Western India Regional Council of
The Institute of Chartered Accountants Of India

Direct Tax Refresher Course (DTRC)
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Current Issues in International Taxation in India

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Content Summary

Multilateral Instrument

MLI - Introduction

- Tool to get developed and developing countries with diverse interest, but with a common objective of putting an end to international tax avoidance, to sit across the table and hammer out a consensus, that would in one stroke, amend 3000 bilateral tax treaties.

- On June 7, 2017, 68 countries signed the Multilateral Instrument as part of the first joint signing ceremony held in Paris.

- 8 countries including Cameroon, Côte d'Ivoire, Estonia, Jamaica, Lebanon, Mauritius, Nigeria and Tunisia have expressed their intent to sign the Convention.

- BEPS project has identified 15 Action Plans to address various concerns arising out of tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

MLI - Introduction

- Implementation requires changes to model tax conventions and bilateral tax treaties.

- Sheer number of more than 3000 bilateral tax treaties makes it very burdensome and time consuming, thus limiting the effectiveness of multilateral efforts.

- In this regard, Action 15 contemplated preparation of a Multilateral Instrument ('MLI') to implement the BEPS related measures in tax treaties

- It is a complex instrument divided into VII Parts and running into 39 articles, which once signed and effective, will modify the existing bilateral tax treaties of the countries signatory to the MLI.

MLI – List Of Signing Countries

- Andorra
- Argentina
- Armenia
- Australia
- Austria
- **Belgium**
- Bulgaria
- Burkina Faso
- **Canada**
- Chile
- China
- Colombia
- Costa Rica
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Fiji
- Finland
- France
- Gabon
- Georgia
- **Germany**
- Greece
- Guernsey
- Hong Kong
- Hungary
- Iceland
- **India**
- Indonesia
- Ireland
- Isle of Man
- Israel
- Italy
- **Japan**
- Jersey
- Korea
- Kuwait
- Latvia
- Liechtenstein
- Lithuania
- Luxembourg
- Malta
- Mexico
- Monaco
- **Netherlands**
- New Zealand
- Norway
- Pakistan
- Poland
- Portugal
- Romania
- **Russia**
- San Marino
- Senegal
- Serbia
- Seychelles
- **Singapore**
- Slovak Republic
- Slovenia
- South Africa
- **Spain**
- Sweden
- Switzerland
- Turkey
- **United Kingdom**
- Uruguay

MLI - Structure

MLI - Mechanism

- Allows flexibility to countries by allowing them to specify tax treaties covered, opt out of non-minimum standard provisions and choice to apply optional and alternative provisions.

- **Both the MLI and a bilateral tax treaty CTA will have to be read together to implement the CTA** i.e. MLI does not directly amend treaty provisions but simultaneously applied with treaties.

- The Convention was opened for signature as on December 31, 2016 and a first joint signing ceremony was held in Paris on June 7, 2017. **Signature is the first step in the process of expressing consent to be bound by the Convention, which will become binding only upon ratification**.

- A list of CTAs, **reservations and options chosen by a country is required to be made at the time of signature or when depositing** the instrument of ratification.

MLI - Scope

- The MLI addresses the following action plans:

- MLI also enables countries to include MBTA (Mandatory binding treaty arbitration) in their tax treaties in accordance with the special procedures provided by the MLI.

Key Documents To Assess Modifications By The MLI

Steps For Application Of The MLI

Changes To Safe Harbour Rules

Safe Harbour Rules - Introduction

- Section 92CB of the Income Tax Act, 1961 defines the term "safe harbour" as circumstances in which the income-tax authorities shall accept the transfer price declared by the assessee.

- CBDT notified revised Safe Harbour Rules w.e.f. April 1, 2017 applicable for 3 AY's, i.e., AY 2017-18, AY 2018-19 and AY 2019-20. However, eligible assessees are provided an option to apply margins under earlier or revised rules, whichever is more beneficial.

- Margins for almost all eligible international transactions like IT, ITES, KPO services, contract research services etc. have been revamped except manufacture and export of core & non-core auto components for which margins remain unchanged.

- The Rs 50cr monetary threshold for intra-group loans classification has been removed and instead specifies margins (after taking into account CRISIL based credit rating of AE) based on whether loan amount is denominated in Indian or foreign currency.

Safe Harbour Rules - Introduction

- The revised rules rationalizes margin at 1% p.a. of amount guaranteed for all corporate guarantee transactions.

- Further, a new category of "low value-adding intra group services" under Safe Harbour ambit, specifies that entire value of the international transaction (including a mark-up) should not exceed 5% and should not exceed Rs 10 crore, further the cost pooling method and reasonableness of allocation keys used should be certified by an accountant

Safe Harbour Rules - Comparison

Sr. No.	Eligible International Transaction	Old Margin	Revised Margin
1.	Provision of software development services and Information technology enables services (ITES)	>= 20% if value of transaction does not exceed 500 cr. or >= 22% if value of transaction exceeds 500 cr.	>= 17% if value of transaction does not exceed 100 cr. or >= 18% if value of transaction exceeds 100 cr. but less than 200 cr.
2.	Provision of knowledge process outsourcing services	Operating profit margin to operating expense >= 25%	Value of international transaction <= 200 cr. **and** the operating profit margin to operating expense is – (i) >= 24 % and the Employee Cost to Operating Expense is >= 60%.; (ii) >= 21% and the Employee Cost to Operating Expense is >=40% but < 60% (iii) >= 18% and the Employee Cost to Operating Expense <= 40%

Safe Harbour Rules - Comparison

Sr. No.	Eligible International Transaction	Old Margin	Revised Margin	
3.	Intra-group loan to WOS when amount of loan is in INR	If amount of loan: a) <= 50 cr. SBI base rate as on 30th June of relevant previous year plus 150 bp b) > 50 cr. SBI base rate as on 30th June of relevant previous year plus 300 bp	CRISIL Credit Rating or its equivalent	SBI rate as on 1st April plus:
			AAA to A	175 bp
			BBB-, BBB or BBB+	325 bp
			BB to B	475 bp
			C or D	625 bp
			Not available and loan <= 100 cr. as on 31st March	425 bp
4.	Intra-group loan to WOS when amount of loan is in Foreign Currency	-	CRISIL Credit Rating or its equivalent	LIBOR as on 30th September plus:
			AAA to A	150 bp
			BBB-, BBB or BBB+	300 bp
			BB to B	450 bp
			C or D	600 bp
			Not available and loan <= 100 cr. as on 31st March	400 bp

Safe Harbour Rules - Comparison

Sr. No.	Eligible International Transaction	Old Margin	Revised Margin
5.	Providing corporate guarantee	If amount of guarantee: a) <= 100 cr. Commission or fee of 2% or more p.a. b) > 100 cr. Commission or fee of 1.75% or more p.a.	Commission or fee declared in relation to the eligible international transaction is at the rate not less than one per cent. per annum on the amount guaranteed.
6.	Provision of contract research and development services wholly or partly relating to software development	Operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 30 per cent	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent., where the value of the international transaction does not exceed a sum of two hundred crore rupees.
7.	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 29 per cent.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent., where the value of the international transaction does not exceed a sum of two hundred crore rupees.

