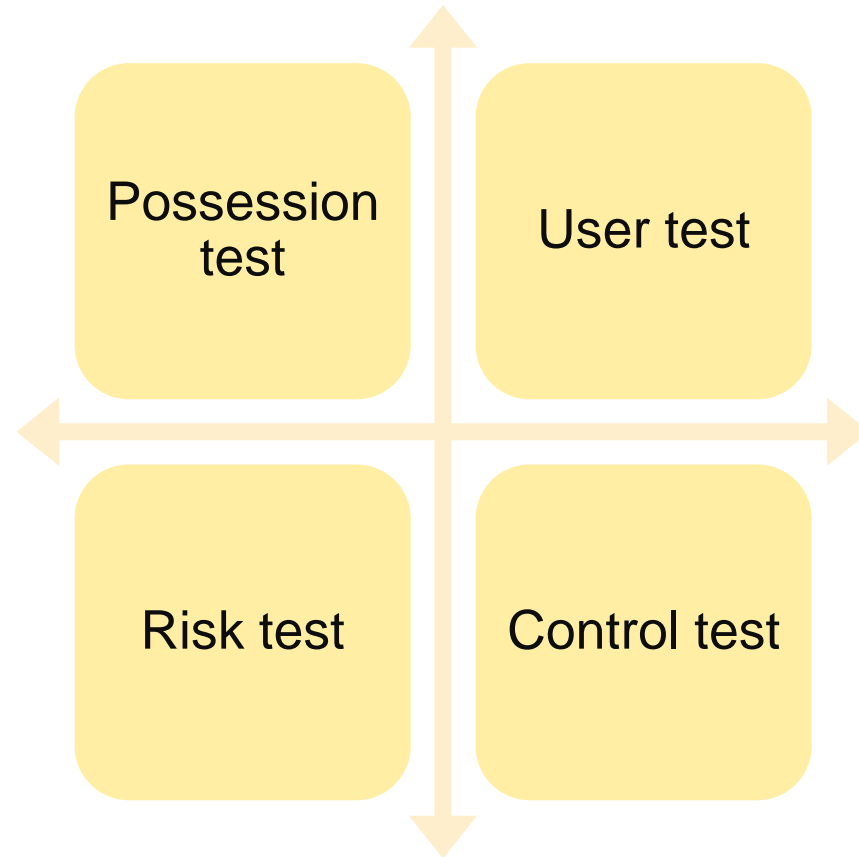


- ▶ I Co pays interest to S Co
- ▶ Singapore Treaty Art 11(2) reads as below:
  - ▶ *interest may also be taxed in the Contracting State in which it arises (India), but if the beneficial owner of the interest is a resident of the other Contracting State (Singapore), the tax so charged shall not exceed 10%.....*
- ▶ On facts, suppose, US Co is held to be beneficial owner
- ▶ Is treaty applicable? If yes, which one?
- ▶ Similar is the text of Article 11(2) of India-US Treaty but for tax rate of 15%

# Beneficial owner

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**Beneficial owner : Some tests to establish Beneficial Ownership**



# Capital Gains Article – India-Mauritius treaty

## Old India- Mauritius treaty

(1) .....

(2) .....

(3) .....

(4) *Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in that State*

## Revised India-Mauritius Treaty

(1) .....

(2) .....

(3)...

(3A) *Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.*

(3B) *However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;*

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

# Capital Gains Article – India-Mauritius treaty

## Old India- Mauritius treaty

- (1) .....
- (2) .....
- (3) .....
- (4) *Gains derived by a resident of **Mauritius** from the alienation of any property other than those mentioned in paragraphs (1), (2) and (3) of this article shall be taxable only in **Mauritius***

## Revised India-Mauritius Treaty

- (1) .....
- (2) .....
- (3)...
- (3A) *Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of **India** may be taxed in that State.*
- (3B) *However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in **India**;*
- (4) *Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only **Mauritius** of which the alienator is a resident*

It is not mandatory for Mauritius to subject the income to tax

# Capital Gains Article – India-Germany treaty

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▶ Article 13(4) / 13(5) of India-Germany tax treaty

(4) Gains from the alienation of shares in a company which is a resident of a Contracting State may be taxed in that State.

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

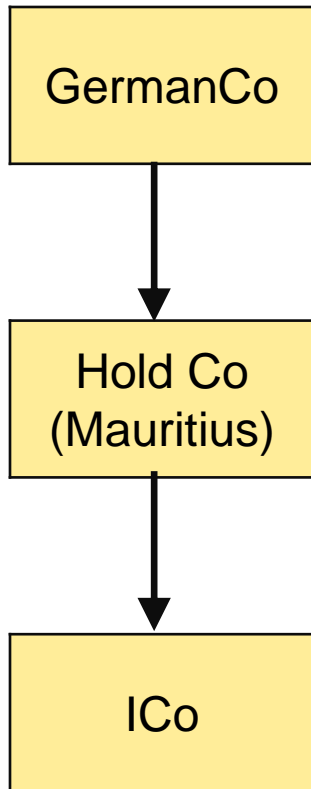
How to read?



(4) Gains from the alienation of shares in a company which is a resident of a Contracting State **(INDIA)** may be taxed in that State **(INDIA)**.

(5) Gains from the alienation of any property other than that referred to in paragraphs 1 to 4 shall be taxable only in the Contracting State in which the alienator is a resident **(Germany)**.

# Illustrative Treaty Interplay - No taxation rights to India



- ▶ Transfer of shares of Mau Co by GermanCo may be regarded as transfer of an asset located in India
- ▶ Treaty protects GermanCo if the transfer is of shares of a company which is not a resident of India
  - ▶ Pursuant to the amendment, Mauco is neither considered to be a company incorporated in India nor considered to be a resident of India
- ▶ Similar conclusion under Treaties with Swiss, UAE, Luxembourg, Russia, Syria, Hungary, Ireland, Portugal, Poland, Belgium, France, Denmark, Spain,

# Interplay of section 9(1)(i) vs. Article 13

| Particulars | Section 9(1)(i)  | Capital gains as per Article 13  |
|-------------|--|--|
| Scope       | <p>Transfer of a capital asset situated in India</p> <p>Includes indirect transfer thus making the scope very wide</p>   | Narrow   |
| Example     | <p>Shares of a French company transferred by a resident of France could be subject to tax in India if such shares derive their value substantially from assets located in India</p> <p>Retrospective amendment to section 9(1)(i) of the Act does not prevent the application of the benefits of the India – France tax treaty</p> | <p>Shares of a French company transferred by a resident of France would be subject to tax in France</p> <p>Capital gains may not be liable to tax in India on account of application of section 90(2) of the Act read with India-France tax treaty</p> |

# Equalisation Levy





# Background

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- ▶ The CBDT had constituted a Committee on Taxation of E-commerce to examine the tax issues arising from the new business models employed in the digital economy which submitted its report in Feb 2016
- ▶ The Committee recommended introduction of EL as it provided a simpler option to tax digital transactions without having the need to amend tax treaties
- ▶ Key proposals made:
  - ▶ **EL not a tax on income and should be imposed outside the income-tax law**
  - ▶ Income from transactions on which EL is chargeable should be exempt from income-tax
  - ▶ **Proposed a list of 13 specified services** and facilities on which EL can be chargeable
  - ▶ **Rate of 6-8%** of the gross payment for specified services
  - ▶ A threshold of INR 100,000 on the basis that the same will keep almost all business-to-consumer (B2C) transactions
- ▶ In June 2016, India introduced **EL at 6%** on following services provided by a non-resident:
  - ▶ Online advertisements
  - ▶ Any provision for digital advertising space
  - ▶ Any other facility or service for the purpose of online advertisement
- ▶ **Compliance obligation on payer resident in India** carrying on business or profession

# List of 13 specified services recommended

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- ▶ **online advertising** or any services, rights or use of software for online advertising, including advertising on radio & television;
- ▶ **digital advertising space**;
- ▶ **designing, creating, hosting or maintenance of website**;
- ▶ **digital space** for website, advertising, e-mails, online computing, blogs, online content, online data or any other online facility;
- ▶ any provision, facility or service for **uploading, storing or distribution of digital content**;
- ▶ **online collection or processing of data** related to online users in India;
- ▶ any facility or service for online sale of goods or services or collecting **online payments**;
- ▶ **development or maintenance of participative online networks**;
- ▶ use or right to use or download **online music, online movies, online games, online books or online software**, without a right to make and distribute any copies thereof;
- ▶ **online news, online search, online maps or global positioning system applications**;
- ▶ **online software applications** accessed or downloaded through internet or telecommunication networks;
- ▶ **online software computing facility** of any kind for any purpose; and
- ▶ **reimbursement of expenses** of a nature that are included in any of the above;

# E-Commerce EL

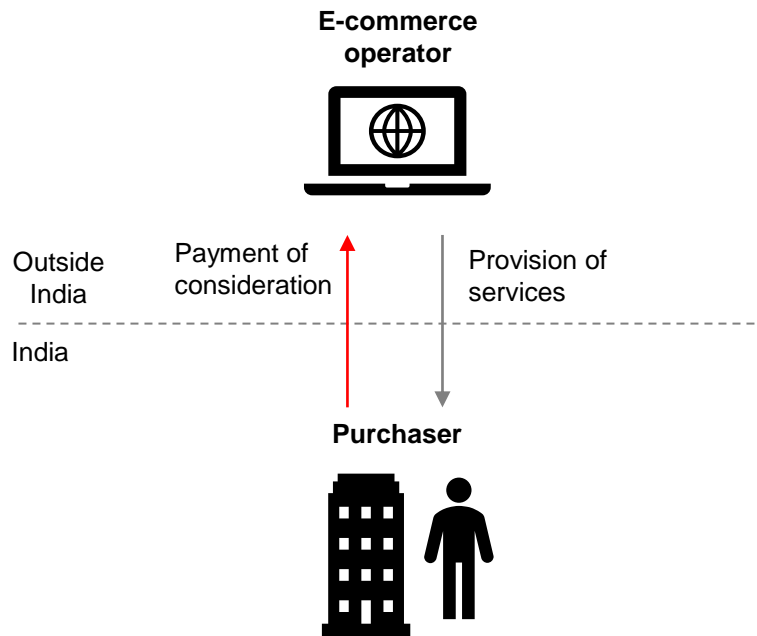
| Obligation on    | Scope    | Rate   | Specified Persons    |
|---|---|---|---|
| <ul style="list-style-type: none"> <li>▶ <b>Non-resident e-commerce operator</b> <ul style="list-style-type: none"> <li>▶ Not having a PE in India</li> <li>▶ Sales, turnover, gross receipts equal to or higher than INR 20 million</li> <li>▶ Not covered under existing online advertisement related EL</li> </ul> </li> </ul> <p><i>E-commerce operator defined to mean a non-resident who:</i></p> <ul style="list-style-type: none"> <li>- <b>Owns;</b></li> <li>- <b>Operates; or</b></li> <li>- <b>Manages</b></li> </ul> <p><i>a digital or electronic facility or platform for online sale of goods or online provision of services or both</i></p> | <ul style="list-style-type: none"> <li>▶ <b>‘E-commerce supply or services’</b> made or provided or facilitated by it</li> </ul> <p><i>e-commerce supply or services means-</i></p> <ul style="list-style-type: none"> <li>(i) <b>Online sale of goods owned by the e-commerce operator;</b> or</li> <li>(ii) <b>Online provision of services provided by the e-commerce operator;</b> or</li> <li>(iii) <b>Online sale of goods or provision of services or both, facilitated by the e-commerce operator;</b></li> <li>(iv) Any <b>combination</b> of activities listed in clause (i), (ii) or (iii)</li> </ul> <p><b>"online"</b> means a facility or service or <b>right</b> or <b>benefit</b> or <b>access</b> that is obtained through the internet or any other form of digital or telecommunication network;</p> | <ul style="list-style-type: none"> <li>▶ <b>2%</b> on amount of consideration received / receivable from e-commerce supply or services</li> <li>▶ <b>Levy not in nature of income-tax</b> – therefore, credit may be subject to domestic law of the home country</li> </ul> | <p><b>‘E-commerce supply or services’</b> made or provided or facilitated, by ecommerce operator to:</p> <ul style="list-style-type: none"> <li>▶ a person resident in India</li> <li>▶ a non-resident           <ul style="list-style-type: none"> <li>▶ for sale of advertisement targeted at a customer resident in India or accessing such advertisement through an Indian IP address</li> <li>▶ for sale of data collected from a person resident in India or from a person who uses an Indian IP address</li> </ul> </li> <li>▶ a person who buys goods or services or both using an Indian IP address</li> </ul> |

