

Basics of international taxation

ICAI - WIRC

16th December 2017

Contents

1. Introduction

2. Residence

3. Scope of total income

4. DTAA

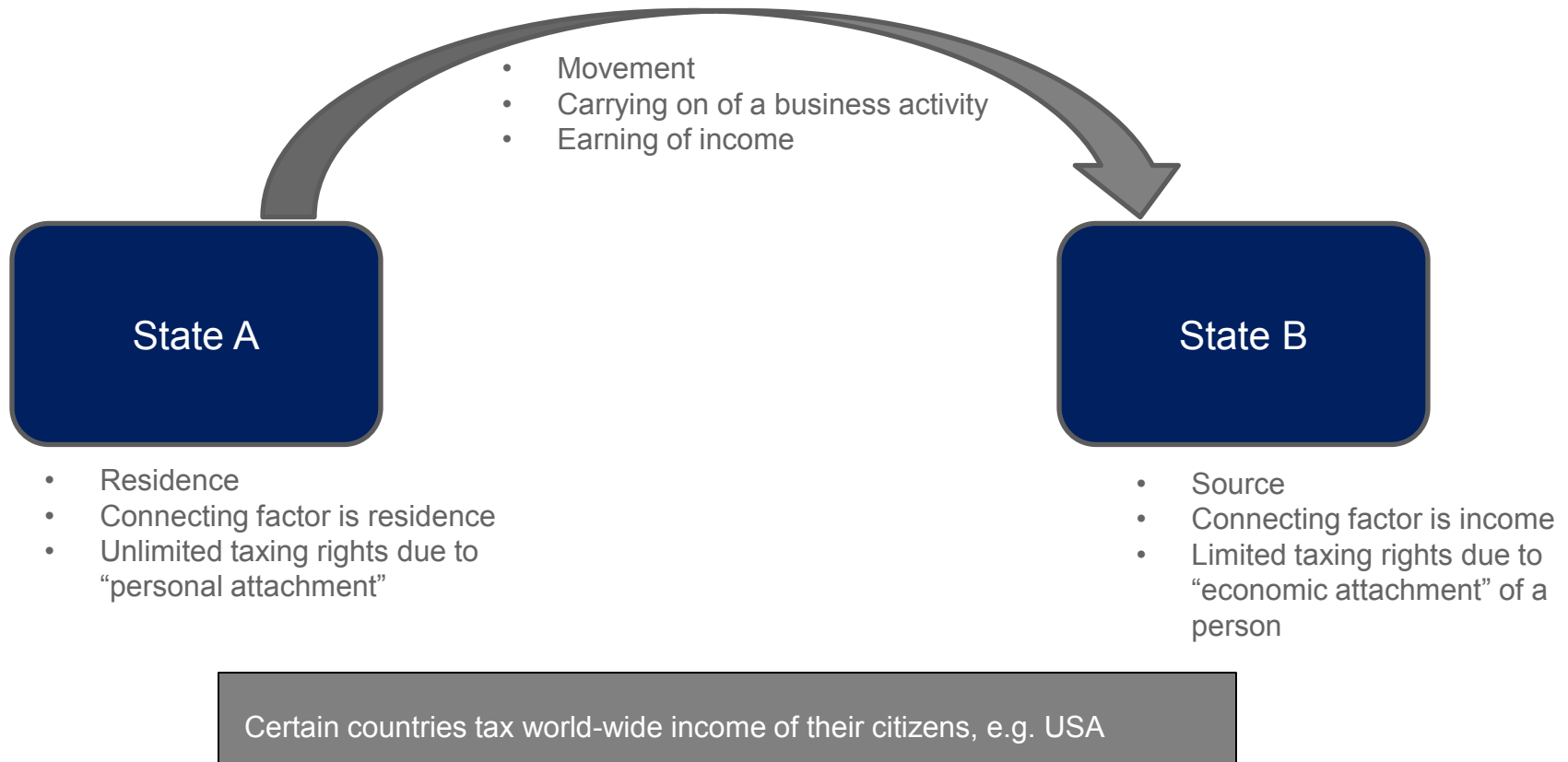
5. Interpretation of treaties

6. Key articles of tax treaties

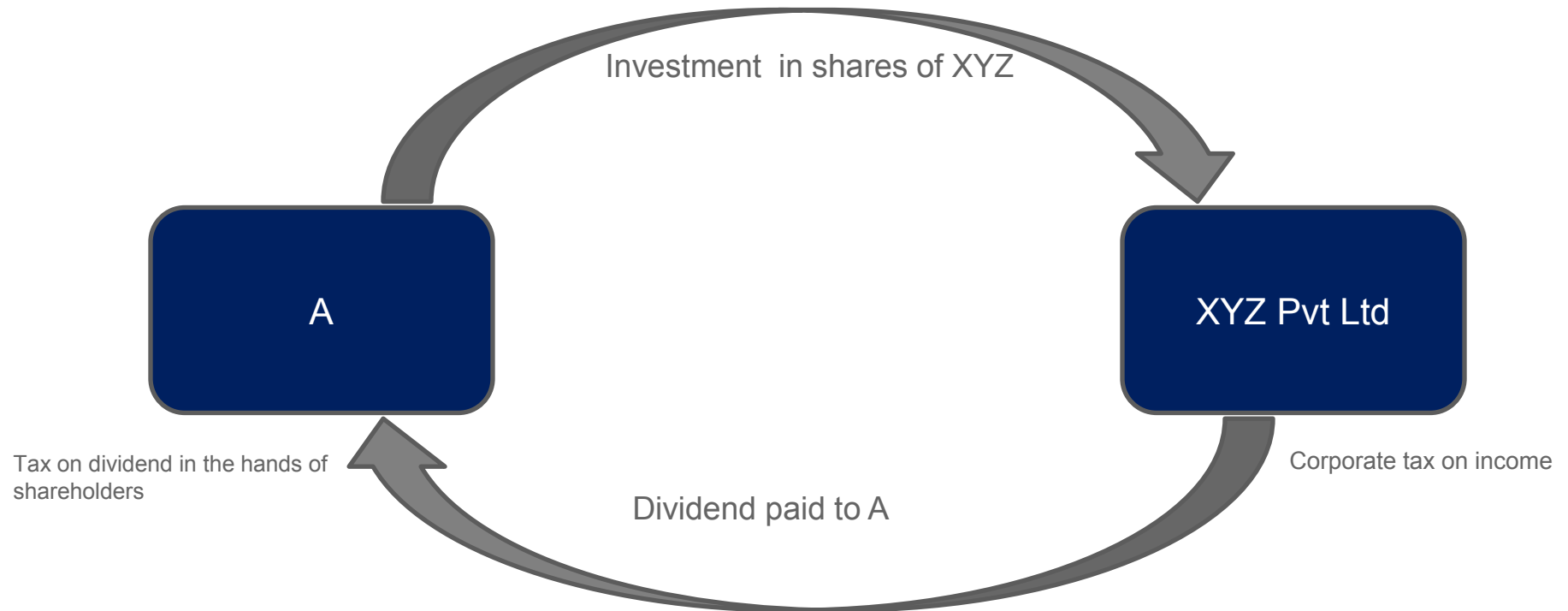
7. Place of effective management (**'POEM'**)

Introduction

Why does double taxation occur?