Safe Harbour Rules - Comparison

Sr. No.	Eligible International Transaction	Old Margin	Revised Margin
8.	Receipt of low value-adding intra-group services	-	The entire value of the international transaction, including a mark-up not exceeding 5 per cent., does not exceed a sum of ten crore rupees: Provided that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.”

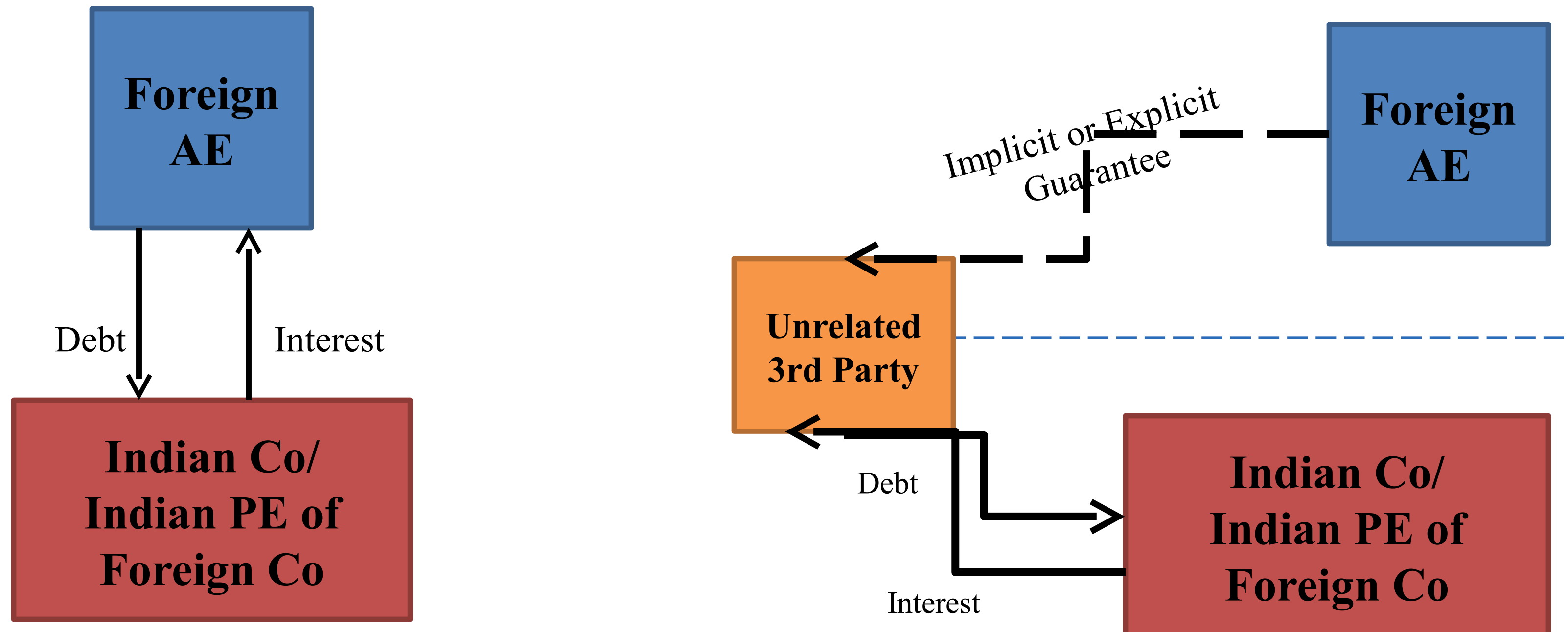
Thin Capitalization Rules

Thin Capitalization Rules

<u>Section 94B (BEPS Action Plan 4)</u>

- Finance Bill proposes to insert Sec 94B in line with recommendation of BEPS Action Plan 4 restricting deduction towards interest paid to non-resident AE to 30% of EBITDA (earnings before interest, taxes, depreciation and amortization).
- Excess interest shall be lower of:
  - Total interest paid (to both AE and non-AE) in excess of 30% of EBITDA; or
  - Interest paid to AEs
- Borrowers being Indian company and Indian PE of foreign entity
- Lender or guarantor has to be non-resident AE
- Excludes banks and insurance companies
- Disallowed interest can be carried forward for 8 subsequent years
- Bombay HC judgement DIT v/s Besix Keir Dabhol S.A. (2012) 210 Taxman 151 (Bombay) – no longer stands as good law

Applicability of Sec.94B



If Interest paid to non-resident AEs or interest paid with respect to loans guaranteed by non-resident AE exceeds Rs. 1 crore

Sec 94B Disallowance Examples

Particulars	Case I	Case II	Case III	Case IV
EBIDTA	1000	1000	1000	(1000)
Interest Paid/ Payable to				
Associated Enterprises	90	90	250	90
Non-AEs	250	350	190	250
Total	**340**	**440**	**440**	**340**
Total Interest % of EBITDA	34%	44%	44%	NA
Excess: lower of				
(a) Excess of 30% of EBITDA	40	140	140	340
(b) AE Interest	90	90	250	90
AE Interest disallowed and to be c/f	**40**	**90**	**140**	**90**
AE interest allowed	**50**	**NIL**	**110**	**NIL**
Non-AE interest allowed	**250**	**350**	**190**	**250**

BEPS 4 v. Sec 94B

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Payee of the interest for which the deduction is Claimed	Covers all interest payments, not only AE interest This is to address a situation where an MNE incurs excessive 3rd party interest expenses in high tax country through excessive borrowing, and funds its subsidiaries located in low/ no tax jurisdictions	Covers only interest payments to non-resident AEs. Accordingly, tax planning arrangements involving third party debts would still not be addressed.

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Amount to be considered for applying the Limit	The limit should be applied to a deduction of net interest expenses, wherein the interest expense, net of interest income, will be considered for deductibility purposes	It limits the **gross** interest expenses incurred by a taxpayer. As also recognised by the OECD, a **gross** interest rule could lead to double taxation, where an entity is subject to tax on its full **gross** interest income, but part of its **gross** interest expense is disallowed.
Exclusion of certain sectors from its Applicability	Banks and insurance companies are excluded. Further, the OECD also recommends the exclusion of certain public-benefit infrastructure companies.	Only banks and insurance companies are excluded, without any mention of public infrastructure companies.