# Compliance and penal consequences

| Particulars                             | Compliance  |               |                     |         |        |              |           |             |           |          |          |
|---|---|---------------|---------------------|---------|--------|--------------|-----------|-------------|-----------|----------|----------|
| Registration                            | Obtain tax registration in India  |               |                     |         |        |              |           |             |           |          |          |
| Deposit of tax                          | <p>Quarterly, as per the due dates mentioned below, through a challan</p> <table border="1"> <thead> <tr> <th>Quarter ended</th> <th>Due date to deposit</th> </tr> </thead> <tbody> <tr> <td>30 June</td> <td>7 July</td> </tr> <tr> <td>30 September</td> <td>7 October</td> </tr> <tr> <td>31 December</td> <td>7 January</td> </tr> <tr> <td>31 March</td> <td>31 March</td> </tr> </tbody> </table> <p>For deposit, non-resident 'e-commerce operator' may be required to tie-up with an Indian bank</p> | Quarter ended | Due date to deposit | 30 June | 7 July | 30 September | 7 October | 31 December | 7 January | 31 March | 31 March |
| Quarter ended                           | Due date to deposit   |               |                     |         |        |              |           |             |           |          |          |
| 30 June                                 | 7 July  |               |                     |         |        |              |           |             |           |          |          |
| 30 September                            | 7 October   |               |                     |         |        |              |           |             |           |          |          |
| 31 December                             | 7 January   |               |                     |         |        |              |           |             |           |          |          |
| 31 March                                | 31 March  |               |                     |         |        |              |           |             |           |          |          |
| Annual statement                        | Annual statement to be filed by 30 June immediately after the end of FY (the form of the statement yet to be prescribed)  |               |                     |         |        |              |           |             |           |          |          |
| Consequences of failure to discharge EL | <ul style="list-style-type: none"> <li>▶ Interest at 1% per month (or part of month) for which default continues</li> <li>▶ Penalty equal to 100% of the EL</li> <li>▶ Prosecution in case of furnishing false statement</li> </ul>   |               |                     |         |        |              |           |             |           |          |          |
| Representative assessee                 | <ul style="list-style-type: none"> <li>▶ If non-resident e-commerce operator does not discharge liability, payer may be obligated</li> </ul>  |               |                     |         |        |              |           |             |           |          |          |

# Case study 1 – Online provision of services

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## Businesses which potentially may get impacted:

- ▶ Subscription based services
- ▶ Web hosting/ cloud computing
- ▶ Domain name registration services
- ▶ Data analysis
- ▶ Back end infrastructure service providers
- ▶ Online gaming
- ▶ Cyber security

## Key considerations

1. Will these businesses be covered:

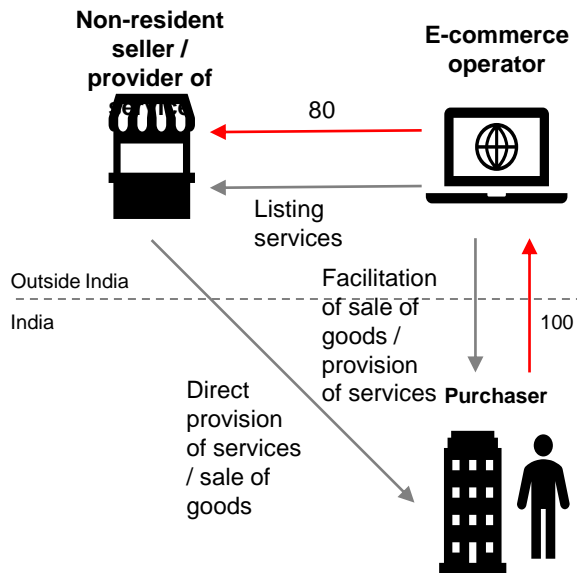
- ▶ Services purchased online, but delivered offline (hotel accommodation, cab services, flight tickets, etc)?
- ▶ Contract / MSA negotiated offline, but provision of service online?

2. Whether Consideration will include?

- ▶ AMC charges where separately charged and timing of EL applicability

3. Ambiguity between royalty/ FTS vs EL

# Case study 2 – E-commerce marketplace



## Businesses which potentially may get impacted:

- ▶ **Aggregator based e-commerce operator – where privity of contract is between a) seller/ provider of service and b) buyer/ users**

### Key considerations

1. Whether “Consideration” will include:

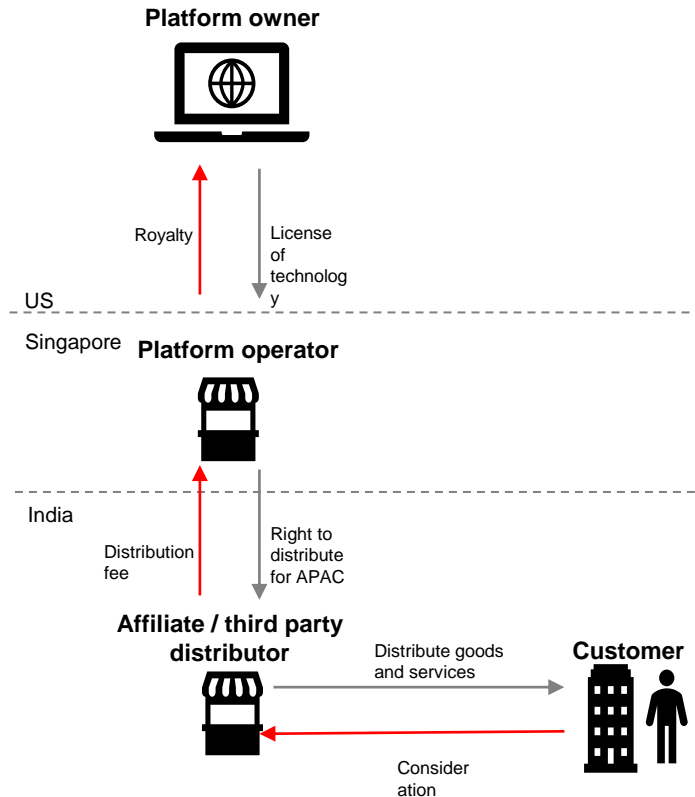
- ▶ Facilitation of payment by ecommerce operator (ie 100); or
- ▶ Fees/ Commission received by e-commerce operator from seller/ provider of service (ie 20); or
- ▶ Fees/ Commission received by e-commerce operator from buyer/ users (say 20)?

“Gross vs net” a key question for applicability of EL in case of market place models

2. Rate of levy on listing services (6% vs 2%) – applicable to resident payer

3. Interplay between TDS obligation of e-commerce operator vs EL levy on e-commerce operator (applicable for resident seller)

# Case study 3 - Onshore Models – Distributor model



## Businesses which potentially may get impacted:

- Digital economy players operating through onshore subsidiaries for distributing/ reselling their products/ services to Indian customers

## Key considerations

1. Who is the e-commerce operator?

- ▶ Platform owner; or
- ▶ Platform operator/ manager; or
- ▶ Both

2. Are these payments chargeable to EL?

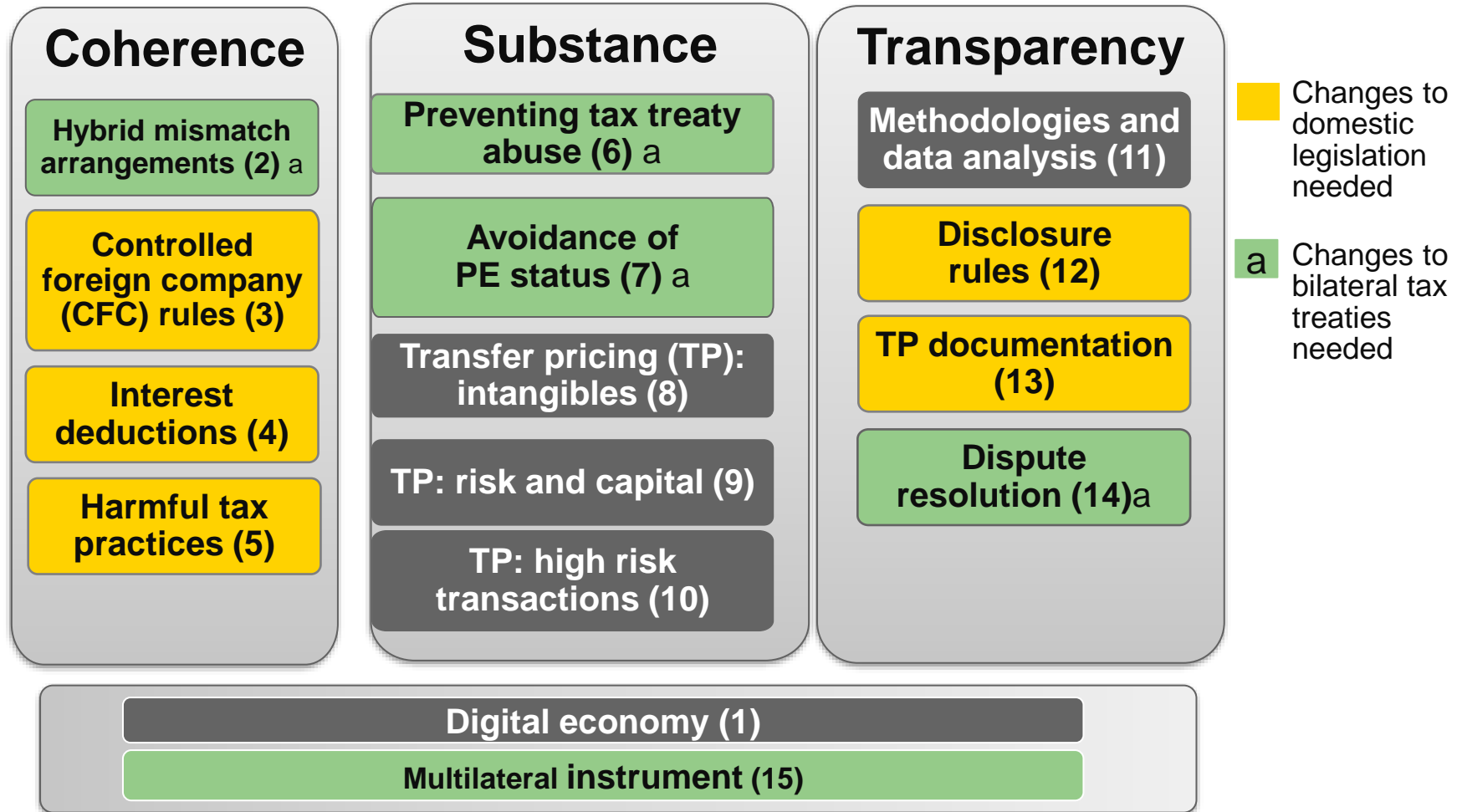
- ▶ Payment by resident distributor to non-resident platform operator/ manager? If yes, whether on Consideration payable to Platform operator or on revenues received from an Customer?
- ▶ Payment by non-resident platform operator to non-resident platform owner for facilitation