Economic Double Taxation Contd



Same economic transaction, item of income is taxed in the hands of different tax payers

Economic Double Taxation



Remedy from double taxation in India

▶ Section 90

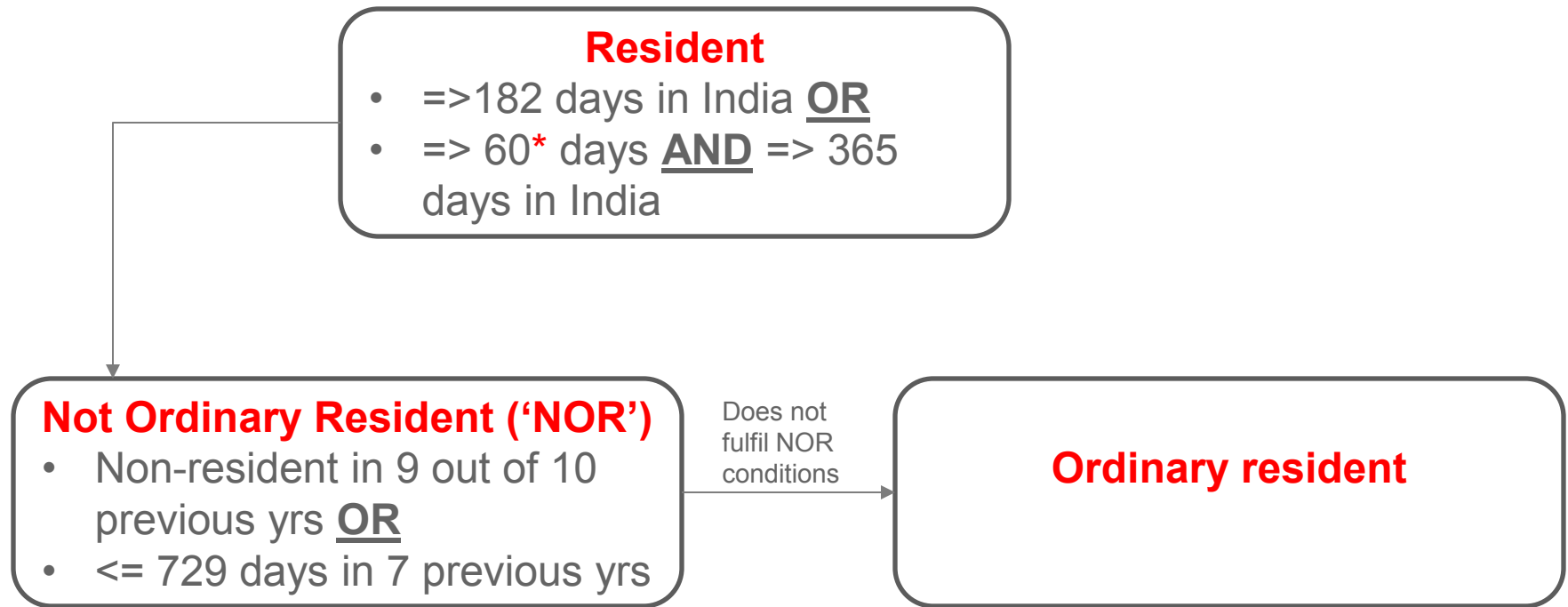
- ▶ Tax payer has the option to be taxed under the provisions of the tax treaty or the domestic tax laws, whichever are more beneficial
- ▶ CBDT Circular 333 - Specific provisions of the tax treaty override the general provisions of the domestic tax laws

▶ Section 91

- ▶ Relief from double taxation in countries with which India has no tax treaties
- ▶ Person resident in India is allowed credit for foreign taxes paid (in respect of income accruing or arising outside India) against the Indian taxes as per prescribed rules

Residence

Residence – Section 6 of Income tax Act



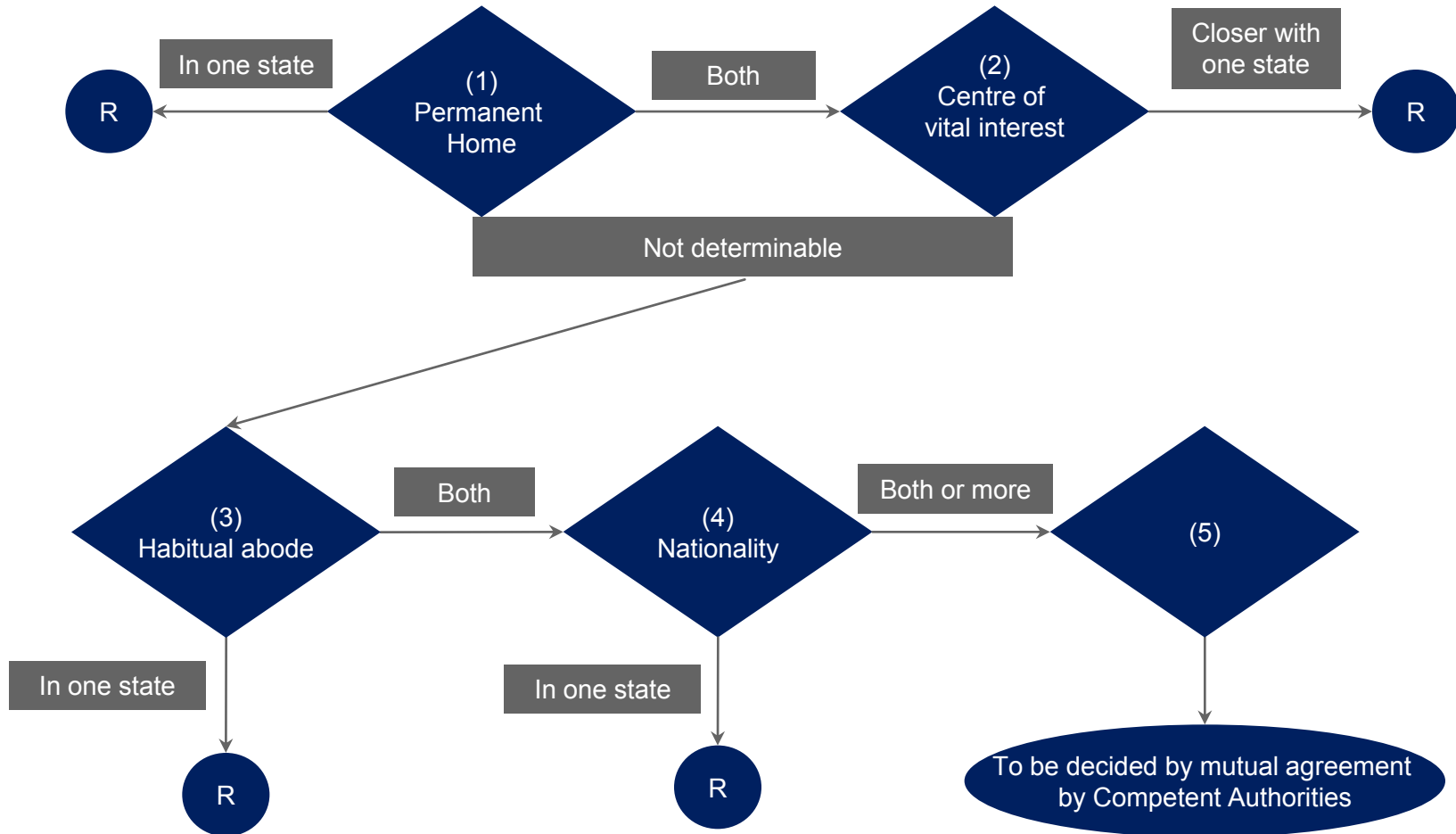
*60 days is substituted by 182 days in the following cases:

- Leaving India as a member of crew on Indian ships or for the purpose of employment outside India
- Indian citizen / PIO who comes on a visit to India

Article 4 – Resident

- ▶ In order to claim treaty benefit, a person should be resident of one of the contracting states
- ▶ A person is a resident of a country if he is **liable to tax** in the country by virtue of:
 - ▶ Domicile
 - ▶ Residence
 - ▶ Place of management
 - ▶ Any other criterion of a similar nature
- ▶ Does not include persons who are liable to tax only by virtue of source
- ▶ Certain treaties expression used is subject to tax [e.g. India – Sweden tax treaty, India US tax treaty] - Liable to tax v/s subject to tax
- ▶ In case a person is resident of both countries
 - ▶ In the case of an individual -- tie breaker rule determines residency
 - ▶ In any other case -- the place of effective management determines residency

Residence of individuals -- Tie breaker rule



Scope of total income

Scope of total income

Ordinary Resident

- Accrue/ arise/ receive or deemed to accrue/ arise or receive in India
- Accrue/ arise/ receive or deemed to accrue/ arise outside India

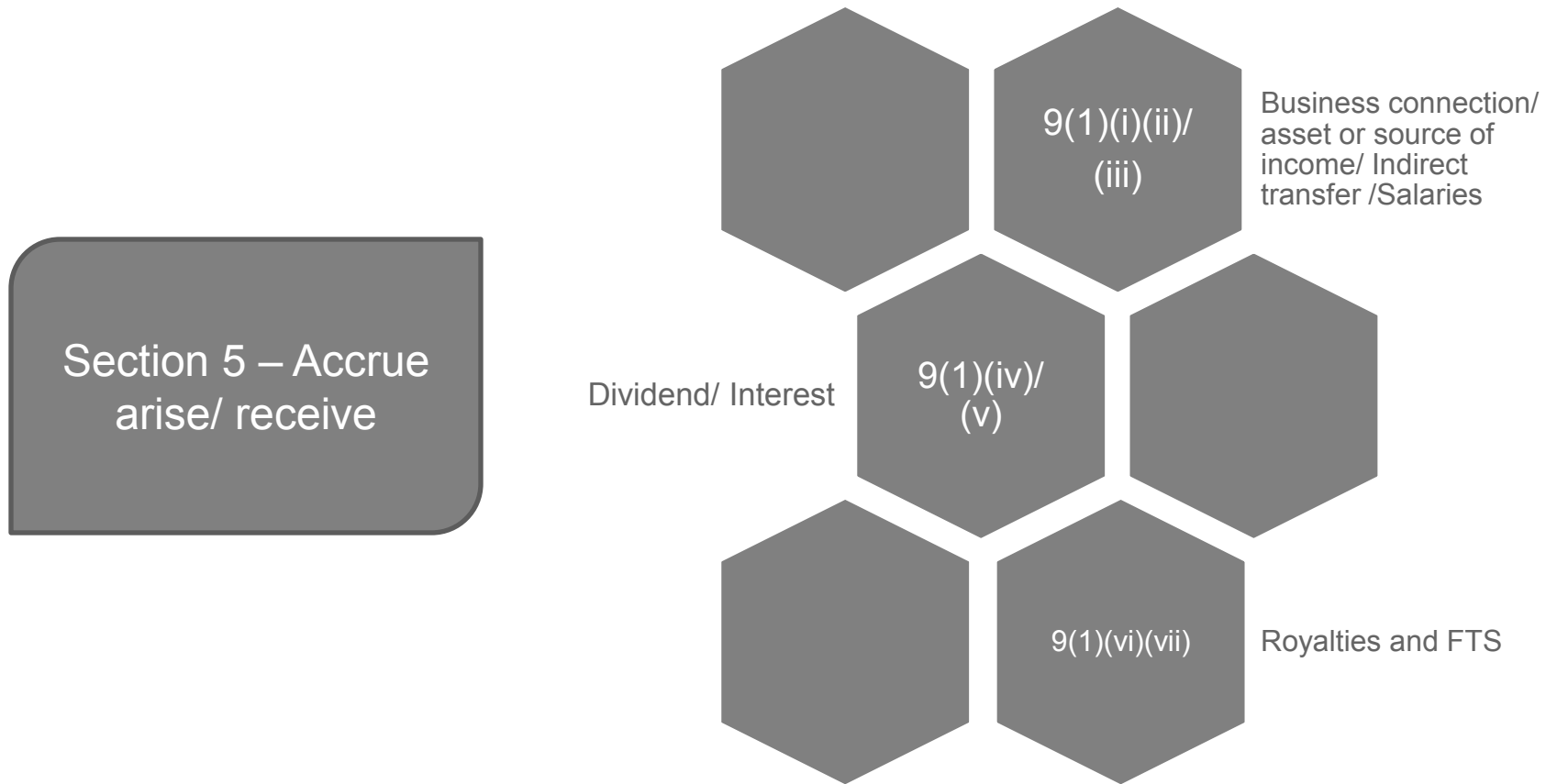
Not Ordinary Resident

- Accrue/ arise/ receive or deemed to accrue/ arise or receive in India
- Income accruing/ arising outside India if from business controlled or profession set up in India

Non-resident

- Accrue/ arise/ receive or deemed to accrue/ arise or receive in India

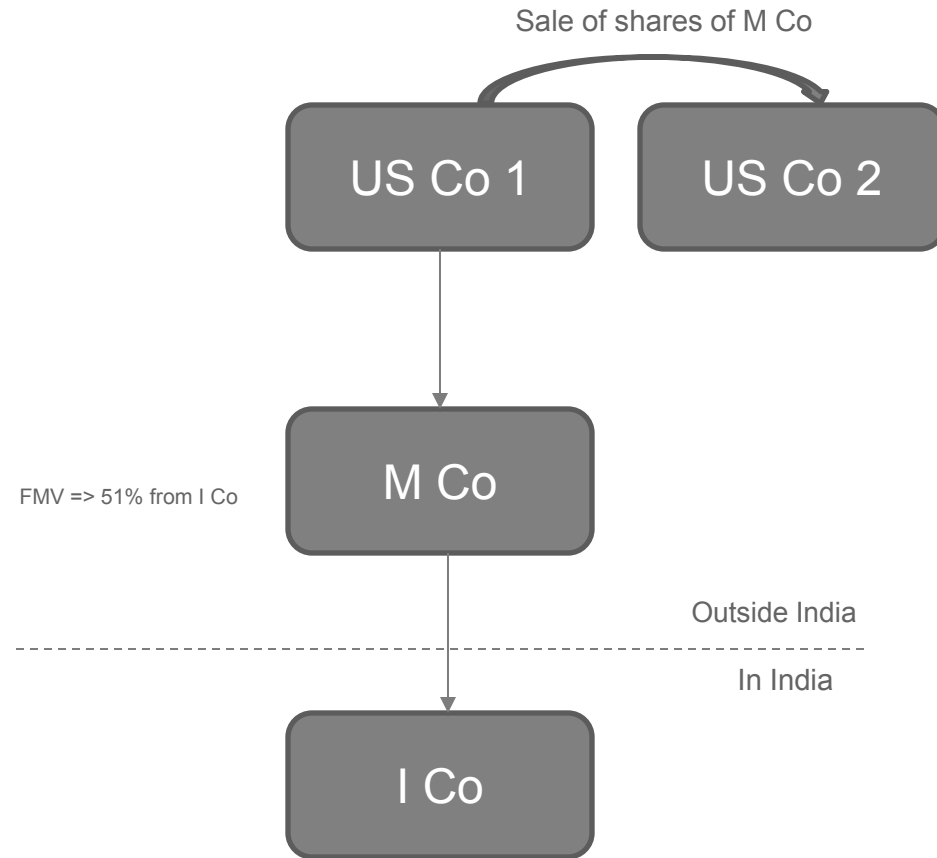
Source rules – Arise / Receive / Deemed to accrue or arise