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Manner of computing the EBITDA	The EBITDA should be computed by considering the taxable income in accordance with the local country tax laws. Action Plan 4 discusses that, rather than linking an entity's ability to deduct net interest expense to economic activity in a single year, the impact of short term volatility could be reduced through the use of average EBITDA of few years.	The proposed provisions are silent on the manner of computation of the EBITDA. The Indian taxpayer will need to wait for any clarifications to be issued by the CBDT.
Carry forward/ Carry back provisions	The OECD recommends carry forward and carry back of disallowed interest expenses, wherein the disallowed interest expenses in the current year are allowed to be set-off against future profits and past profits	Only carry forward of disallowed interest expenses is allowed. No carry-backs allowed.

Sec 94B – Issues

- Whether the loan arrangements covered by Sec. 94B be again reviewed by GAAR
- If the interest is to be capitalized to a Fixed Asset, then whether such entire interest which is capitalized or interest in proportion to depreciation claimed shall be considered for the purpose of calculating excess interest
- Is Rs. 1 crore threshold for applicability to be considered on basis of total interest to all non-resident AEs or basis of interest to each non-resident AE?

Sec 94B – Issues

- Whether the guarantee commission paid to the overseas parent for guarantying the borrowings from a third party lender shall be included in determining the threshold of excess interest?

- Even debt given by highly geared non-resident AE to Indian Co/ PE will be covered by the disallowance?

- Increased cost of borrowing – it discourages cheaper borrowing in foreign jurisdictions and re-lending to Indian Co/ PE

Implicit Support v/s Implicit Guarantee

- The concept of “Implicit Support” has been discussed in the case of GE Capital Canada, Inc v/s The Queen (2009): Implicit support is the assumption that a parent would not permit its subsidiary (if it is a “core” subsidiary) to become insolvent and, with or without the guarantee, the parent would be expected to take actions to protect the subsidiary’s creditworthiness in order to, among other things, protect the parent’s investment and its own good name and reputation.

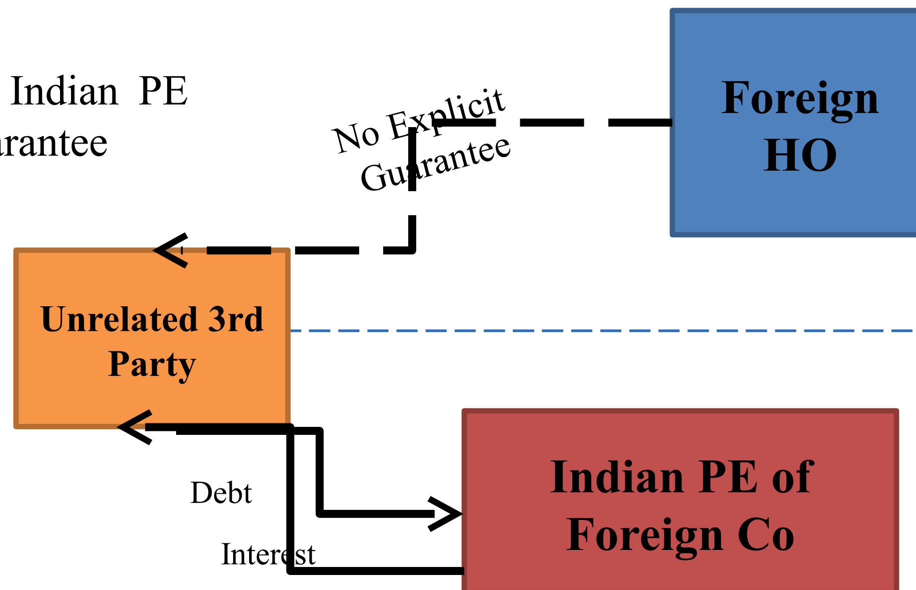
- However, it is accepted that in general, there is often a substantial difference between an explicit guarantee and implicit support since implicit support may be limited to the hope that the parent company will act even though it is not legally bound to do so. There are many examples where parents walk away from subsidiaries in financial difficulty, which indicates that implicit support assumption by a subsidiary’s external creditors can, in practice, be worthless.

- Implicit support can also be assumed where an entity is able to take a loan beyond its standalone credit-worthiness due to the credit-worthiness of the entity as part of a larger MNE group.

- But what is Implicit Guarantee?

Implicit Support v/s Implicit Guarantee

- Ambiguity with respect to meaning of 'implicit guarantee'
- letter of comfort or similar undertakings
- AO may contend that any borrowing by Indian PE from 3rd party lender has HO's implicit guarantee



- Third party Bank giving loans to the Indian PE of the foreign party where no explicit guarantee is given by foreign party
- However, if the Indian PE defaults, then the assets of the foreign HO shall be exposed to the default of Indian PE
- Can this be an implicit guarantee or implicit support so as to attract section 94B limitations?

Secondary Adjustment

Sec 92CE – Secondary Adjustment

- New section 92CE to provide for secondary adjustments in certain cases, in order to align TP provisions with OECD TP Guidelines and "international best practices"
- If total income increases (or loss decreases) as a result of a primary adjustment, the excess money available with the AE will be treated as an advance if not repatriated to India within the prescribed time, and interest on such advance shall be computed as income of assessee
- "Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee
- "Secondary adjustment" means an adjustment in the books of account of the assessee and its AE to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

Sec 92CE – Secondary Adjustment

- The secondary adjustment will not be made if primary adjustment does not exceed Rs. 1 Cr and if primary adjustment was made for the assessment years up to AY 2016-17

- This amendment will apply from AY 2018-19 and onwards.

Methods of SA

- OECD TP Guidelines discusses two methods of making Secondary Adjustments:
  - Constructive Dividends – excess profits are treated as a deemed dividend
  - Equity Contribution Rule – excess profits are treated as deemed equity contribution

- These 2 methods benefit from being one-off adjustments that require minimal on-going monitoring or administration.

Sec 92CE – Issues

South Africa tried the deemed loan route and moved to a deemed dividend about three years after introducing the deemed loan. The main issues faced in South Africa were:

- If a taxpayer did not repay the deemed loan, interest would incur. The first issue was to calculate a deemed (arm's length) interest rate
- Should one get across the hurdle of calculating the deemed interest which incurs annually, the other related party does not have an obligation in its books to actually repay the loan (as there is no corresponding entry)
- Furthermore, in South Africa, no one (neither taxpayer nor tax authority) really kept track of the increasing deemed debt which could render a taxpayer insolvent if this carried on for too long, which brings other issues.

Sec 92CE – Issues

Does treaty permit Secondary Adjustments?