# Multilateral Instrument (MLI)





# BEPS implementation



# BEPS recommendations

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## Minimum standards

- Action 5 – Harmful tax practices
- Action 6 – Treaty abuse
- Action 13 – Country-by-country reporting
- Action 14 – Dispute resolution

## Reinforced standards

- Actions 8-10 (transfer pricing)
- Action 13 (TP documentation)
- Action 7 (permanent establishment status)

## Analytical reports

- Action 1 - Digital economy
- Action 11 - Economic analysis
- Action 15- Multilateral Instrument

## Common approaches and best practices

- Action 2 – Hybrid mismatch arrangements
- Action 3 – Controlled foreign company (CFC) rules
- Action 4 – Interest deductions and other financial payments
- Action 12 – Mandatory disclosure rules

Conservative estimates indicate annual losses from 4% to 10% of global corporate income tax revenues, i.e. USD 100 to 240 billion annually\*

\*Source: <https://www.oecd.org/ctp/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm>

# Implementation of BEPS Actions in India

|                  |  |                    |   |
|------------------|--|--------------------|---|
| <b>Action 1</b>  | <ul style="list-style-type: none"><li>▶ Equalization Levy – Finance Act 2016 and 2020</li><li>▶ “Significant economic presence” from FY 18-19</li></ul>                                  | <b>Action 13</b>   | Country by Country Reporting (CbCR) and Master File TP documentation from FY 16-17              |
| <b>Action 6</b>  | Bilateral re-negotiation of tax treaties to ensure greater source based taxation/ prevent treaty abuse (e.g. India – China DTAA <sup>[1]</sup> )   | <b>Action 8-10</b> | Tax administration and taxpayers expected to give consideration while applying ALP              |
| <b>Action 4</b>  | Interest deduction limitation rule (S. 94B) from FY 17-18  | <b>Action 14</b>   | Committed to minimum standards for improving effectiveness on Mutual Agreement Procedures (MAP) |
| <b>Action 15</b> | On 7 June 2017, India (along with 67 countries) signed the Multilateral Instrument (MLI) to modify existing tax treaties. India submitted ratified copy of MLI with OECD on 25 June 2019 |                    |   |

[1] Provisions influenced by MLI/ BEPS- Principal purpose test (PPT), competent authority rule as tie-breaker test for dual resident entities, narrowing the permanent establishment definition

# BEPS Action 15 - Multilateral Instrument



# Features of MLI

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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
- MLI intended to impact 3000+ existing tax treaties

Status

- 94 countries have signed MLI (as on 30 April 2020)
- 45 countries have submitted ratified copy of MLI with OECD (as on 30 April 2020)

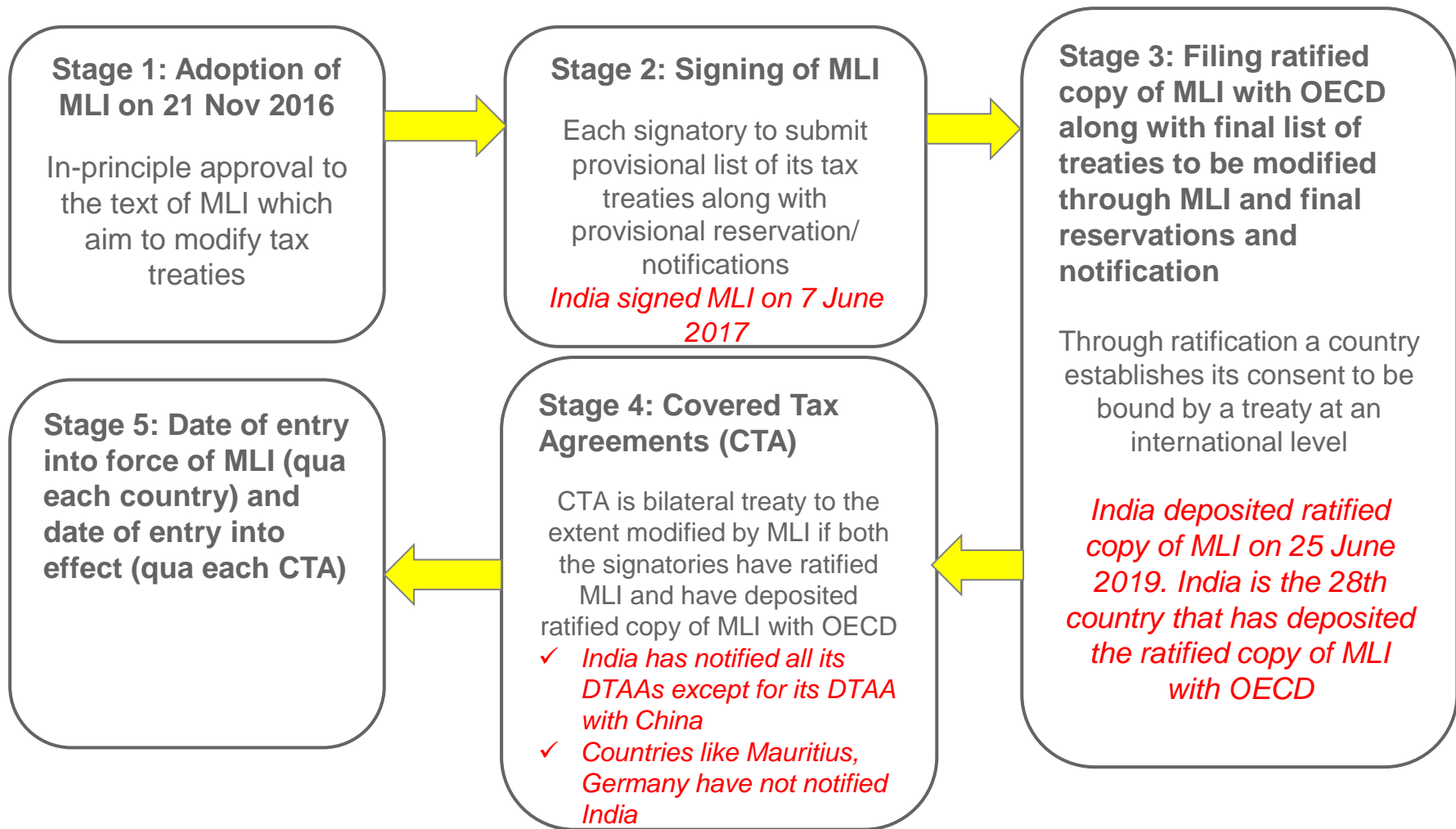
BEPS Actions implemented through MLI

- Action 2 (Hybrid mismatches- Tie breaker rule, FTE, FTC)
- Action 6 (Treaty abuse) *Minimum standard*
- Action 7 (PE)
- Action 14 (Dispute resolution) *Minimum standard*

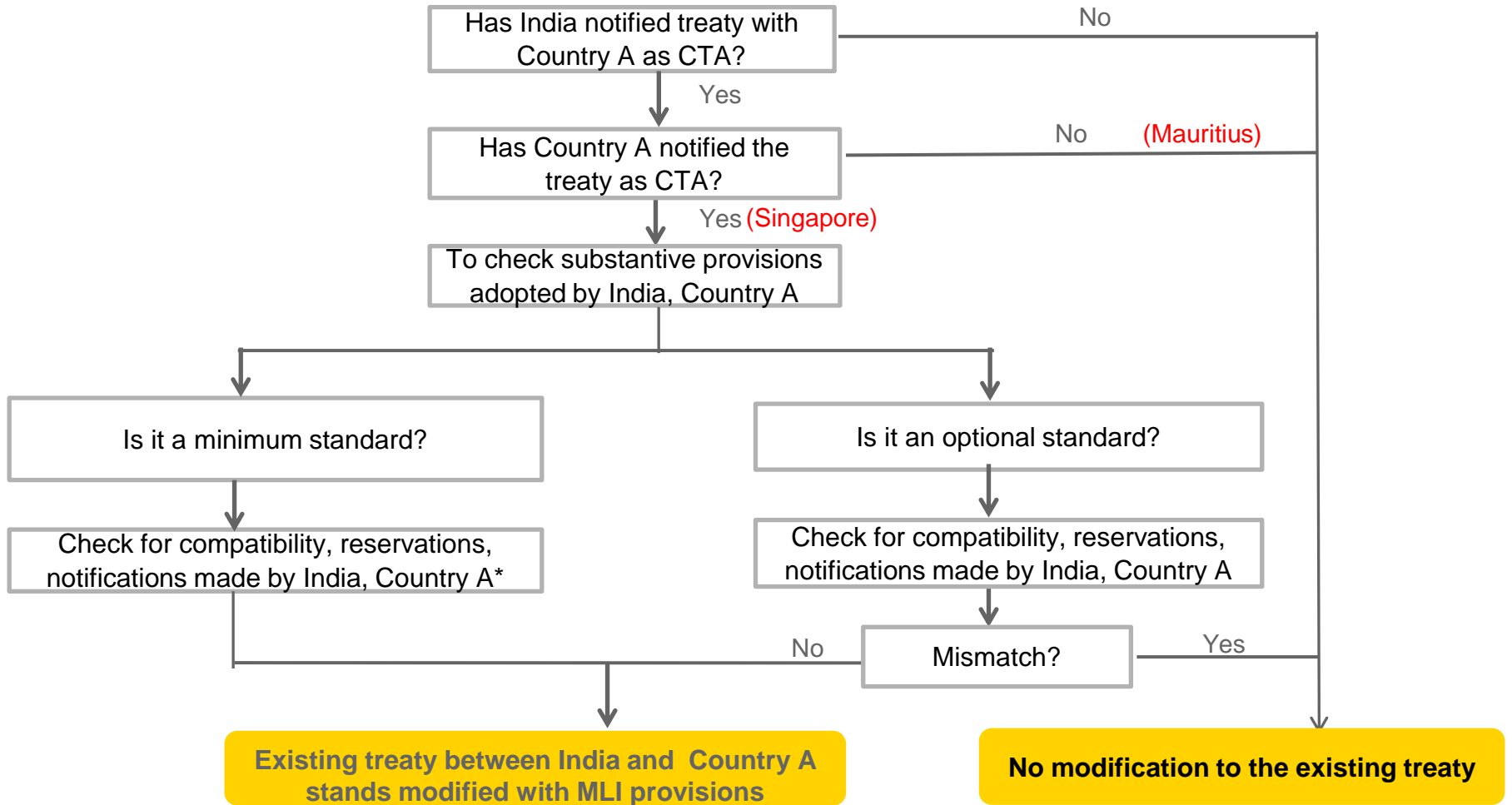
Legal status

- MLI does not function as protocol, need to be read with existing tax treaties
- Does not replace existing tax treaties but modifies them