Treaty source rules different and may be restricted

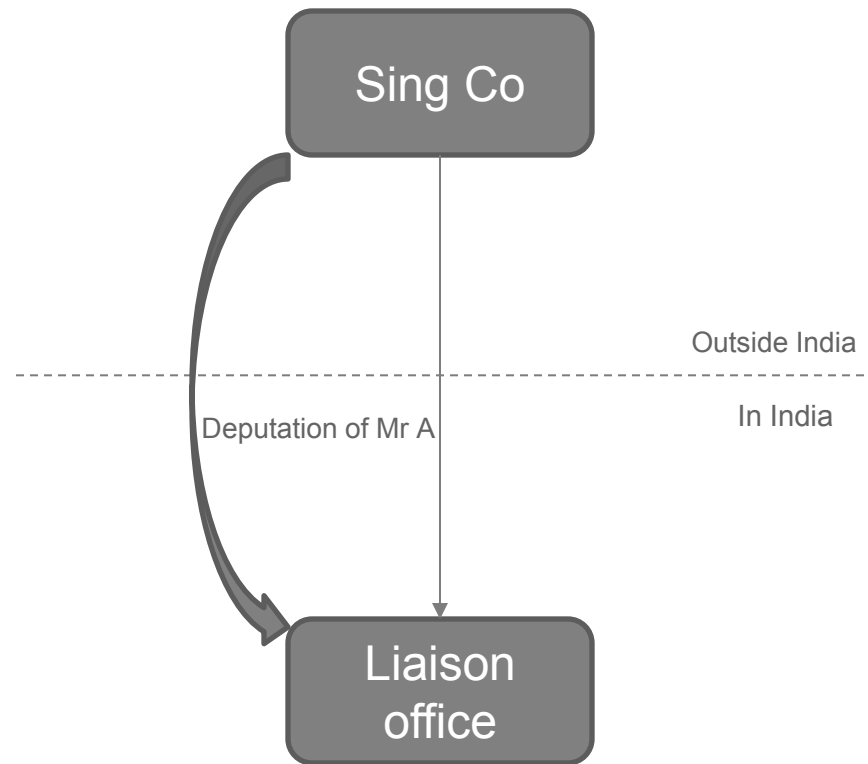
Section 9(1)(i)

- ▶ Income accruing or arising, whether, directly or indirectly, through or from a business connection, asset or source of income in India is deemed to accrue or arise in India except
 - ▶ Activities of news collection, shooting a cinematograph films,
 - ▶ display of cut and polished diamonds in SEZ by foreign diamond mining companies
 - ▶ Mere activities of purchase of goods for export
 - ▶ Section 9A exemption to qualifying Funds
- ▶ Only to the extent of operations in India
- ▶ Share or interest in a foreign entity deemed to be in India, if deriving its value substantially from India.
 - ▶ Category 1 and 2 Foreign Portfolio Investors
 - ▶ Offshore fund vehicles of Category 1 and 2 AIFs [CBDT Circular]



Section 9(1)(ii) & (iii)

- ▶ Income falling under the head 'Salaries' earned in India
- ▶ Earned in India means
 - ▶ Services rendered in India
 - ▶ Leave period (preceded or succeeded) by services rendered in India and part of contract
- ▶ Salary payable to a citizen of India who is a Government employee, for services outside India
- ▶ Short stay exemption – 10(6)(vi) and 10(6)(viii)
- ▶ Article 15 and Article 19 of tax treaties



Article 15

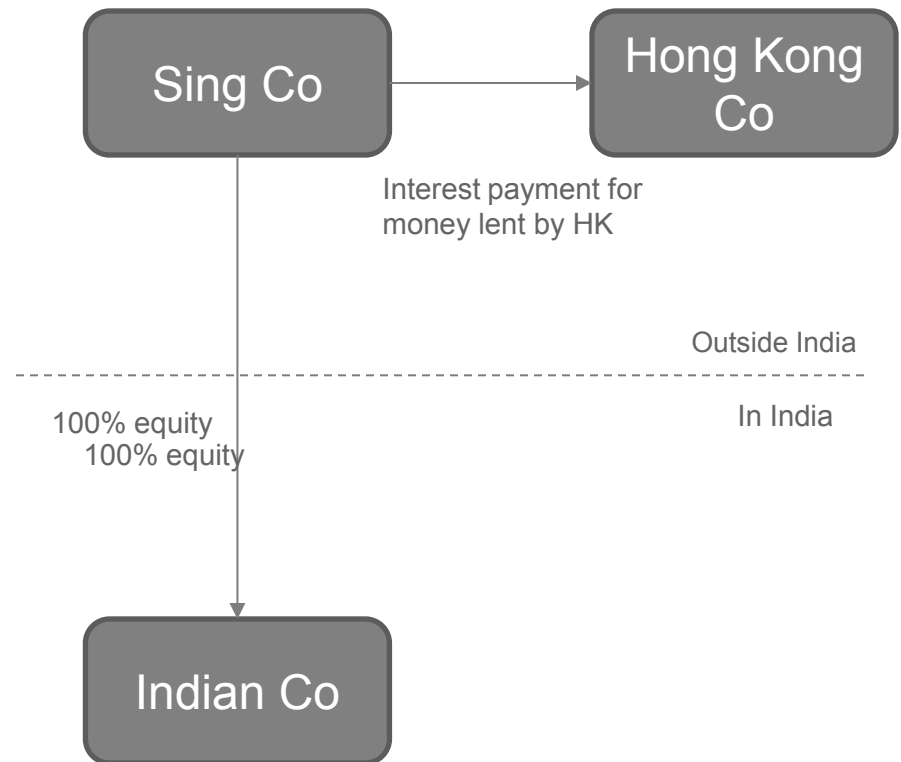
Dependent Personal Service

- ▶ Residence state – right to tax remuneration
- ▶ Source state – right to tax only if employment is exercised therein and any one of the following conditions are satisfied:
 - ▶ Presence in source state for period or periods exceeding 183 days in any 12 month period commencing or ending in the fiscal year concerned
 - ▶ Remuneration is paid by or on behalf of resident of source state
 - ▶ Remuneration is borne by PE which the employer has in the source state