OECD Commentary on Article 9 of the OECD Model Tax Convention (clause 8 and 9 on article 9):

"*It is not the purpose of this paragraph to deal with what might be called "secondary adjustments". ...*

... These secondary adjustments which would be required to establish the situation exactly as it would have been if transactions had been at arm's length, depend on the facts of the individual case. It should be noted that nothing in paragraph 2 prevents such secondary adjustments from being made where they are permitted under the domestic laws of Contracting State."

Sec 92CE – Issues

Economic Double Taxation:

- The OECD commentary on Article 9 of the OECD Model Tax Convention states [clause 5 and 6 on article 9]:

"The re-writing of transactions between associated enterprises in the situation envisages in paragraph 1 may give rise to economic double taxation, insofar as an enterprise of State A whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in State B. Paragraph 2 provides that in these circumstances, State B shall make an appropriate adjustment so as to relieve the double taxation.

It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length."

- Even the European Commission's Final Report on Secondary Adjustments of 2012 reiterates this stance.
- Access to MAP to redress Economic Double Taxation may be difficult.

Sec 92CE – Issues

Practical difficulties in repatriation of "advance"

- law of AE's jurisdiction may not allow repatriation if the order making the primary adjustment is passed with respect to transaction 4-5 years ago
- The exchange control regulations of AE's jurisdiction may prevent such repatriation
- if the entity with which transaction took place ceases to be an AE
- if the AE ceases to be in existence when order making primary adjustment is passed

➢ If repatriation is not possible, impact of secondary adjustment will be PERPETUAL

➢ Should secondary adjustment be in the nature of constructive capital contribution?

Sec 92CE – Issues

<u>Distinction between DEPENDENCE v/s CONTROL</u> – if the entity is an AE due to clause (g) [IPR dependency] or clause (h) [supply dependency] or clause (i) [sale dependency] of section 92A(2), it may not be possible to direct AE to repatriate.

Chennai Tribunal decision Orchid Pharma Ltd v. DCIT – [2016] 162 ITD 30

The fact that an enterprise can "influence prices and other conditions related to sale" does not make it an AE of the assessee if it does not participate in the (a) capital, (b) management, or (c) control of the assessee and thus does not fulfil the basic rule u/s 92A(1). S 92A(2)(i) has to be read with section 92A(1). Even if the conditions of section 92A(2)(i) are fulfilled, these enterprise cannot be treated as AEs if the requirements of section 92A(1) are not fulfilled."

A moot question for considerations, as a common sense approach:

A teenager is dependent on the parents, but in today's context, can the father say that he controls the teenager?

Sec 92CE – Issues

- Is section 94B (2) to be read independent of section 94B(1)?
- Will SA be subject to MAT in year of receipt – this can lead to double taxation, 1st when adjustment is made and again when amount is actually received?
- What if AE is financially unsound and is unable to repatriate – will year-on-year SA be made?
- Will SA interest be included while computing accumulated reserves for deemed dividend considerations?
- Compatibility with Company law provisions relating to ‘loans or advances’? Could create complications under company law [e.g.: due to such advance exceeding limits u/s. 186 of the Companies Act 2013]

Sec 92CE – Issues

- Will SA entail penal consequences?
- Will TP documentation & reporting requirements apply to the "advance" and the imputed interest?
- If foreign withholding tax applies while repatriating the "advance" will foreign tax credit be given in India? At what rate will such FTC be given? What would be the nature of such receipts – if the jurisdiction of the foreign AE treats the payment as a dividend and accordingly WHT applies, will India still give FTC?
- In case foreign AE is subsidiary, if the "advance" arising out of SA is capitalized under FEMA's ODI regulations, or if such amount is adjusted against amounts payable to AE, will the advance be considered to have been repatriated?

Place of Effective Management

POEM Guidelines

- On 24th January, 2017, before the Budget was announced, the CBDT issued a circular containing Guiding Principles for determination of POEM of a Company.

- The guidelines contain the manner in which a company's POEM has to be determined under different circumstances and situations, considering various factors. The guidelines also contain illustrations to clarify the situations whether POEM shall or shall not apply.

- The Press Release states that the POEM guidelines shall not apply to companies having turnover or gross receipts of Rs. 50 crore or less.

POEM Guidelines

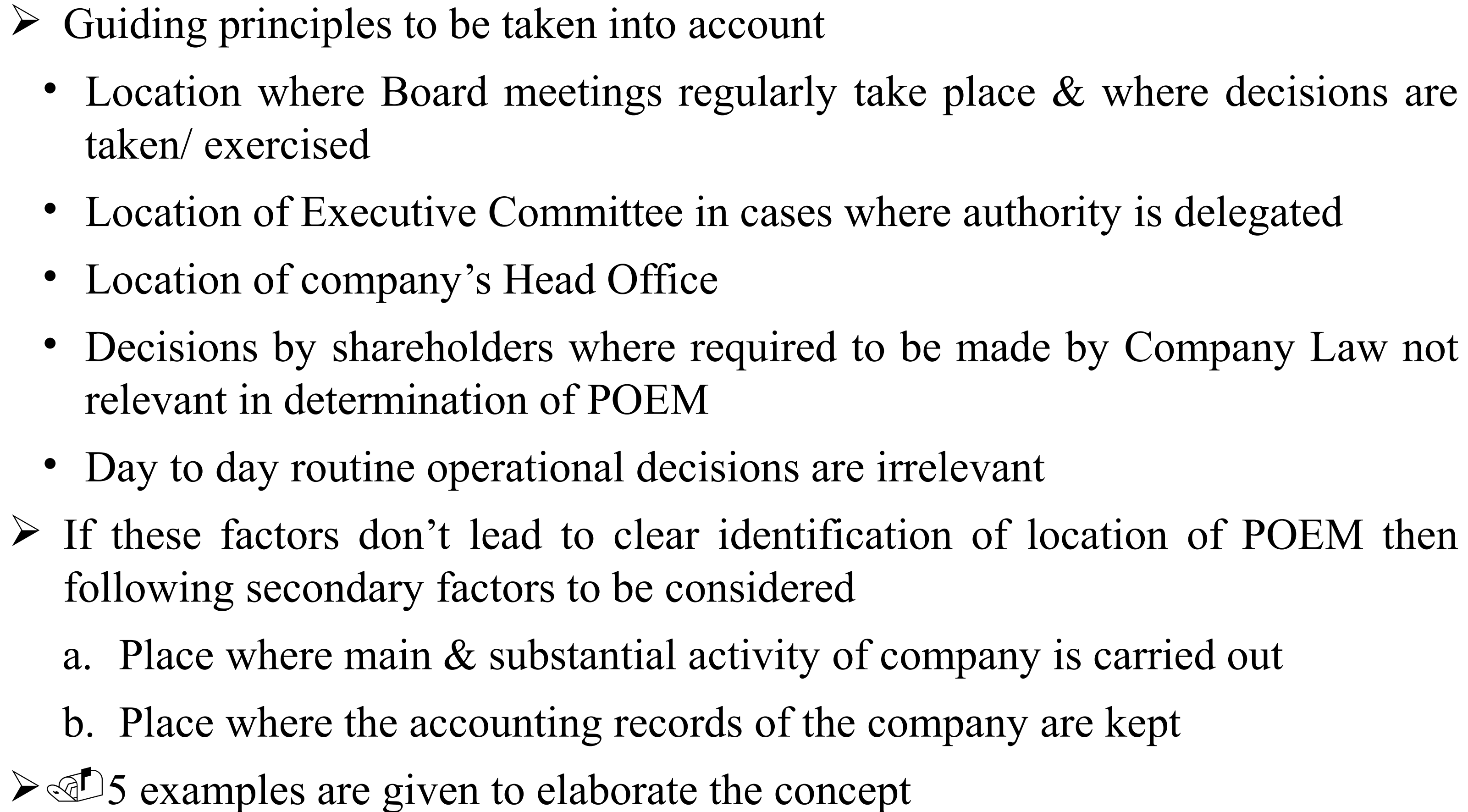
Few Important Aspects from the Guidelines