# Evolution of MLI



# Application of MLI to CTA



\* A country can opt out of minimum standard only if the treaty already meets the min std or if it is willing to bilaterally negotiate the minimum standard

# Structure of MLI

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**Part I**

Scope and interpretation of terms

**Part II**

Hybrid mismatches

**Part III**

Prevention of treaty abuse

**Part IV**

Avoidance of PE status

**Part V**

Improving of dispute resolution

**Part VI**

Arbitration

**Part VII**

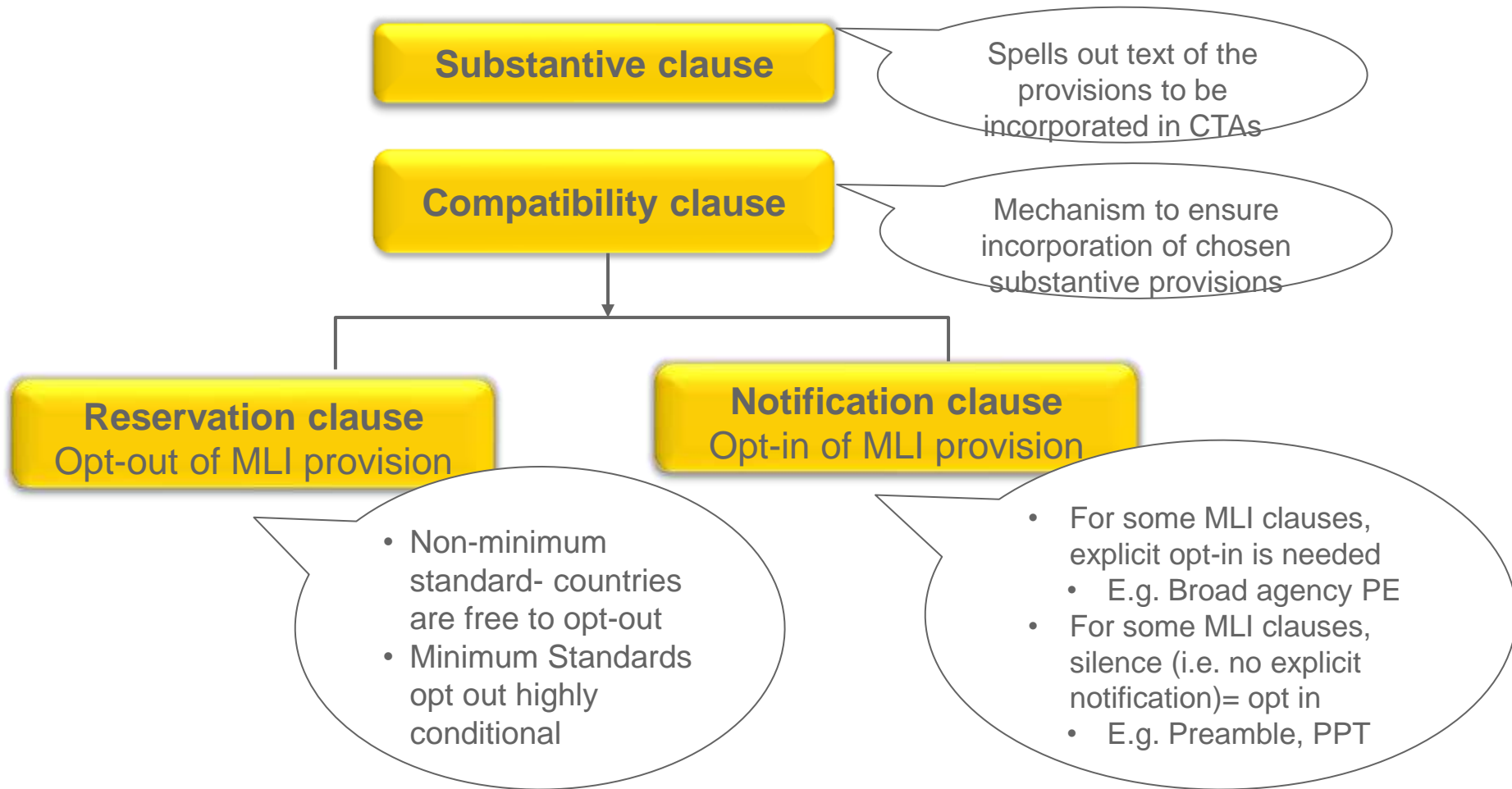
Final provisions such as entry into force, entry into effect etc.

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# Broad structure of any MLI Article

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# Compatibility clauses

| Types of compatibility clause | Frequency | When does it apply  | Examples (Illustrative)   | Impact on existing treaty   |
|-------------------------------|-----------|---|---|---|
| In place of or in absence of  | 12        | Applies in all circumstances (i.e. irrespective of whether treaty has or does not have a similar provision) | <ul style="list-style-type: none"> <li>• Preamble, PPT,</li> <li>• Inclusion of Art 9(2)</li> </ul>                               | <ul style="list-style-type: none"> <li>• Replaces or supersedes existing provision, if notified</li> <li>• Added to CTA in absence of existing provision</li> </ul> |
| “applies to” or “modifies”    | 1         | Applies only when there is an existing provision in the CTA   | <ul style="list-style-type: none"> <li>• Anti-fragmentation clause</li> </ul>   | Supplements existing provision without replacing it   |
| In place of                   | 4         | Applies only when there is an existing provision in the CTA   | <ul style="list-style-type: none"> <li>• Broad agency PE rules,</li> <li>• Specific activity exemption rule activities</li> </ul> | <ul style="list-style-type: none"> <li>• Replaces the existing CTA provision</li> <li>• Existing provision needs to be identified</li> </ul>                        |
| In absence of                 | 3         | Applies only when the provision is absent in the CTA and both confirm absence                               | <ul style="list-style-type: none"> <li>• MAP implementation irrespective of domestic law time limits</li> </ul>                   | India has notified those treaties where provision is absent   |

# Synthesised text of CTA

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- ▶ Countries, at their discretion, may develop consolidated versions of their CTA which would provide the text of treaty as modified by the MLI
  - ▶ Such consolidated version of CTA is called as “Synthesised text” (ST).
- ▶ ST would reproduce the text of each CTA and the provisions of the MLI that will modify that CTA in light of the interaction of MLI positions of parties to CTA
- ▶ The sole purpose of ST is to facilitate the understanding of the application of the MLI to the CTA
  - ▶ ST does not constitute a legal document.
  - ▶ The authentic legal texts of the Agreement and the MLI take precedence and remain the legal texts applicable
  - ▶ However, STs may have persuasive value. For instance, Australia in its STs state *“If you follow the information in this document, and it turns out to be incorrect, or it is misleading and you make a mistake as a result, the ATO will take that into account when determining what action, if any, we should take.”*
- ▶ ST can be prepared unilaterally or bilaterally in discussion with competent authority of CTA partner
- ▶ Countries like UK, Japan, Australia, Poland, Israel have released ST of their CTA
  - ▶ CBDT has also released ST of various Indian CTAs
    - ▶ ST of CTAs with UAE, UK, Australia, Poland, Lithuania, Slovak Republic prepared bilaterally
    - ▶ ST of CTAs with Japan, Singapore prepared unilaterally

# OECD Matching database

OECD database makes projections on how the MLI modifies a CTA by matching information from Signatories' MLI Positions.

Extracts from OECD database of India- Singapore CTA:

MLI Matching Database beta  
© OECD 2017-19

| Select jurisdictions:   |                                   | <u>India</u>  | <u>Singapore</u> | <a href="#">Read the Disclaimer</a>           |
|---|-----------------------------------|---|------------------|---|
|  | Status as of 19 December 2019     | India   | Singapore        | -   |
|   | Signature MLI                     | 07-06-2017  | 07-06-2017       | <a href="#">Jump to entry into effect MLI</a> |
|   | Ratification instrument deposited | 25-06-2019  | 21-12-2018       |   |
|   | Mock-up date of ratification      |   |                  | -   |
|   | Status of List                    | Definitive  | Definitive       |   |
| Synthesised text  | published by India                | <b>Synthesised text published by India</b>  |                  |   |
|   | published by Singapore            | <a href="#">Not available yet</a>   |                  |   |
| Article 2   Covered Tax Agreement   |                                   | <b>The agreement would be a 'Covered Tax Agreement'.</b>  |                  |   |
| Article 3   Transparent Entities  |                                   | Article 3 would not apply.  |                  |   |
| Article 4   Dual Resident Entities  |                                   | Article 4 would not apply.  |                  |   |
| Article 5   Application for methods for Elimination of Double Taxation            |                                   | Article 5 would not apply.  |                  |   |
| Article 6   Purpose of a Covered Tax Agreement                                    |                                   | <b>The preamble text described in Article 6(1) would be included in addition to the existing preamble language. Article 6(3) would not apply.</b>   |                  |   |
| Article 7   Prevention of Treaty Abuse  |                                   | <b>Article 7(1) would apply and supersede the provisions of the agreement to the extent of incompatibility. India has expressed acceptance of the PPT as an interim measure. Article 7(4) would not apply. The Simplified Limitation on Benefits Provision would not apply.</b> |                  |   |

# Entry into force and entry into effect

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- ▶ **MLI enters into force** qua each ratifying country for all its CTAs
- ▶ Purpose of date of EOF determines reference date for CTA's Entry into Effect (EIE)
- ▶ Art 34 of MLI - The MLI shall enter into force qua each country from:
  - ▶ 1st day of the month after expiry of 3 calendar months from the date of deposit of ratified copy of MLI with OECD
- ▶ India deposited ratified copy of MLI with OECD on 25 June 2019
  - ▶ MLI has entered into force for India from 1 October 2019
- ▶ **Date of entry into effect (EIE)** is to be determined qua each CTA
- ▶ Separate dates of EIE for withholding taxes and other taxes
- ▶ "Relevant date" for determining EIE of CTA- Latter of the dates when MLI enters into force for the parties to CTA (Article 35 of MLI)