90 day threshold under the Act – relevant in case of non-treaty jurisdiction – section 10(6)(vi)

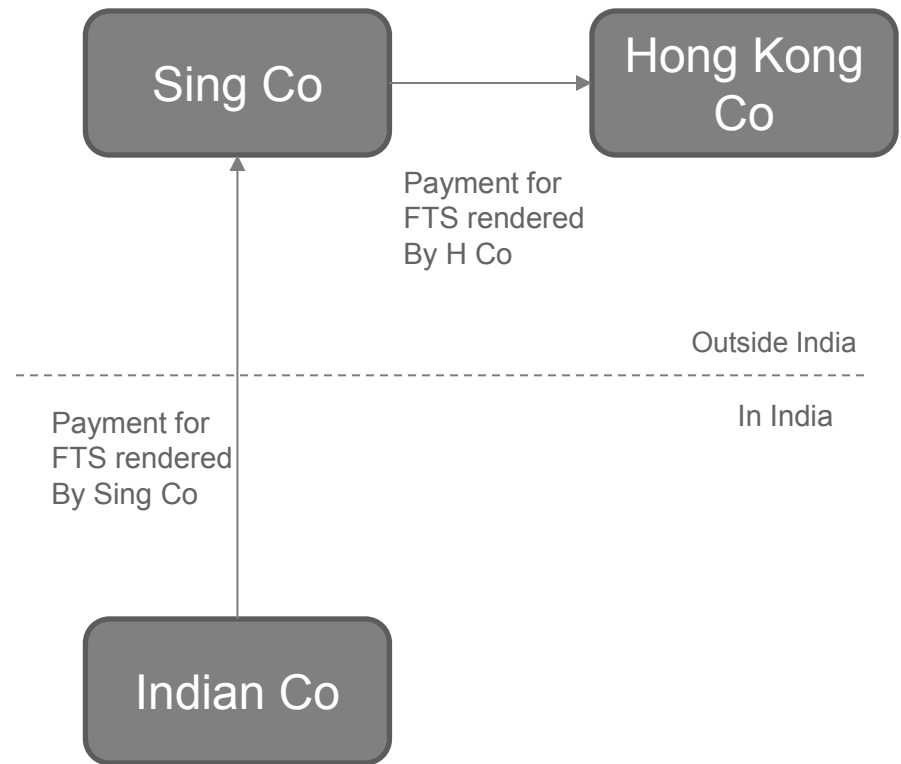
Section 9(1)(iv) & (v)

- ▶ Dividend paid by an Indian Company
- ▶ Interest paid by
 - ▶ Government
 - ▶ Resident EXCEPT where debt incurred for the purpose of business/ profession carried on outside India or earning a source of income outside India, by such person
 - ▶ Non-resident where debt incurred for the purpose of business/ profession carried on by such person in India
 - ▶ Interest paid by an Indian Permanent Establishment of a foreign bank

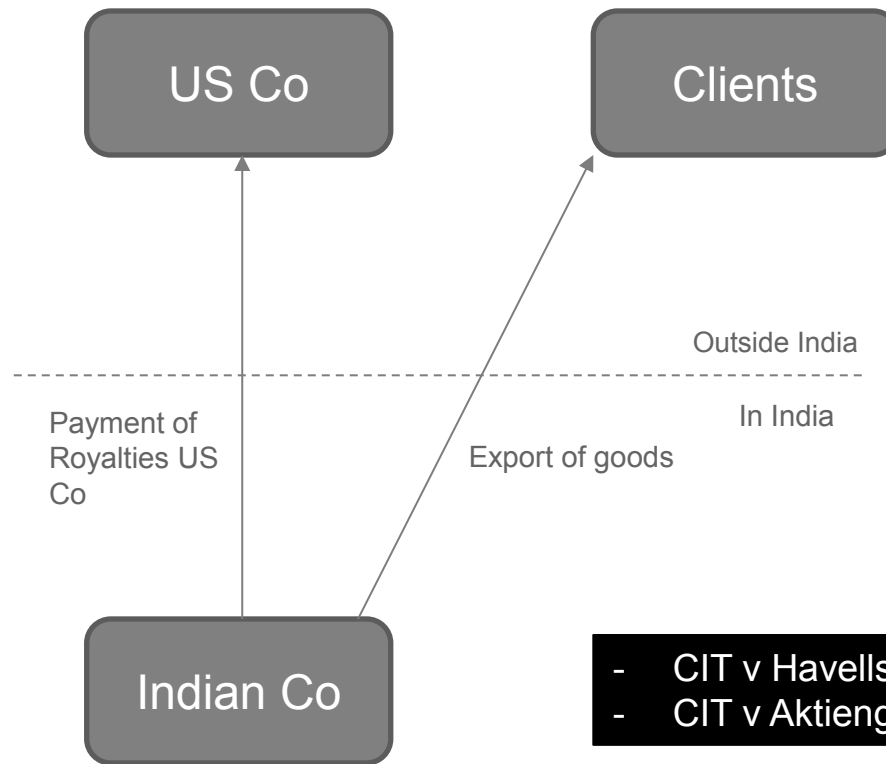


Section 9(1)(vi) & (vii)

- ▶ Section 9(1)(vi) - Royalties
- ▶ Section 9(1)(vii) - FTS means any consideration (including lumpsum) for
 - ▶ Managerial
 - ▶ Technical
 - ▶ Consultancy
 - ▶ Including for provision of services of technical or other personnel) but does not include consideration for
 - ▶ Construction, assembly, mining, or like project
 - ▶ Income taxable under head 'Salaries'
- ▶ Royalties and FTS taxable in India whether or not non-resident has Biz connection or services are rendered in India
- ▶ Royalties and FTS payable by
 - ▶ Government
 - ▶ Resident EXCEPT where debt incurred for the purpose of business/ profession carried on outside India or earning a source of income outside India, by such person
 - ▶ Non-resident where debt incurred for the purpose of business/ profession carried on by such person in India or for the purpose of earning a source of India



What is source in case of exports?



Double tax avoidance agreement (DTAA)

Objectives of a DTAA

- ▶ Elimination of double taxation on income and capital
- ▶ Development of economic relations, trade and investment
- ▶ Enhancing co-operation in tax matters
- ▶ Intending to eliminate double taxation with respect to taxes on income and capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including treat shopping)

Treaty models and Indian tax treaties

- ▶ Model Conventions
 - ▶ OECD Model
 - ▶ UN Model
 - ▶ US Model
 - ▶ Andean model
- ▶ Indian tax treaties

Interpretation of Treaties

Vienna Convention on the law of treaties

- ▶ The Vienna Convention on the Law of Treaties (VCLT) codified in 1969 customary norms of international law; entry into force in 1980
- ▶ Applies to all international treaties including tax treaties
 - ▶ *Article 26 - Every treaty in force is binding upon the parties to it and must be performed by them in good faith*
 - ▶ *Article 27 - Internal law not to be invoked to perform the treaty*
 - ▶ *Article 28 – Do not apply to act or fact which took place prior to entry into force of the relevant tax treaty*
- ▶ 115 states have ratified the VCLT (Nov 2017)
- ▶ Growing number of decisions in international courts refer to the rules in the Vienna Convention
- ▶ India is not a signatory to Vienna Convention