- Fact based, Year on Year determination of POEM.
- Intent not to target MNEs – shell/ conduit overseas companies are target
- POEM of "active" business entity is outside India if majority Board meetings are held outside India
- AO shall take prior approval of Pr. CIT.
- 3 member collegium to take final call if POEM held to be in India
- Opportunity to taxpayer before adjudicating the issue
- Active & Passive Business Outside India – definition & guidelines
- Determination of POEM to be a two-staged process

  (1) identifying KMPs & decision makers

  (2) Determination of place where decisions are in fact made

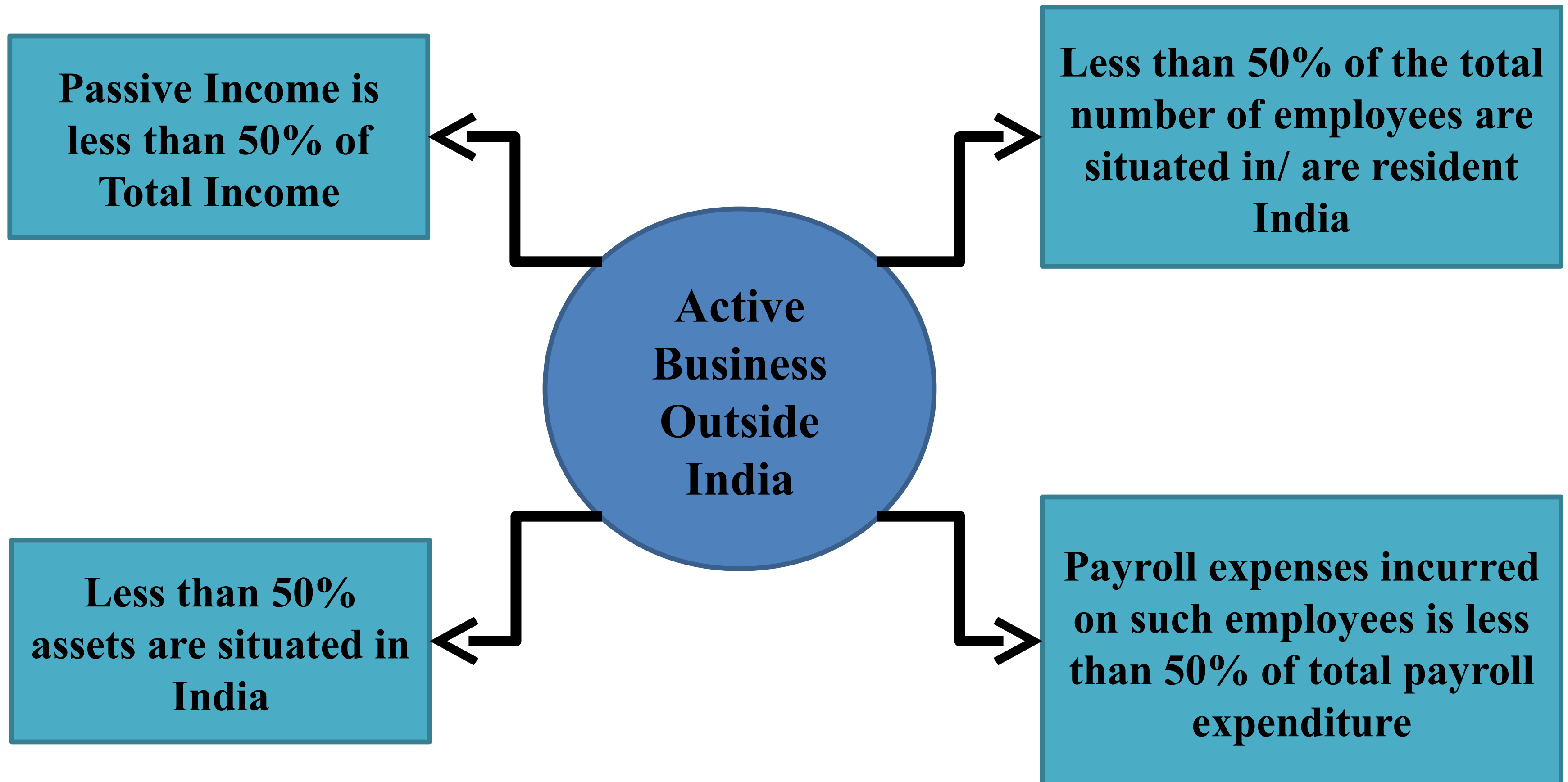
POEM Guidelines

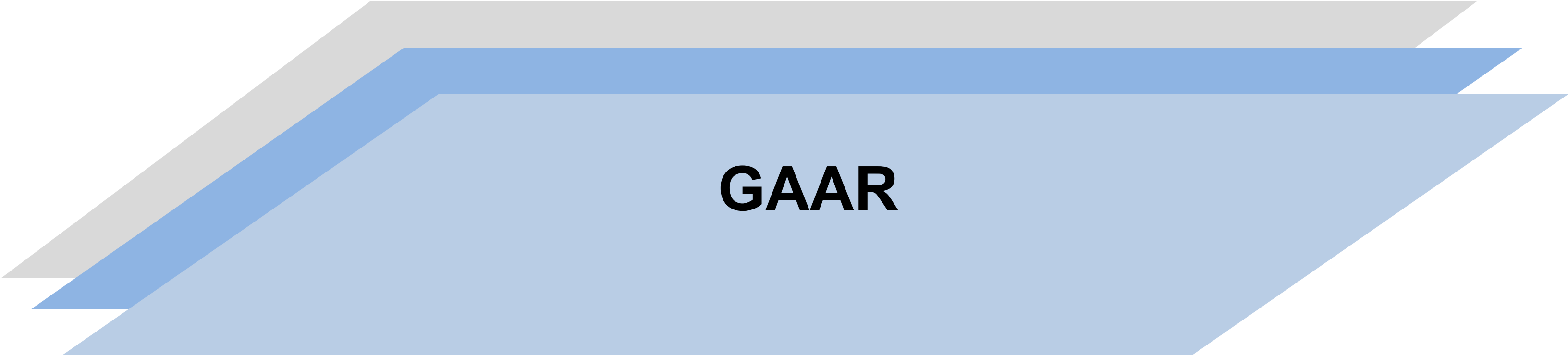


<u>Few Important Aspects from the Guidelines</u>

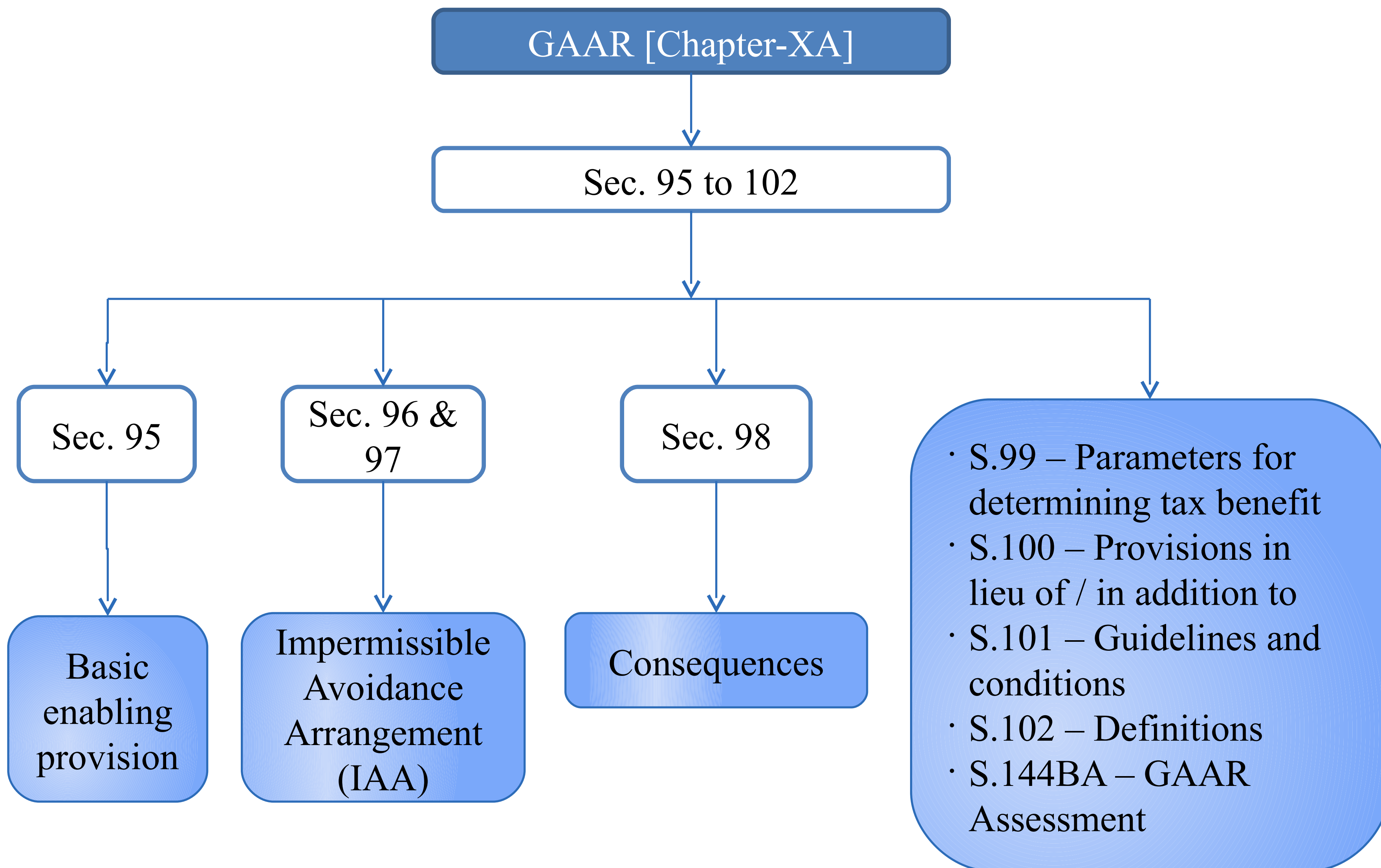
- Guiding principles to be taken into account
  - Location where Board meetings regularly take place & where decisions are taken/ exercised
  - Location of Executive Committee in cases where authority is delegated
  - Location of company's Head Office
  - Decisions by shareholders where required to be made by Company Law not relevant in determination of POEM