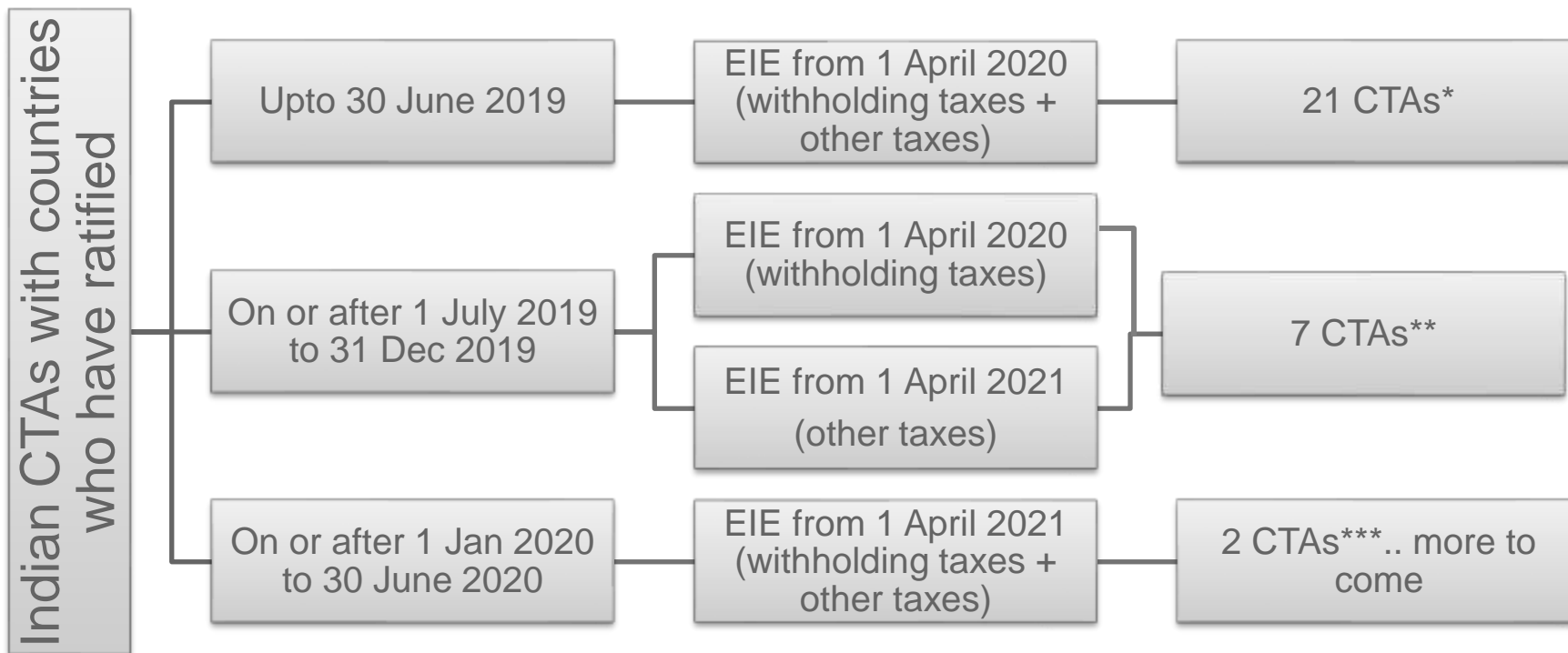
| Particulars           | Date of entry into effect   |
|-----------------------|---|
| For withholding taxes | 1st day of next calendar year/taxable period that begins on or after the "relevant date"      |
| For other taxes       | Taxable period that begins on or after expiry of six calendar months from the "relevant date" |

# Illustration- Date of EIE for India – Singapore CTA

| Particulars  | Dates        |
|--|--------------|
| (a) Date of entry into force of MLI in Singapore <sup>[1]</sup>  | 1 April 2019 |
| (b) Date of entry into force of MLI in India   | 1 Oct 2019   |
| (c) Latter of the two dates (i.e. later of (a) or (b))<br><b>[Relevant date for determining EIE of India- Singapore CTA]</b>       | 1 Oct 2019   |
| <b>(e) EIE - withholding taxes (1st day of calendar year/ taxable period that commences after relevant date i.e. 1 Oct 2019)</b>   |              |
| India  | 1 April 2020 |
| Singapore  | 1 Jan 2020   |
| <b>(f) EIE - other taxes (Taxable period that begins after expiry of 6 calendar months from the relevant date i.e. 1 Oct 2019)</b> |              |
| India  | 1 April 2020 |
| Singapore  | 1 Jan 2021   |

[1] Follows calendar year

# Date of EIE for Indian CTAs



\*Australia, Austria, Belgium, Finland, France, Georgia, Ireland, Israel, Japan, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Poland, Serbia, Singapore, Slovak Republic, Slovenia, UAE, UK

\*\* Canada, Denmark, Iceland, Latvia, Norway, Qatar, Ukraine

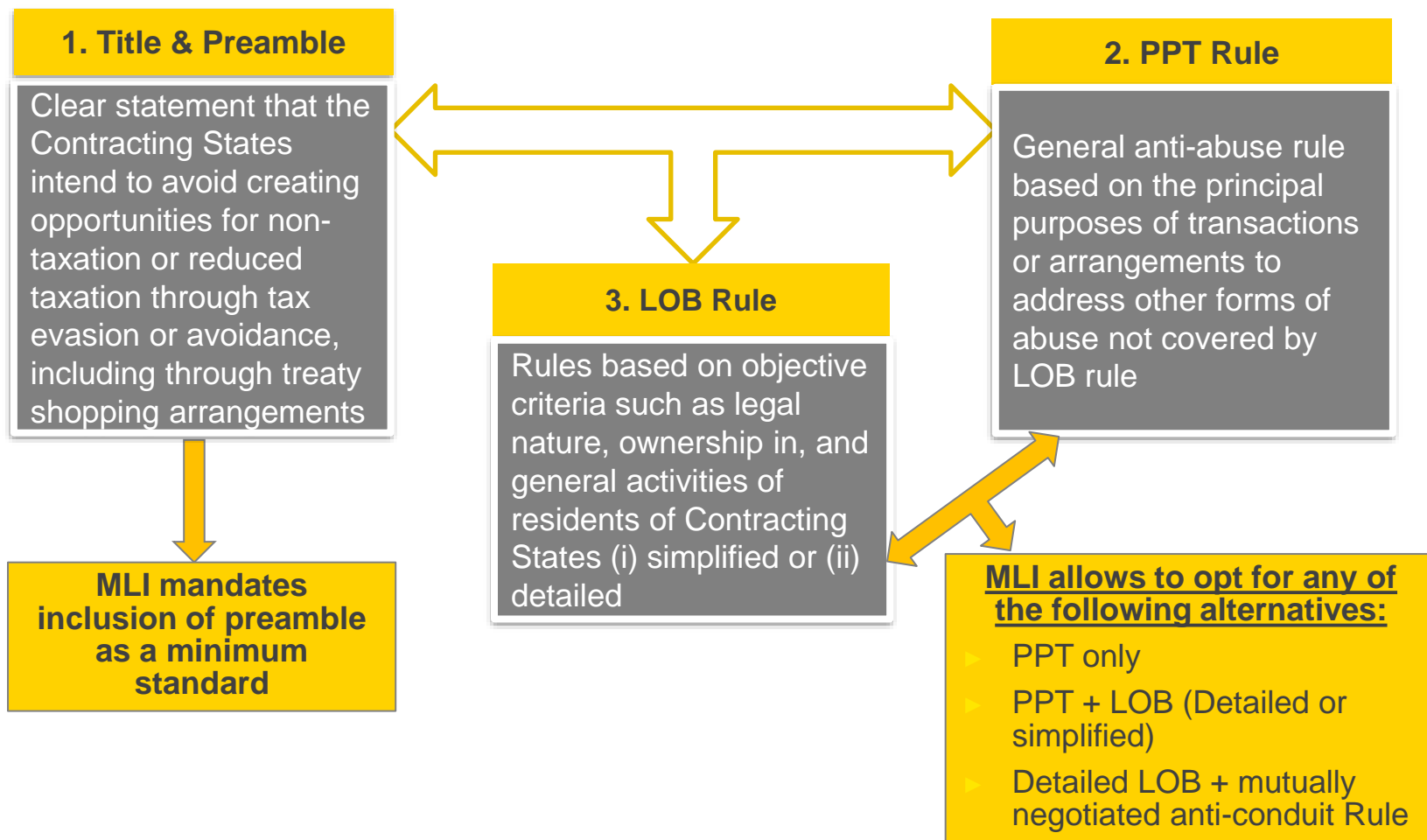
\*\*\*Cyprus, Saudi Arabia

# Preventing treaty abuse and targeting treaty shopping





# Three-pronged approach of BEPS Action 6 for prevention of treaty abuse

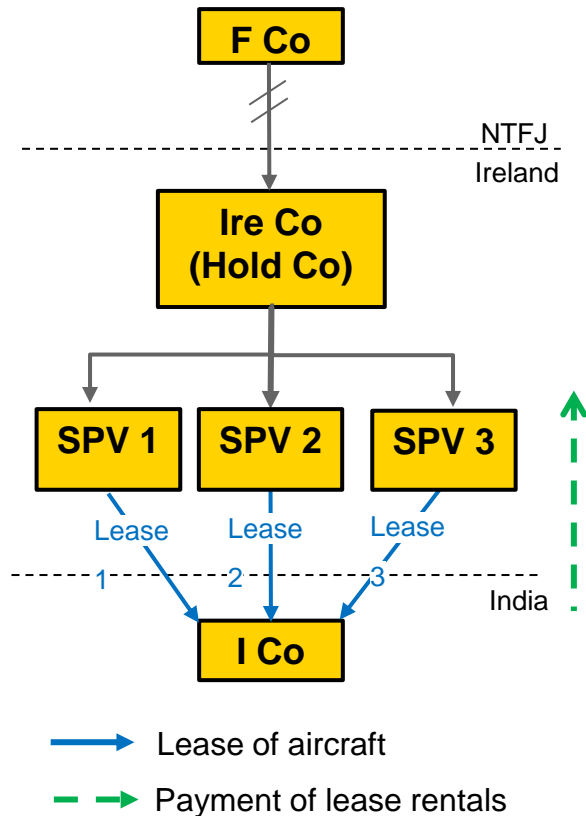


# India's MLI positions

| MLI provisions             |                                | Is it a minimum standard? | Art. No. of MLI | India Position |
|----------------------------|--------------------------------|---------------------------|-----------------|----------------|
| Action 6 Anti-treaty abuse | Preamble                       | Yes                       | 6(1)            | Yes            |
|                            | Preamble (additional sentence) | No                        | 6(3)            | No             |
|                            | PPT Rule                       | Yes                       | 7(1)            | Yes*           |
|                            | Discretionary relief for PPT   | No                        | 7(4)            | No             |
|                            | SLOB Provision                 | No                        | 7(8) to 7(13)   | Yes            |

\* India has adopted PPT as an interim measure

# Illustrative fact pattern: What challenges MLI can pose ?



- ▶ Ire Co is a well-established company in Ireland actively engaged in the business of aircraft leasing
- ▶ Most aircrafts are financed out of borrowings
- ▶ Ire Co prefers to have specific SPV per aircraft, *inter alia* to:
  - ▶ Facilitate borrowing, investor participation, ring fence liabilities, better protect commercials; etc.
- ▶ As financiers' insist, aircrafts are acquired in separate SPVs
- ▶ I Co has entered into lease arrangements with 3 SPVs of Ire Co
- ▶ I Co makes lease payments of INR 20 Cr to each SPV
- ▶ SPVs hold valid TRC and claim to be BO of rentals
- ▶ India-Ireland tax treaty stands modified by MLI with effect from 1 April 2020
  - ▶ PPT and Preamble gets inserted
- ▶ I Co remits rentals considering the treaty benefit

|                                |           |
|--------------------------------|-----------|
| WHT under ITL                  | @10% + SC |
| WHT under India-Ireland treaty | NIL       |

# Article 6 of MLI – Purpose of a CTA

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▶ **Text of the 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**)”*

▶ Being a minimum standard, requires insertion in CTA **in absence of** or **in place of** present text.