Aids to interpretation

- ▶ Protocols and clarificatory circular
- ▶ OECD/UN model tax conventions and commentary
- ▶ Technical explanation and Memorandum of understanding
- ▶ Parallel treaties
- ▶ Reference to domestic law under Article 3(2)
- ▶ Indian judicial precedents
- ▶ International case laws

Reliance on MC Commentary – Indian perspective

- ▶ Disapproving reference to OECD/UN commentary
 - ▶ P. No. 28 of 1999 242 ITR 208 - AAR “**refused**” to follow the OECD Commentary observing that it is “contrary to the well-established principle of statutory interpretation”
 - ▶ CIT v S.R.M.Firm and Others 208 ITR 400 (Mad) - Observations may give an impression that reliance upon the OECD Commentary is “**inappropriate**” and “**unjustified**”
- ▶ Reliance placed by the Indian Revenue on the OECD Commentary
 - ▶ Indian Revenue has itself placed reliance on the OECD Commentary when it found the Commentary to support its contentions
 - ▶ British Airways Plc. vs. DCIT 73 TTJ 519 (Del)
 - ▶ CIT vs. Vijay Ship Breaking 261 ITR 113 - Gujarat High Court “followed” the OECD Commentary

OECD/UN Commentary

- ▶ Relevance of the “revised” OECD / UN Commentary in construing a treaty signed “prior” to the revision
 - ▶ P No 30 of 1999 238 ITR 296 - AAR held that a **“useful reference”** could be made to the revised OECD Commentary and that the tax treatment **“has to conform”** to the revised Commentary **“to accommodate the emerging developments”**
 - ▶ Many amendments are intended to simply, clarify, not change, the meaning of the articles or the commentaries, and such a contrary interpretation would clearly be wrong in those cases – OECD Commentary
- ▶ Base Erosion and Profit Shifting work - Multilateral Instrument – Minimum standards (Changes to preamble, Prevention of treaty abuse, TP documentation and country by country reporting and Improving dispute resolution,

Key articles of tax treaty

Anatomy of a typical tax treaty

- ▶ The Articles of a Convention can be divided into the following six groups for the purpose of analysis
 - ▶ **Scope provisions** -- These provisions determine the persons, taxes and time period covered by the Treaty (personal scope, taxes covered, entry into force, termination)
 - ▶ **Definition provisions** -- These include Article 3 (General Definitions), 4 (Residence) and 5 (Permanent Establishment) as well as definition of some of the substantive provisions of the Treaty
 - ▶ **Substantive provisions** -- Articles which apply to particular categories of income and allocate tax jurisdictions between contracting states
 - ▶ **Provisions of elimination of double taxation** -- Includes Mutual Agreement
 - ▶ **Anti-avoidance provisions** - Exchange of information, Limitation of benefits
 - ▶ **Miscellaneous provisions** -- Non-discrimination

Anatomy of a typical tax treaty ... (contd.)

SCOPE PROVISIONS

- ▶ Article 1 - Personal Scope
- ▶ Article 2 - Taxes covered
- ▶ Article 29 - Entry into force
- ▶ Article 30 - Termination

DEFINITIVE PROVISIONS

- ▶ Article 3 - General definitions
- ▶ Article 4 - Residence
- ▶ Article 5 - Permanent establishment

SUBSTANTIVE PROVISIONS

- ▶ Article 6 – Immovable property
- ▶ Article 7 – Business Profits
- ▶ Article 8 – Shipping, etc
- ▶ Article 10 - Dividends
- ▶ Article 11 - Interest
- ▶ Article 12 – Royalties & FTS
- ▶ Article 13 – Capital gains
- ▶ Article 14 – Independent personal services
- ▶ Article 15 – Dependent personal services
- ▶ Article 16 - Directors
- ▶ Article 17 – Artistes and Sports persons
- ▶ Article 18 - Pensions
- ▶ Article 19 – Government service
- ▶ Article 20 - Students
- ▶ Article 21 – Other income
- ▶ Article 22 - Capital

ANTI - AVOIDANCE

- Article 9 - Associated enterprise
- Article 26 - Exchange of Information

ELIMINATION OF DOUBLE TAXATION

- ▶ Article 23 - Elimination of double taxation
- ▶ Article 25 - Mutual agreement

MISCELLANEOUS PROVISIONS

- ▶ Article 24 - Non-discrimination
- ▶ Article 27 - Diplomats
- ▶ Article 28 - Terminal extension

Article 3 - General definitions

▶ Key definitions

- ▶ Company -- Body corporate or entity treated as company or body corporate for tax purposes
- ▶ Contracting state -- India or the other country
- ▶ Enterprise of a Contracting State -- enterprise carried on by a resident
- ▶ Fiscal year -- previous year
- ▶ Person -- Individual, company, taxable unit
- ▶ Tax -- typically does not include interest or penalty

Article 5 – PE - significance

- ▶ Concept of PE is important for different articles of a tax treaty, especially Article 7 (Business profits are taxable only if there is a PE)
- ▶ The concept of PE is used to determine the right of the Source State to tax the business profits of the foreign enterprise
- ▶ Article on PE
 - ▶ Fixed place PE
 - ▶ Agency PE
 - ▶ Service PE
 - ▶ Construction PE
 - ▶ Insurance PE

Fixed PE - Conditions to be satisfied

- ▶ Article 5(1)
 - ▶ There is an “enterprise”
 - ▶ It is carrying on “business”
 - ▶ There is a “place of business” (“Place of business” test)
 - ▶ This place of business is at the “disposal” of the enterprise (“Power of disposition” test)
 - ▶ This place of business should be “fixed” (“Location” or “Permanence” test)
 - ▶ Business of the enterprise should be carried on wholly or partly through this fixed place of business (“Business activity” and “Business connection” test)

Fixed PE - Place of business

- ▶ The term 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose.
- ▶ Power of disposition test
- ▶ Place of business has to be fixed
 - ▶ Location test
 - ▶ Permanence test
- ▶ Duration Test
 - ▶ **OECD Commentary** – *PEs normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months*
 - ▶ **Klaus Vogel** - *PE is usually constituted when the duration for which the activities have been carried on are for at least 6 months or more, and almost always constituted in cases where the duration of activities are for more than 18 months*

Fixed PE - Exception to basic rule

▶ **Auxiliary** - Aiding; attendant on; ancillary. **Ancillary** – Aiding; attendant upon; describing a proceeding attendant upon or which aids another proceeding considered as principal. Auxiliary or subordinate. **Aid** - To support, help, assist or strengthen; act in co-operation with; supplement the efforts of others. **Prepare** - To provide with necessary means; to make ready; to provide with what is appropriate or necessary.

▶ Examples of preparatory and auxiliary activities

- ▶ Back office operations
- ▶ Advertising of goods or services
- ▶ Gathering market data for the enterprise
- ▶ Supplying information

▶ The decisive criteria is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole.

Agency PE

▶ Conditions

- ▶ The person is a 'an agent' of the enterprise;
- ▶ He is an agent other than 'an agent of independent status' of the overseas enterprise.