  - Day to day routine operational decisions are irrelevant
- If these factors don't lead to clear identification of location of POEM then following secondary factors to be considered
  a. Place where main & substantial activity of company is carried out
  b. Place where the accounting records of the company are kept
- 5 examples are given to elaborate the concept

POEM Guidelines




GAAR

Basic Scheme of GAAR



Impermissible Avoidance Arrangement (IAA)

- Essential two conditions:

1. The **Main Purpose** + Obtain **Tax Benefit** (part or whole or in any step of such arrangement)

2. "Either of the given four conditions":
   a) Not at Arm's Length
   b) Represents Misuse or Abuse of the provisions of the Act
   c) "Lacks Commercial Substance"
   d) Entered or carried on in a manner not normally employed for "Bona-fide Purposes".

"arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

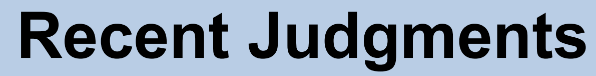
FAQs on GAAR

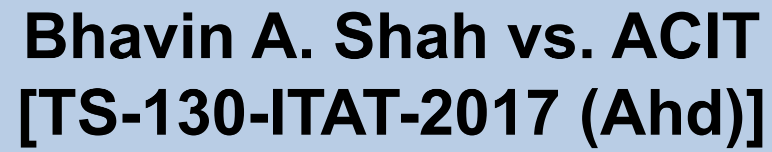
- Soon after the circular on POEM, on 27th January, 2017 the CBDT issued a circular containing clarifications in the form of answers to 16 “Frequently Asked Questions” on GAAR.