▶ **Optional additional text [not adopted by India]:**

*“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters”*

# Article 7 of MLI – Prevention of Treaty Abuse

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*“Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement **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, (‘reasonable purpose test’)*

*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 Covered Tax Agreement.**” (‘object and purpose test’)*

# Meaning of arrangement

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- ▶ Action 6 final report provides the interpretation of the term 'arrangement':

*The terms “arrangement or transaction” should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. These terms also encompass arrangements concerning the **establishment, acquisition or maintenance of a person who derives the income**, including the qualification of that person as a resident of one of the Contracting States, ....*

- For a typical holding structure, the taxpayer needs to explain reasons for having a separate entity and also non-tax reasons for establishing the entity in a given jurisdiction.
- **Need to satisfy separate entity test and location test**

# Tax benefit under treaty

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- ▶ Non-obstante provision with mandate of denial of treaty benefit
- ▶ Denial of treaty benefit is the only consequence
- ▶ Extends to direct as also indirect benefit under CTA
- ▶ “Benefit” covers all limitations on taxation imposed on the COS as also treaty benefit obtained in COR
  - ▶ Example: tax reduction, exemption, tax sparing, UTC, etc.
- ▶ No impact on tax concessions admissible in domestic law (e.g. lower withholding rate admissible u/s 194LC/LD)

# Reasonable purpose test

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- ▶ Granular approach: Evaluate w. r. t. each arrangement, each stream of income; not qua entity as a whole
- ▶ Applies to an arrangement if its “one of the principal purpose” is treaty benefit
  - ▶ Obtaining treaty benefit need not be sole or dominant purpose
- ▶ Purpose of “arrangement” – an inanimate exercise
  - ▶ Question of fact: Requires objective analysis of all facts and circumstances
- ▶ “Reasonable to conclude”:
  - ▶ Having sound judgment, fair, sensible, logical (not unreasonable)
  - ▶ Alternative views need to be examined objectively
  - ▶ All evidences must be weighed
  - ▶ Looking merely at the ‘effect’ not sufficient – tax benefit purpose not to be assumed lightly
  - ▶ Self assertion by taxpayer not sufficient; also no conclusive evidence requirement

Is arrangement capable of being explained but for treaty benefit? **OR,**  
Is treaty benefit in itself justifying the transaction?



# Object and purpose carve out

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- ▶ Even if treaty benefit is one of the principal purpose, PPT carve out protects treaty benefit if ***‘it accords with object and purpose of relevant provisions of CTA’***
- ▶ Onus to “establish” applicability of carve out lies on taxpayer
- ▶ Reasonable purpose test = Question of fact;  
  
Object and purpose carve out = Question of law
- ▶ Evaluate object and purpose of relevant treaty provisions (implicitly, in overall treaty context including modified preamble)
- ▶ Object and purpose of distributive articles based on quantitative criteria v/s other distributive rules v/s general anti-avoidance provision of the treaty

# Object and purpose carve out

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## ▶ Treaty objects; object of a particular article<sup>1</sup>

- ▶ Eliminate double taxation: promote (bona fide) exchange of goods and services, and movements of capital and persons
- ▶ Foster economic relations, trade and investment
- ▶ Provide certainty to taxpayers
- ▶ Prevent tax avoidance and evasion
- ▶ Promote exchange of information
- ▶ Strike a bargain between two treaty countries as to division of tax revenues
- ▶ Eliminate certain forms of discrimination
- ▶ Language of Preamble (as modified by MLI) to aid determination of object and purpose

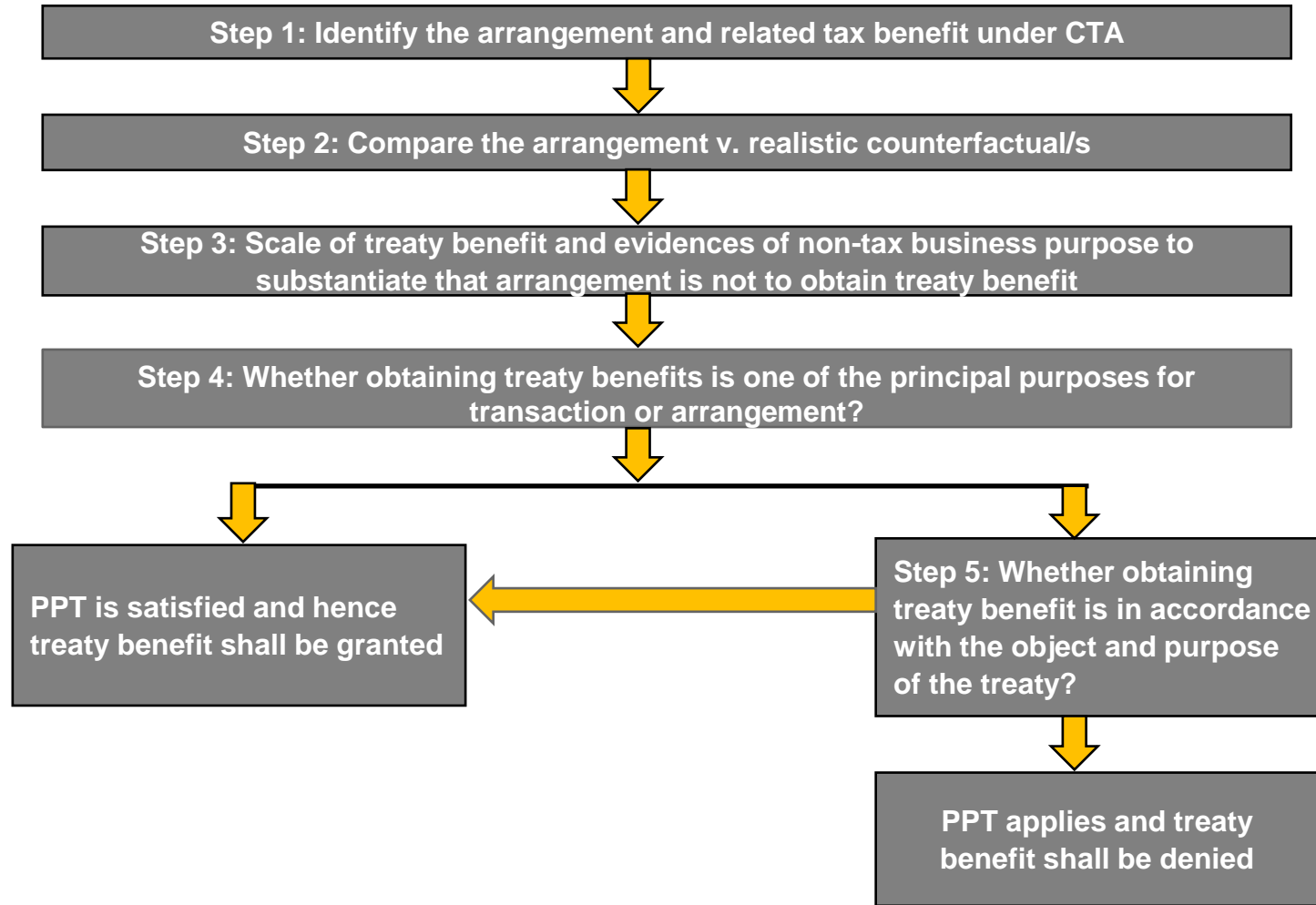
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<sup>1</sup> Commentary by Prof. Philip Baker titled “Double Taxation Conventions” at Para B.09 on Page B-7; OECD Commentary 2017 on Article 1; para 174 of OECD Commentary 2017 on Article 29(9); Linklaters LLP [2010] 40 SOT 51 (Mum.)

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# Step process for evaluation of PPT

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# PPT and GAAR interplay

| Particulars                      | Domestic GAAR   | Article 7 of MLI (PPT)  |
|----------------------------------|---|---|
| <b>Applicability</b>             | <ul style="list-style-type: none"> <li>Main purpose is tax benefit; and</li> <li>One of the tainted element tests is present</li> </ul> | <ul style="list-style-type: none"> <li>One of the principal purposes is tax benefit; and</li> <li>Such purpose is not in accordance with object and purpose of treaty/ article</li> </ul> |
| <b>Consequences</b>              | Re-characterization of transaction, re-allocation of income (includes denial of treaty benefit)   | Denial of treaty benefit  |
| <b>Onus</b>                      | Primary onus on tax authority   | Primary onus on tax authority and rebuttal assumption for carve out   |
| <b>Administrative safeguards</b> | Approving Panel   | To be determined by respective states. OECD and UN Model Commentaries suggests this   |
| <b>Grandfathering</b>            | <b>Yes</b>  | <b>No</b>   |
| <b>De-minimis threshold</b>      | <b>Yes</b>  | <b>No</b>   |

# PPT and GAAR interplay

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- ▶ Is GAAR inapplicable to the facts of the case due to de-minimis tax impact of the arrangement ?
- ▶ If yes, whether taxpayer can contend non-applicability of PPT by virtue of s.90(2A) of ITA ?
  - S. 90(2A)** - *“Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.”*
- ▶ What is the impact of India not opting for discretionary relief under Article 7(4) of MLI ?
  - ▶ PPT consequence if Ire Co was owned by equivalent beneficiary
- ▶ GAAR’s ability to re-characterise v/s PPT operating on “look at” principle

**Para 22.1 of Article 1 of 2003 OECD Commentary (Para 79 of 2017 OECD Commentary) :**

*“To the extent that the application of the (**domestic**) rules results in a re-characterization of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied taking into account these changes.....”*

# Interplay of GAAR, PPT and LOB

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- ▶ Taxpayer needs to fulfil all objective conditions of treaty entitlement such as being a resident, beneficial owner, ALP payment, LOB conditions, etc.
- ▶ PPT rule is a “notwithstanding” over-arching rule
- ▶ PPT may fail qua arrangement/transaction though the entity may otherwise fulfil BO, LOB tests
- ▶ If arrangement/transaction is PPT tainted, treaty benefit is denied:
  - ▶ GAAR invocation may not be necessary for denying treaty benefit
  - ▶ GAAR may still re-characterise the transaction
- ▶ If arrangement passes PPT, GAAR test most likely gets fulfilled
  - ▶ Main purpose test of GAAR is, if at all, stricter
  - ▶ S.97(1)(c) test likely to be passed as location/residence is likely to be for substantial commercial purposes

# PPT and GAAR interplay - “One of the principal purposes” v. “main purpose” test

## Threshold is practically same

- ▶ Dictionary meanings of ‘main’ and ‘principal’ suggest that they both refer to something ‘chief’, ‘primary’ or ‘most important’
- ▶ OECD PPT examples give flavour that PPT applies only when treaty benefit is “the main” reason for the transaction
- ▶ Both require objective analysis of facts and circumstances; and both factor the object and purpose of an arrangement
- ▶ Para 181 of OECD Commentary 2017 states that, to trigger PPT, obtaining treaty benefit should be “a principal consideration” behind entering into any arrangement or transaction

## Threshold is not same, PPT has lower threshold

- ▶ In India, “main purpose” threshold introduced post significant debate and allay fear of wider canvass of “one of the main purpose” test
- ▶ UK HMRC GAAR guidance states that “one of the main purpose” test is wide to cover transactions implemented for commercial reasons and also ‘substantial’ tax advantage
- ▶ UN Commentary 2011 on Article 1 – “main purpose test” may be interpreted restrictively in favour of taxpayers and render provision ineffective
- ▶ UN handbook suggests that “one of the main purpose” test is relatively easy to satisfy than “main purpose test”

# Spectrum of PPT

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## OECD Examples

- Setting up manufacturing plant in low cost jurisdiction for expansion of business (Example C)
- Bona fide increase in shareholding to match limit fixed by treaty to grant benefit (Example E)
- Establishing intra-group service company in a jurisdiction with real business, real assets and real risks assumed (Example G)

- Assignment of income stream to a person in TFJ (Example A)
- Artificial split of contract to avoid trigger of PE (Example J)
- Change of residence to TFJ just prior to sale (Para 177 of OECD Commentary 2017)
- Steps taken to hold BOD for residence in TFJ (Para 177 of OECD Commentary 2017)