▶ Independent Agent

- ▶ An agent is considered to be an independent agent if the following conditions are satisfied:
 - ▶ the agent is independent of the enterprise both legally and economically;
 - ▶ he is acting in the ordinary course of his business; and
 - ▶ his activities are not wholly/almost wholly devoted to the enterprise.

▶ As a dependant agent, he:

- ▶ has and habitually exercises in India, an authority to conclude contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods for the enterprise,
- ▶ habitually maintains in India, a stock of goods or merchandise, from which he regularly delivers goods for or on behalf of the enterprise, or
- ▶ habitually secures orders in India, wholly or almost wholly, for the enterprise or an affiliate of the enterprise

Service PE

- ▶ A PE could be constituted in India under the Service PE clause where any enterprise:
 - ▶ *furnishes services in India (other fees for technical services)*
 - ▶ *through employees or other personnel*
 - ▶ *for a specified period*
- ▶ Do the basic conditions of fixed place PE need to be satisfied for a service PE to be constituted?
- ▶ Morgan Stanley ruling – SC
 - ▶ Deputation arrangement could constitute a service PE
 - ▶ Stewardship activities (e.g. briefing staff, monitoring outsourcing, day to day management) do not result in a PE

Construction PE and Insurance PE

- ▶ Construction PE
 - ▶ Building site, a construction, assembly or installation project or supervisory activities in connection with the above;
 - ▶ Such site, project or activities last more than six months in any 12 month period.
- ▶ Insurance PE
 - ▶ Does not correspond to provisions of the OECD model; peculiar to UN model
 - ▶ Insurance PE constituted where an enterprise insures risks or collects premium in the other State (other than through an independent agent)
 - ▶ Does not apply to reinsurance business

Key substantive provisions

- ▶ DTAA categorizes income under different heads, some of which are as follows:
 - ▶ Immovable property
 - ▶ Business income
 - ▶ Dividend, interest, royalties and fees for technical services
 - ▶ Independent personal services
 - ▶ Dependent personal services
 - ▶ Capital gains
 - ▶ Other income

Article 6 and 7

▶ Article 6- Income from immovable property

- ▶ Primary right to tax has been provided to the state where the property is situated.

▶ Article 7- Business profits

- ▶ Business profits of an enterprise is taxable in the state of residence, unless it carries on business in the other state through a PE.
- ▶ Profits may be taxed in the state of PE but only to the extent attributable to
 - ▶ PE
 - ▶ Arising from the sale of goods or merchandise in the country which are same or of a similar to those sold through the PE
 - ▶ Arising from other business activities carried on in the country which are the same or of a similar kind as those effected through a PE (**Force of attraction**)

Article 7

- ▶ Attribution rule- Profits it might be expected to make if it were a separate and distinct enterprise
- ▶ Deduction of allocable head office expenses allowed subject to provisions of the domestic law
- ▶ Deduction/income for royalty, commission, management services, interest on moneys lent (except in the case of banking enterprise) not to be considered in computing profits

Article 10, 11 and 12

- ▶ Dividend, (Article 10) Interest (Article 11) , Royalties and Fees for technical services (Article 12)
 - ▶ Grants the source state to tax the income, however this right is limited to the rates prescribed.
 - ▶ Recipient must be the beneficial owner.
 - ▶ Anti-avoidance measures –”Substance over form”
 - ▶ Taxable on a gross basis.
 - ▶ Income from dividends, interest, royalty and fees for technical services, if attributable to a PE shall be taxable on a net basis as business profits/independent personal services
 - ▶ Source rules under these articles restricted than under the domestic law

Article 10, 11 and 12

Nature of income	Indicative rates	Remarks
Dividend	5%/ 10/ 15%	Lower rate if holding $\geq 10\%$
Interest	0%/ 10%/ 15%	Lower rate for payments to specific institutions, banks or financial institutions
Royalty	0%/ 10%/ 15%	Lower rate for use of industrial, commercial or scientific equipment
Fees for included services	0/ 10%/ 15%	Lower rate for services ancillary and subsidiary to the lease of equipment.

Article 10, 11 and 12

▶ Royalties

- ▶ Definition under the Treaty similar to that under the Act [Section 9(1)(vi)]
- ▶ Certain treaties do not have ICS equipment clause [e.g. Sweden, Israel]

▶ Fees for technical services

- ▶ Definition under the Treaty similar to that under the Act [Section 9(1)(vii)]
- ▶ Restricted Source rule under certain treaties [e.g. US, Canada, UK]
 - ▶ Payments for rendering of any technical or consultancy services, if such services:
 - ▶ are ancillary and subsidiary to application or enjoyment of right, property, or information for which royalty is received, or
 - ▶ **make available** technical knowledge, experience, skill, know-how, or processes, or consist of development and transfer of a technical plan or technical design.
 - ▶ Key exclusions
 - ▶ Services for the personal use of individual;
 - ▶ Teaching in or by educational institutions; etc

Article 10, 11 and 12

▶ Fees for technical services

▶ What is make available?

- ▶ Technology will be considered 'made available' when person acquiring service is enabled to apply the technology
- ▶ The fact that the provision of the service requires technical input by the person providing the service does not per se mean that technical knowledge, skills, etc, are made available to the person purchasing the service
- ▶ The use of a product which embodies technology shall not per se be considered to make the technology available

Article 13 – Capital gains

Sr No	Nature of property alienated	Right of taxation
1	Immovable property	Country in which property is situated
2	Capital stock/ shares of company, interest in firm, trust estate property of which principally consists of immovable property	Country in which property is situated -Principally - > 50% Certain treaties – specifically exclude listed companies
3	Shares (other than those in 2 above) of a company resident in other state	Country in which company is resident
4	Any property forming part of business property of a PE (including on disposal of PE)	Country in which PE is situated
5	Any other property	Country in which alienator is resident

Article 14

Independent personal service

- ▶ Deals with taxation of income in respect of professional services or other activities of independent character
- ▶ Taxable in source state
 - ▶ If regular fixed base available in that state or
 - ▶ Stay exceeds 183 days in any 12 months period
 - ▶ Amount taxable – only amount attributable to fixed base or activities carried out in source state
- ▶ OECD model convention deleted this article in 2001
- ▶ Calculation of number of days

Article 21

Other income

- ▶ Income not dealt with any of articles of the treaty
 - ▶ State in which income arises
- ▶ Such income could also be taxed in other State
 - ▶ If the Income is effectively connected with right/ property of the PE or fixed base is the other state
 - ▶ If the income arises in the other state

Elimination of double taxation

- ▶ Relief from Double Taxation
 - ▶ Exemption method
 - ▶ Full exemption; and
 - ▶ Exemption by progression
 - ▶ Credit method
 - ▶ Full credit;
 - ▶ Ordinary credit
 - ▶ India follows mostly credit method
 - ▶ **Underlying tax credit**
 - ▶ **Tax sparing**

Anti-avoidance provisions

▶ Article 26 - Exchange of Information

- ▶ The competent authorities shall exchange information concerning taxes covered for the prevention of fraud or evasion of such taxes.

▶ Article 9 - Associated Enterprise

- ▶ Any profits which, would have accrued to one of the enterprises, but by reason of conditions in their commercial or financial relations have not so accrued, may be included in the profits of that enterprise
- ▶ Corresponding adjustments – provision exists in certain treaties
- ▶ Secondary adjustments – not provided under domestic laws of India

Anti-avoidance provisions... (contd.)