- The FAQs dealt with topics like GAAR v/s SAAR, grandfathering of previous actions, AAR and court approved structures, and the manner of invoking GAAR.

FAQs on GAAR

- FAQ 1 – Coexistence with SAAR
- FAQ 2 – Treaty override where LOB test is satisfied
- FAQ 3 – Right of taxpayer to implement transaction
- FAQ 4 – GAAR in certain situations relating to FPIs
- FAQ 5 – Grandfathering of Bonus, Conversions and Share splits
- FAQ 6 – Coverage of grandfathering
- FAQ 7 – GAAR v/s AAR
- FAQ 8 – Arrangements sanctioned by judiciary
- FAQ 9 – Fund choosing treaty in one year and domestic law in next
- FAQ 10 – Invoking GAAR
- FAQ 11 – Notional income & disallowance of actual expenditure
- FAQ 12 – Time periods where GAAR will not apply
- FAQ 13 – Safeguards/ Procedures to invoke GAAR
- FAQ 14 – Calculation of Tax Benefit for invoking GAAR
- FAQ 15 – Can contrary view be taken in subsequent year?
- FAQ 16 – No penalty proceedings under GAAR for 1st 5 years

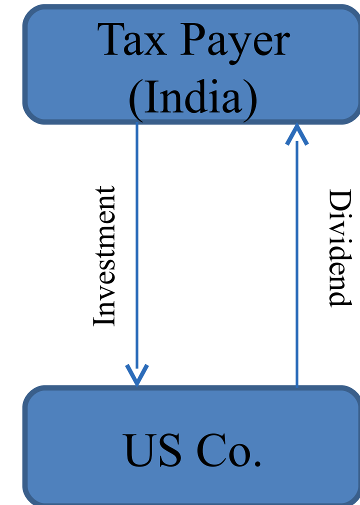

Recent Judgments


Bhavin A. Shah vs. ACIT
[TS-130-ITAT-2017 (Ahd)]

Bhavin A. Shah

Facts

- Taxpayer was an individual resident in India.
- He had invested in shares of US companies and earned dividend therefrom during the relevant year.
- Tax was withheld in US from the dividend received by the Taxpayer.
- The Taxpayer offered such dividend for tax in India and claimed foreign tax credit (FTC) aggregating to roughly **30% of the gross dividend** in respect of tax withheld in USA.



- The AO rejected the claim of the Taxpayer on the ground that FTC is available only in respect of actual payment made while filing return of income (i.e., tax paid directly by the Taxpayer) and not on tax withheld in USA.
- While upholding the order of the AO, the CIT(A) observed that the documents/ evidence furnished by the Taxpayer in support of the FTC claim did not mention the name of the Taxpayer and/ or were not signed by the relevant authorities and further that the taxes withheld were almost 30% of the gross receipt.

Bhavin A. Shah

Held:

- The following conditions should be satisfied for claiming FTC in India in respect of dividend:
  - The Taxpayer should be a resident in India, in terms of Article 4 of India-USA DTAA and not merely a resident under the Act.
  - Income received by the Taxpayer should be "dividend" as defined in Article 10(3) of India-USA DTAA.
  - Dividend should have been taxed in USA in accordance with Article 10(2) of India-USA DTAA.
  - Tax may be either by way of direct payment or withholding

- AO should ascertain the withholding tax rate in respect of each dividend income. In cases where tax was withheld at rate lower than that stipulated in India-USA DTAA, FTC should be granted at actual. **In cases where tax was paid/withheld at rate higher than that stipulated in India-USA DTAA, FTC should be restricted to the amount corresponding to that rate.** The matter was remanded to the AO to accordingly compute the eligible amount of FTC.

Issue:

- Can the DTAA limit the FTC to 25% (making reference to the specific article of the DTAA) and promote Double Taxation

- Can the credit of the 5% FTC be taken u/s 91 of the ITA ?

Saira Asia Interiors (P.) Ltd.
V. Income-tax Officer
TS-134-ITAT-2017 (Ahd)

Saira Asia Interiors (P.) Ltd.

Facts

- The assessee was liable to make a payment on account of technical know-how to Saira Europe SPA, Italy. This liability was duly **accounted for in the books of account on 22-11-2010**, though **the payment was made, a bit later, on 12-5-2011**. The tax was duly withheld from the payment so made, and it was deposited on 20-6-2011.

- Later, the AO raised a demand for interest under section 201(1A) on the assessee by treating the due date for depositing tax deductible at source as 7-12-2010, being 7 days from the end of the month in which amount was credited in the books of account.

- On appeal before the CIT(Appeals), it was contended by the assessee that the **taxability on the amount** which taxable under article 12(3) of India Italy DTAA **arose only at the point of time when it was actually paid, it did not arise at the point of time when credit was afforded to the recipient in the books of account**. However, the Commissioner (Appeals) upheld the order of the Assessing Officer.

Saira Asia Interiors (P.) Ltd.

<u>Held:</u>

- The withholding tax provision cannot be applied in vacuum. It should be read in conjunction with the charging provisions under the Act as well as the provisions of the DTAA, depending upon whichever is more beneficial.

- In terms of **Article 13(1) of India-Italy DTAA, royalty is taxable only when it is actually paid to the non-resident**. Further, in terms of Article 13(3), the term "royalties" means payments of any kind “received”. **Thus, mere credit does not trigger the tax liability**. This view is also supported by the decision of the Mumbai Tribunal in National Organic Chemical Industries Ltd. (2005) 96 TTJ 765 (Mum).

- Since the amount was not taxable at the time of credit of the amount, the Taxpayer did not have any tax withholding obligation.
- **However, since under the DTAA tax liability is on payment, adoption of the lower rate under the Act tax liability will not be triggered on accrual of income.**

Torrent Pharmaceuticals Ltd. V. ITO
[2016] 76 taxmann.com 341 (Ahmedabad Trib.)

Torrent Pharmaceuticals Ltd.

Facts

- The assessee manufactured and marketed pharmaceutical products. It remitted payments to overseas payees located at Switzerland, Canada and USA **without deducting any TDS** thereupon for rendering **consultancy services**.
- The AO passed sections 201 and 201(1A) order raising demand holding that the above remittances were in fact in the nature of fee for royalty/technical services covered by deeming fiction under section 9(1)(vi) and (vii). He rejected assessee's contention of that payees in question had not '**made available**' any technical knowhow as well.
- The Commissioner (Appeals) considered assessee's pleadings seeking to invoke specific clause pertaining to taxation of income arising from technical services in respective DTAA but he held that the payment made to the Swiss company was of the nature of 'fees for technical services', and was deemed to be income accrued in India under section 9(l)(vii), was also taxable in India as per India-Switzerland DTAA Agreement. Commissioner (Appeals) thereafter held that assessee was not liable to deduct TDS on its Canadian remittances.