# Shome Committee

## Shome Committee Examples

- Availing tax incentive by setting up unit in SEZ (Example 1)
- Lease v/s purchase; buy-back v/s dividend; debt v/s equity; timing of divestment (Example 4, 12, 5, 9 resp.)
- Pooling vehicle - neutral jurisdiction, ease of incorporation, operation, low costs of compliance, good treaty network, etc. (Example 18)

- Routing investment through entity in TFJ without any business purpose (Example 10)
- Artificial split of shareholding to avail portfolio investment benefit (Example 15)
- Assignment of loan to branch in TFJ (Example 14)

### What CBDT says:

- ▶ **FAQ 2:** *“GAAR will not interplay with the right of taxpayer to select or choose method of implementing a transaction.”*
- ▶ **FAQ 4:** *“GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply”*

# Withholding obligations on I Co

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- ▶ Is PPT, like GAAR, a measure to be invoked by tax authority against primary taxpayer alone and hence no cognizance to be taken/ possible at the stage of credit/ payment?
- ▶ Reasonable safeguard steps expected of the payer: Declarations, health check, S.195(2), S.197, etc.
- ▶ Is S.163 obligation onerous and ring fenced only with the help of order obtained under S.162(2)
- ▶ **Shome Committee Observations:**

*“In view of the above, the Committee recommends that, while processing an application under section 195(2) or 197 of the Act pertaining to the withholding of taxes,*

*(a) the taxpayer should submit a satisfactory undertaking to pay tax along with interest in case it is found that GAAR provisions are applicable in relation to the remittance during the course of assessment proceedings; or*

*(b) in case the taxpayer is unwilling to submit a satisfactory undertaking as mentioned in (a) above, the Assessing Officer should have the authority with the prior approval of Commissioner, to inform the taxpayer of his likely liability in case GAAR is to be invoked during assessment procedure.”*

# Action 7 – Definition and scope of Permanent Establishment



# MLI Articles and India positions

▶ Action 7 is not a minimum standard

▶ Classified as “reinforced international standard”

| MLI provisions on Action 7           |                                  | Is it minimum standard? | Art. No. of MLI | India Position |
|--------------------------------------|----------------------------------|-------------------------|-----------------|----------------|
| <b>Broad agency PE</b>               | Dependent Agent PE (expanded)    | No                      | 12(1)           | Yes            |
|                                      | Independent Agent PE (curtailed) | No                      | 12(2)           | Yes            |
| <b>Specific activity exemption</b>   | Option A [PoA condition]         | No                      | 13(2)           | Yes            |
|                                      | Option B [automatic exemption]   |                         | 13(3)           | N.A.           |
|                                      | Anti-fragmentation Rule          | No                      | 13(4)           | Yes            |
| <b>Construction/ installation PE</b> | Anti-splitting of contracts      | No                      | 14              | Yes            |

# Broader Dependent Agency PE (DAPE) Rule

## Article 12(1) of MLI/ Article 5(5) of OECD MC

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### MLI provision

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#### Wider scope of DAPE

- DAPE rule extended to cover persons who **habitually play a principal role leading to conclusion of contracts** that are routinely\* concluded without material changes
- such contract can either be-
  - in name of the foreign enterprise (FE); or
  - for the transfer of ownership of, or the granting of the right to use, property (including tangible/intangible) owned or licensed by FE; or
  - for the provision of services by FE

### India's stand

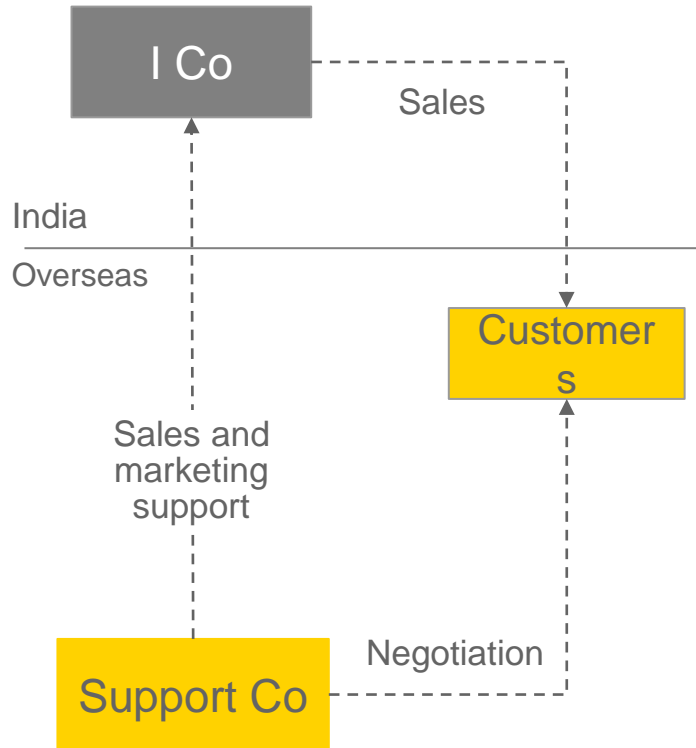
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- India has opted for broader agency PE rule for all its treaties
- Applicable where the treaty partner has also notified India's treaty in this respect
- Replaces DAPE provision only to the extent refers to agents having authority to conclude contracts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

*\* In OECD MC (2017), India has reserved a right not to include the word "routinely"; Explanation 2 to s.9(1)(i) of ITA omits reference to "routinely concluded without material modification" from comparable text*

# Case Study: Sales and marketing support entities

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- ▶ Support Co in State S provides sales and marketing support services to I Co
- ▶ Functional profile of Support Co includes -
  - ▶ Market study and identify potential customers
  - ▶ Liaising with customers in State S
  - ▶ Making offers to customers in State S basis a price list (+/- permissible delta) provided by ICo
  - ▶ Explain other standard terms of contract
  - ▶ Negotiations and finalization of deals with the customers is by senior employees of I Co
  - ▶ Following-up for LC/ payments from customers
  - ▶ Addressing customer complaints with I Co's support
- ▶ Support Co is compensated at 10% mark-up on its cost
- ▶ Hitherto, Group takes a 'No PE' position in absence of authority to conclude contract with Support Co

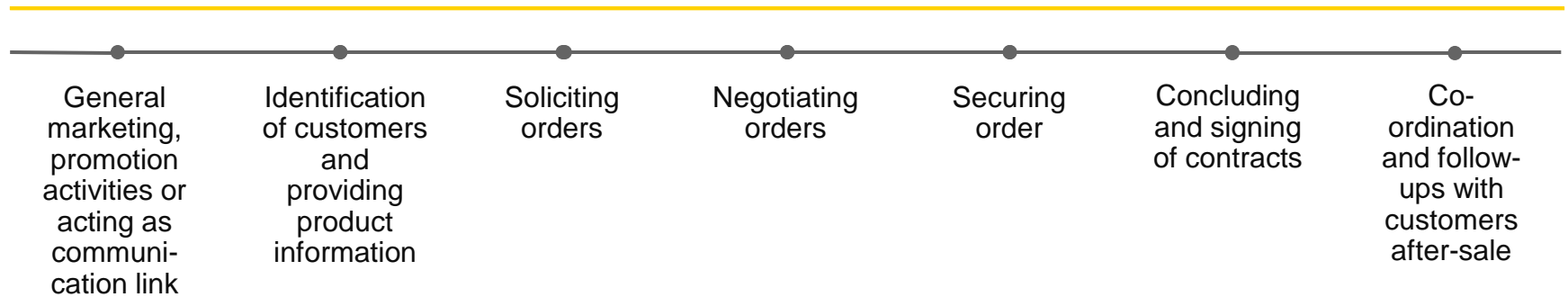
# Contours of broader DAPE rule

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- ▶ Pre-MLI: Authority to conclude contract
  - ▶ Substance based exercise unlike commissionaire concept in civil law countries
- ▶ Guidance on broader DAPE - OECD Commentary 2017:
  - ▶ Acting as a sales force and convincing a 3rd party without legally binding the principal amounts to playing a “principal role” to conclude contract (Para 88)
  - ▶ Conclusion of contracts should be direct result of activities of representative
    - ▶ Whether or not representative can vary the terms of contracts (Para 90)
  - ▶ There needs to be regularity in conclusion of contracts without material modification by representative; isolated cases not covered (Para 83)
  - ▶ Contract needs to create obligation that will effectively be performed by FE, even though the contract is signed by another person (Para 94)
    - ▶ FE needs to be directly/ indirectly be affected by action of the person (Para 86)

**Illustrative treaties not modified due to reservation by other country in Article 12 of MLI**  
Australia, Cyprus, Ireland, Luxembourg, Netherlands, Singapore, UK

# Scale of representative's activities



- ▶ **Guidance in Technical Expl. to India-US treaty (scope of securing orders):**
  - ▶ Frequently accepts orders on behalf of the FE;
  - ▶ Habitually represents to buyers that acceptance of an order by an agent constitutes agreement of FE under the terms or conditions specified in the order;
  - ▶ FE takes actions that give basis for reasonable belief that agent has authority to bind FE
- ▶ **Guidance from OECD Commentary:** Solicitation orders (without formal finalization) which are routinely approved by FE and sent directly to a warehouse for
- ▶ **India's reservation in OECD Commentary 2017:** FE may trigger a PE if a person habitually secures orders in the other Contracting State wholly or almost wholly for FE

**Is “Securing Order Agent” rule in Indian treaties (e.g. Japan, Russia, Norway) broader compared to MLI’s broader DAPE?**



# Independent Agent

## Article 12(2) of MLI/ Article 5(6) of OECD MC

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### MLI provision

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#### Stringent condition for independent agent exclusion

- Not available to agents
  - Acting **exclusively or almost exclusively** on behalf of one or more enterprise to which it is closely related\*
- CRE defined with respect to control/beneficial holding with threshold of 50% of voting/beneficial/equity interest

### India's stand

---

- India has opted for the amended provision for independent agent to all its treaties
- Applicable where the treaty partner has also notified India's treaty in this respect

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\* In OECD MC (2017), India has reserved a right on non-inclusion of term "to which it is closely related"

# Preparatory or Auxiliary activity exemption

## Article 13 of MLI/ Article 5(4) of OECD MC

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### Option A

PE exemption to specified activities  
subject to activities being PoA in  
nature

OR

### Option B

Automatic exemption to the listed  
activities

AND/OR

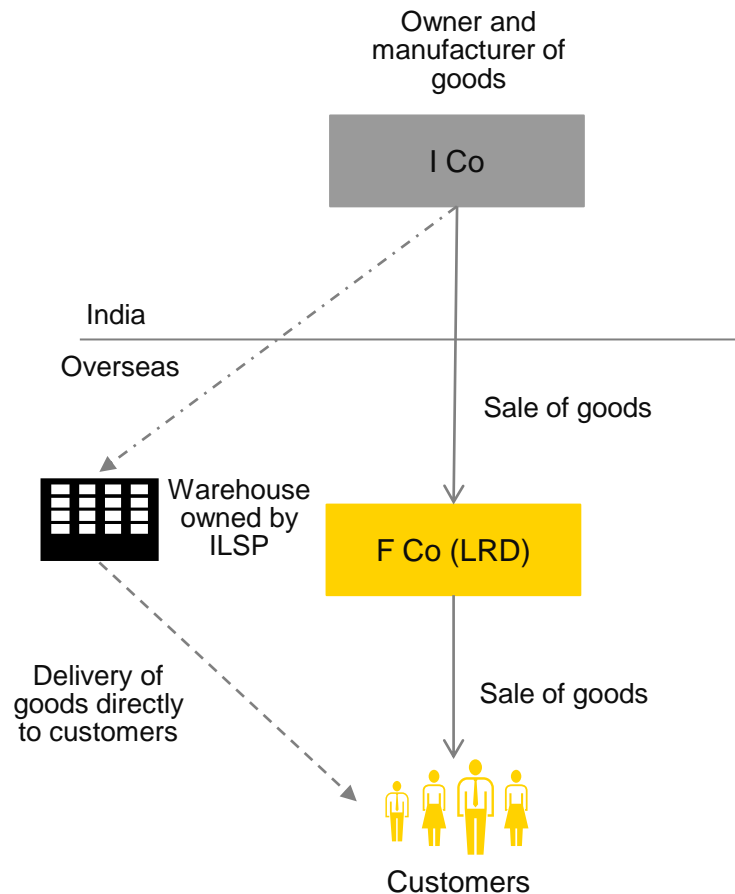
### Anti-fragmentation rule

Denies specific activity exemption to a place of business  
maintained by the enterprise or a CRE in specific  
circumstances

### India position

- Opted for Option A by specific notification
- Not made specific reservation on anti-frag; thus, choosing to apply anti-frag.