Limitation of benefits

- ▶ Prevention of treaty shopping i.e. setting up of shell entities simply to take advantage of beneficial treaty provisions
- ▶ Provides for fulfillment of certain conditions/ tests by resident companies in order to be eligible to claim benefits of treaty
 - ▶ In the India – US treaty (Article 24)
 - ▶ Beneficial ownership test i.e. who are actual owners holding more than 50% of the company's shares and
 - ▶ Base erosion test i.e. income is not used directly or indirectly to meet liabilities outside the contracting states of a DTAA
 - ▶ Exclusion for active entities and listed entities
 - ▶ Protocol to India-Singapore treaty
 - ▶ Shell or conduit company set-up or where the affairs are arranged with a primary purpose to take the benefit of favorable capital gains clause
 - ▶ Expenditure test
 - ▶ Other treaties
 - ▶ Protocol to India – UAE treaty, India - Luxembourg treaty, India - Armenia treaty

Most favored nation (MFN) clause

- ▶ Extends similar benefits to one country as extended to certain other countries
- ▶ Ensures non-discrimination between a subset of countries
- ▶ Examples of MFN-in terms of
 - ▶ Rates of taxes
 - ▶ Liability to tax
 - ▶ Deductions permissible
- ▶ Extended refund periods under tax treaties
 - ▶ India-Netherlands tax treaty
 - ▶ India-France tax treaty

MFN clause... (contd.)

▶ Eg: Protocol to India/ France tax treaty

“In respect of Dividends, Interest, Royalties, FTS and payment for use of equipments, if under the Convention, Agreement or Protocol signed after 1st Sept 1989 between India and a third State which is a member of the OECD, India limits its taxation at source 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, the same rate or scope as provided for in that Convention on the said items of income shall also apply under this Convention ...”

MFN Clause... (contd.)

The effect of the above clause in the India-France treaty is as follows:

	Indo-France w.e.f 1.4.95	Indo-German w.e.f.1.4.97	Indo-Sweden w.e.f. 1.4.98
Interest	15%	10%	10%
Royalty/FTS	20%	10%	10%
Use of Equipment	20%	10%	NIL

Article 24

Non-discrimination

- ▶ Discrimination on grounds of nationality or ownership is forbidden
- ▶ Non-resident enterprises would not be subject to tax or any other requirement which are more burdensome as compared to those levied on resident enterprises
- ▶ No obligation to grant non-resident individuals personal allowances/relief/reductions, that are available only to resident individuals

Article 25

- ▶ Mutual Agreement Procedure (MAP)
 - ▶ Can be invoked by taxpayer if he considers that the actions of one or both of the Contracting States result or will result for him in taxation, not in accordance with provisions of the tax treaty
 - ▶ Case to be presented within 3 years of date of receipt of notice of taxation not in accordance with the tax treaty
 - ▶ MAP provides for a machinery whereby competent authorities can interact between themselves to resolve issues amicably
 - ▶ Limitation rules do not apply once MAP invoked.

POEM

POEM

- ▶ Applicable from 2016-17
- ▶ A foreign company is regarded as resident in India if the place of effective management is India during that year.
 - ▶ POEM means place where key management and commercial decisions that are necessary for the conduct of business of the entity as a whole, in substance made.
- ▶ PoEM recognizes the concept of substance over form - an entity can have only one place of effective management although it can be resident in multiple countries
- ▶ Determination of PoEM shall be an annual exercise and the process of determining PoEM would be primarily based on the fact whether or not the company is engaged in active business outside India

Place of effective management

Active Business Outside India (ABOI)

- ▶ A company is said to be engaged in ABOI if
 - i. **passive income** is not more than 50% of its total income; **and**
 - ii. less than 50% of its total assets are situated in India; **and**
 - iii. less than 50% of total number of employees are situated / resident in India; **and**
 - iii. Payroll expenses incurred on such employees is less than 50% of its total payroll expenditure
- ▶ In case of a company engaged in an ABOI, the PoEM shall be presumed to be outside India if the majority of board meetings of the company are held outside India
- ▶ Where it is established that such powers of management are exercised by the holding company / other person(s) resident in India, then the PoEM shall be in India
 - For this purpose, merely because the Board of Directors (BoD) follows general and objective principles of global policy of the group laid down by the parent entity which are not specific to any entity(s) per se, then it would not constitute a case of BoD of the company standing aside; General Anti-Avoidance Rules (GAAR) may be triggered in case of abusive/ aggressive planning

The passive income of a company shall be aggregate of,-

- ✓ income from the transactions where both the purchase and sale of goods of a company is from / to its associated enterprises and
- ✓ income by way of royalty, dividend, capital gains, interest (other than in case of banks , financial institutions tc) or rental inc

Where company not engaged in ABOI

- ▶ Determination of PoEM for companies not engaged in ABOI would be a two stage process:
 - i. identification or ascertaining of person(s) who actually make the key management and commercial decision for conduct of the company's business as a whole; and
 - ii. determination of place where these decisions are in fact being made
- ▶ Key points
 - ▶ Location of Board meeting
 - ▶ Delegation by Board
 - ▶ Location of Head Office
 - ▶ Meeting through VC/ Technology
 - ▶ Circular resolution / Round robin voting
 - ▶ Shareholder activity
 - ▶ Secondary factors
- ▶ POEM not applicable where the turnover or gross receipts less than Rs 50 crores in the fiscal year

POEM – safe harbours

- ▶ POEM not applicable where the turnover or gross receipts less than Rs 50 crores in the fiscal year.
- ▶ Certain administrative safe guards have been prescribed as follows in relation to POEM provisions:
 - ▶ AO to seek approval from Commissioner/ Principal Commissioner.
 - ▶ AO shall also obtain approval from collegium of Principal Commissioner before holding POEM of non-resident company is in India.
 - ▶ The collegium so constituted shall provide an opportunity of being hear before issuing directions.

Broad tax implications of POEM in India

Section 115JH – Central Government may notify rules for computation of total income, brought forward losses, unabsorbed depreciation and treatment of a foreign company resident in India

- WDV as per foreign tax records where assessed else accounting records
- B/F losses and unabsorbed depreciation as per foreign tax records where assessed else accounting records
- Financial Statements to be prepared as per Indian Financial Year (where it is different)
- In the case of applicability of more than one provision in respect of withholding taxes, it is clarified that provisions as applicable to a foreign company shall only apply.
- The provisions in respect of making an application to the Tax Authorities for a nil/lower withholding tax order shall apply even to a foreign resident company.
- Once the foreign company is treated as a resident in India by virtue of having its POEM in India, the foreign company would be eligible to claim a credit of taxes paid outside India as per the provisions of the Indian Income Tax Act.
- Indian Income Tax Rules would apply in respect of rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable.
- The tax rate applicable to the companies having POEM in India would be the same as applicable to a foreign company even though they are considered as a resident foreign company.

Royalties – Section 9(1)(vi)

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for

- (i) the transfer of **all or any rights** (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;
- (v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;
- (vi) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or
- (vii) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and(v).

Thank You!

Presenter: Prakash Shah