Torrent Pharmaceuticals Ltd.

Held:

- Argument of assessee is that Indo-Swiss Double Taxation Avoidance Agreement contains a Protocol with respect to articles 10 to 12 thereof which envisages that if after signature of the instant Protocol under any Convention, Agreement or Protocol between India and third State, which is a member of OECD, India should limit its taxation at source on dividends, interest, royalties or fee for technical services to a rate lower or scope more restricted than that provided for in this agreement on the said items of income, then **Switzerland and India shall enter into negotiation without undue delay in order to provide similar treatment to Switzerland as in case of the third State.**
- In view of MFN clause in DTAA between India and Switzerland, assessee, Indian company, could not claim its Swiss remittances for consultancy services as tax exempt, particularly when no make-available clause is used in Indo-Swiss DTAA and said protocol only postulates that India and Swiss shall negotiate either to reduce rate of tax or restrict scope of specified categories of income.
- This is only because of the specific requirement of the MFN clause in the protocol of India-Swiss DTAA that requires a negotiation between the States followed by a notification

Torrent Pharmaceuticals Ltd.

Issues:

- This is only because of the specific requirement of the MFN clause in the protocol of India-Swiss DTAA that requires a negotiation between the States followed by a notification.
- This ruling is distinguished, based on the language of the MFN Clause, from **Steria (India) Limited [Delhi HC]** where it was held that Protocol signed between India and France separately form an integral part of treaty itself, and once DTAA has itself been notified, and contains Protocol including Para 7 thereof, there is no need for Protocol itself to be separately notified.

Important pick from the case of Steria (India) Ltd.:

The judgement of Steria (India) Ltd. alludes the concept of **Pick and Choose Theory in DTAA** wherein an assessee can take the benefit of a MFN clause in such a way that he can choose one treaty for narrower scope of income [e.g. Make available clause] and another treaty for lower rate of tax as one does not exclude the other.

Formula One World Championship Ltd. v. CIT [2017] 80 taxmann.com 347 (SC)

Formula One World Championship Ltd.

Facts:

- Federation Internationale de I' Automobile ('**FIA**') was the **regulatory body** which regulated the FIA Formula One World Championship ('Championship').
- Vide agreement dated April 24, 2001, **FIA provided the commercial rights in respect of the Championship to Formula One Asset Management Ltd ('FOAM')**. In 2011, **FOAM licensed the commercial rights to Formula One World Championship Ltd ('FOWC' or 'taxpayer') for a period of 100 years**. FOWC was thus the Commercial Rights Holder ('CRH') in respect of the Championship and was the exclusive nominating body at whose instance the event promoter was permitted participation.
- FOWC was a company incorporated under the laws of the UK and was a tax resident of UK
- In 2007, **FOWC entered into a Race Promotion Contract ('RPC') with Jaypee Sports International Ltd ('Jaypee')**, an Indian company for promotion of the Formula One races in India. Post this agreement, Jaypee initiated construction of the Buddha International Circuit.

Formula One World Championship Ltd.

Facts:

- In 2011, such RPC was replaced with a new RPC wherein Jaypee was granted the right to host, stage and promote the event. Some of the salient features of this agreement were as under:
  - The Circuit would conform to the guidelines approved by FOWC and FIA
  - For the duration beginning two weeks prior to the race and ending one week after the race, FOWC and its affiliates and contractors had unfettered access to the Circuit
  - The insurance provider and the entity responsible for recording the television feed had to be approved by FOWC
- As consideration for the right to host and promote the event, Jaypee paid a consideration of US 40 million to FOWC.
- On the same day as the new RPC, Jaypee entered into an agreement with three affiliates of FOWC, wherein the media and title sponsorship rights were assigned to Beta Prema 2, the paddock rights were assigned to Allsports and FOM was provided the rights to generate television feed. The assignment was without any consideration to Jaypee and the revenues from such rights were earned by these affiliates situated outside India.

Formula One World Championship Ltd.

Facts:

- Jaypee and FOWC approached the AAR to understand the taxability of the entities under the RPC. The AAR held that the sums paid under the RPC and ALA by Jaypee constituted royalty under the ITA and the India – UK tax treaty. However, FOWC did not constitute a PE in India.
- Against the ruling of the AAR, both Jaypee and FOWC filed a writ petition before the Delhi High Court. The Revenue department also filed a writ petition to challenge the ruling of the AAR that FOWC did not constitute a PE in India. The Delhi High Court reversed the ruling of the AAR and held that the amounts paid by Jaypee to FOWC did not constitute royalty. However, FOWC constituted a fixed place PE in India.
- Against the ruling of the High Court, FOWC and Jaypee filed a SLP before the Supreme Court. The ruling of the High Court that the amounts would not constitute royalty was accepted by the Revenue.

Formula One World Championship Ltd.

Held:

- The Supreme Court held that for determining the nature of control exercised by FOWC, it was important to **peruse the entire arrangement between FOWC and its affiliates on one hand and Jaypee on the other and that various agreements could not be read in isolation**.

- On the basis of the various agreements entered into between FOWC and its affiliates, it was clear that the entire event was taken over and controlled by FOWC and its affiliates and the commercial rights of FOWC were exploited with actual conduct of race in India. **FOWC also had complete physical control over the circuit and omnipresence of FOWC and its stamp over the event was loud, clear and firm.**

Formula One World Championship Ltd.

Held:

- With respect to the argument of the taxpayer that the race was only held for three days in a year and such a short duration would not constitute PE, the Supreme Court relying on the various commentaries and international precedents upheld the High Court's observation that where the business was carried out for limited days, and for the entire duration, FOWC had complete control and access, such duration was enough to constitute a PE.

- Accordingly, the Supreme Court upheld the constitution of a fixed place PE of FOWC in India.

Formula One World Championship Ltd.

<u>Impact:</u>

- There have been divergent rulings on the aspect of permanence and the requirement of the **duration test in the context of a fixed place PE**. In this respect, the ruling of the Supreme Court is a landmark one, since it has held that even the carrying on of business in India for a short duration can constitute a PE, given the nature of the business. Hence, **the nature of the business will play a crucial role in determining the permanence thresholds**.

- Further, the principle laid down by the Supreme Court, that the **arrangement as a whole (including arrangements of all other related parties) should be looked at to determine the conduct of business**, determination of PE, fortifies the changing approach of the judiciary in the international tax landscape to focus on substance of arrangements rather than merely its form. **In the age of GAAR and BEPS anti-fragmentation principles, this assumes greater significance**.

ANY QUESTIONS ?

Thank You

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CHARTERED ACCOUNTANTS