# Case Study: Limited Risk Distributor



- I Co is engaged in manufacturing of consumer goods
- F Co is a WOS of I Co and is exclusive limited risk distributor (LRD) for I Co in State S
- Employees of F Co negotiate and conclude contracts with customers on its own account and not on behalf of I Co
  - In respect of order solicited, privity of contact remains between customers and F Co
- A third party logistics service provider (LSP), working for multiple unrelated groups, maintains stock of goods on behalf of I Co:
  - Goods are delivered directly to customers as and when F Co makes a sale
  - Title and risk in the goods passes from I Co to F Co concurrent with passing to customers from F Co
- F Co is compensated with a relatively lower but assured return on sales (say, 2%)

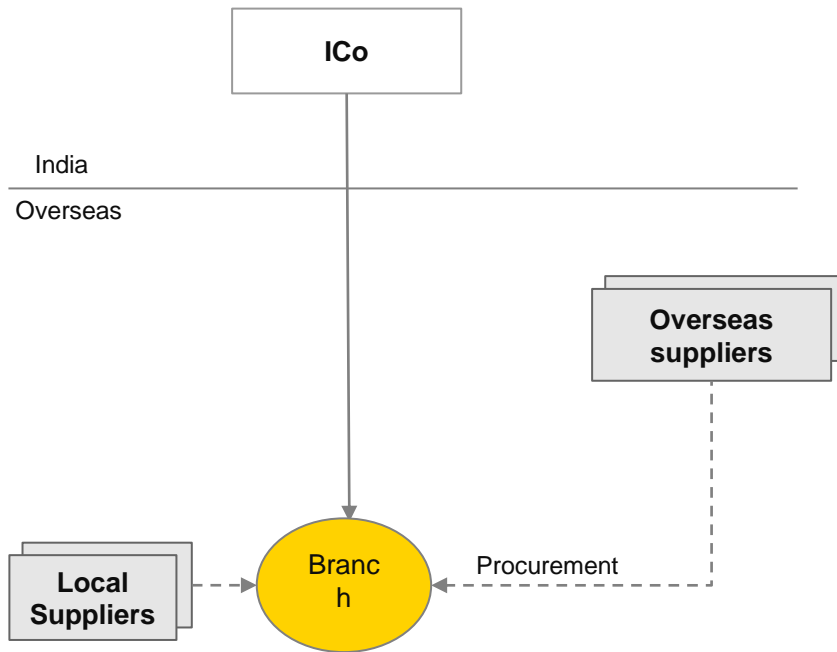
# PE exposure: Pre and Post BEPS

| PE exposure by    | Pre-BEPS   | Post BEPS  |
|-------------------|--|--|
| LRD (F Co)        | No PE (F Co neither acting on behalf of I Co nor is it selling goods that are owned by such I Co)  | No PE (F Co neither acting on behalf of I Co nor is it selling goods that are owned by such I Co)* |
| Warehouse of ILSP | <p>No fixed place PE since disposal test fails -</p> <ul style="list-style-type: none"> <li>I Co does not have unlimited access to a separate part of the warehouse for inspecting and maintaining goods</li> <li>Mere presence of goods belonging to ICo does not mean the place is at disposal of ICo</li> </ul> | No fixed place PE (hence, no need to evaluate PoA exemption and anti-frag. rule)                   |

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*\* India positions on the 2017 OECD Commentary - Distribution of goods owned by an enterprise (through associated or related enterprise) may create PE for FE, particularly in a case where the risks are not borne by such distributor*

# Case Study: Procurement hub outside India



- ▶ ICo has a procurement hub (branch) in State S
- ▶ Branch performs following functions:
  - ▶ Procurement of products in various countries including State S
  - ▶ Co-ordination with existing and potential suppliers
  - ▶ Assist ICo in planning manufacturing process depending on availability of material
  - ▶ Provide supply relevant market information to ICo
  - ▶ Prepare trade confirmation on behalf of ICo and send to its suppliers
  - ▶ Discuss key terms and conclude purchase contracts with suppliers basis purchase price mandate given by ICo

**Whether ICo can avail benefit of exemption under Article 5(4) with respect to its procurement activities in State S?**

# PE exposure : Pre and Post BEPS

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- ▶ **Pre-MLI implications**

- ▶ Arguable, automatic exemption if purchases solely for the enterprise

- ▶ **Post-MLI implications**

- ▶ Treaty exclusion if activities “solely” comprising of purchases
- ▶ Treaty undergoes change if State S has opted for Option A under Article 13 of MLI\*
  - ▶ Purchase exclusion may be denied if activity constitutes core function for ICo
  - ▶ No change in Article 7(5)/ 7(4) of treaty pursuant to MLI which excludes attribution in respect of purchases for FE

- ▶ **Implications under domestic law**

- ▶ Similar to Expl. 1(b) to S.9(1)(i) of ITA, possibility of no attribution in respect of operations which are confirmed to purchase of goods in State S for export

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\* No impact if State S either opts for Option B/ makes reservation/ remains silent in Article 13 of MLI

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# Anti-contract splitting rule in construction PE

## Article 14 of MLI/ Article 5(3) of OECD MC

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### MLI provision

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- Automatic aggregation of time spent by related entities if following conditions are met:
  - FE has construction type project in source state
  - Connected activities are carried out at the same site/ place by one or more CREs\*
  - FE's activities as well as each of such connected activities > 30 days

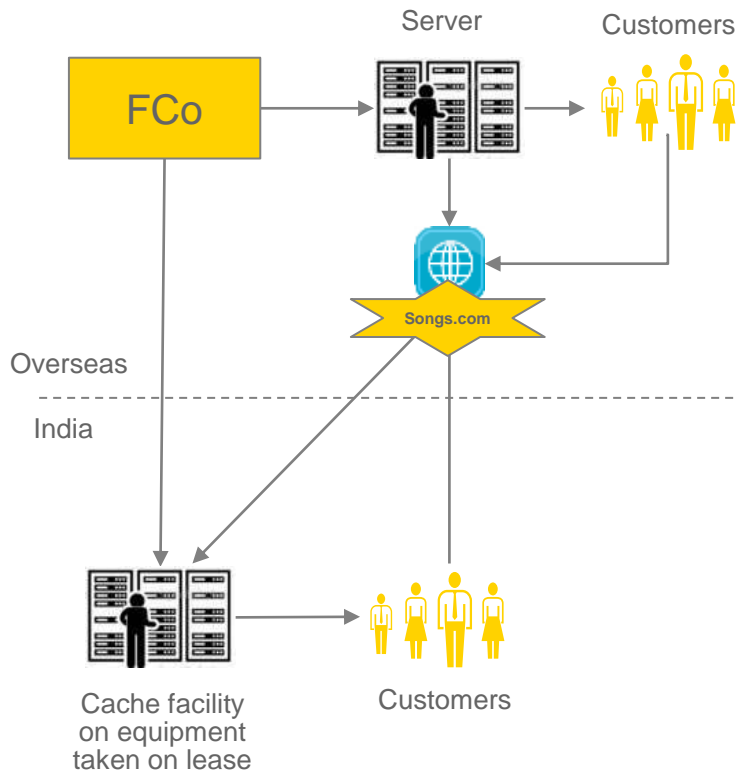
### India's stand

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- No reservation by India on anti-contract splitting rule
- Silence is acquiescence for this MLI provisions
- Unless reserved by other country, provision supersedes the existing CTA to the extent incompatible

\* CRE defined w.r.t. control/ beneficial holding with threshold of 50% of voting/beneficial/equity interest

# Impact on digital business models



- ▶ FCo is the online music streaming service provider and a digital distributor of songs
  - ▶ FCo has rights to > 50mn music tracks in 15 languages incl. Hollywood and regional songs
- ▶ FCo caters to its online users across the globe
- ▶ Playlists for each user is curated basis tastes and preferences
- ▶ It owns a website and App which is stored on servers outside India
  - ▶ It has two versions (1) paid ad-free (2) free with ads
- ▶ Data and algorithm for analysing data is also stored on a server outside India
  - ▶ To avoid latency issues, FCo has set up cache facility along in-built software on a leased equipment in India
  - ▶ FCo remotely controls and maintains the cache facility
- ▶ Website redirects user request to the nearest server/cache facility to speedy delivery

**Whether FCo has a PE in India?**



# PE exposure: Pre and Post BEPS (1)

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| PE exposure by   | Pre and Post BEPS   |
|------------------|---|
| Leased equipment | <ul style="list-style-type: none"><li>• Equipment/ server is at disposal if FE owns (or leases) and operates server on which data/ software is stored and used (para 124)*</li><li>• PE exists even though no personnel of FE is required at the location for operation of equipment/ server (para 127)</li><li>• No PoA exemption since equipment is used for speedy delivery of digital services which is not a tangible property in the nature of “goods” or “merchandise” covered in Article 5(4) (para 66)**</li></ul> |

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\* *Disposal test not met if data/ software is stored or hosted on a server of an Internet Service Provider (ISP) (para 124). ISPs do not constitute an agent of FE under Article 5(5) since they do not conclude contracts or play a principal role leading to conclusion of contracts (para 131).*

\*\* *Also, post BEPS, an equipment used and maintained for speedy delivery of songs may not constitute PoA activity for online music streaming service provider (para 62 and 130 – example of core warehousing activity for e-tailor)*

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# PE exposure: Pre and Post BEPS (2)

| PE exposure by                        | Pre BEPS   | Post BEPS   |
|---------------------------------------|--|---|
| Cache facility with data and software | <ul style="list-style-type: none"> <li>Website does not constitute a tangible property to trigger fixed place PE (para 123)*</li> <li>Website through which FE carries on its business is not an agent under Article 5(5) since website is not itself a “person” as defined in Article 3 (para 131)</li> </ul> | <ul style="list-style-type: none"> <li>No change under BEPS*</li> </ul>   |
| Users in India                        | Users cannot trigger PE*   | Unified Approach under BEPS (2.0) Pillar One contemplates allocation of additional taxation right to market jurisdiction (i.e. where the user is located) in case of consumer-facing business |

\* **India position in OECD Commentary 2017:** India believes that website on any equipment (even if owned by ISP) includes downloading of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with FE. India reserves a right to deem PE of FE if there is a significant economic presence of FE in India as per BEPS Action 1.

# Thank You

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