

Article 10, 11 and 13 - Recent Decisions and updates

Seminar on Recent Updates in International Tax – WIRC ICAI

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3.1%	16.9%	36.1%
9.1%	2.7%	-17.4%
	9.8%	17.9%
		1.9%
		10.2%

	Maturity	Current	One-day change
6.700	Jan. 30, '18	1461	-286
5.875	May 10, '12	3820	-270
6.750	March 15, '12	786	-180
7.625	Nov. 30, '12	949	-131
5.750	Sept. 8, '11	953	-116
7.995	June 1, '36	781	-101
6.875	Feb. 1, '14	804	-24
5.500	Nov. 15, '12	823	-41

Last week	STOCK PERFORMANCE
1,762	Change (%)
15.4	25.72
15.8	50.00
1,800	1.00



Contents

Overview

Recent updates

Recent decisions

Q & A

Article 10 – An overview

- **Article 10(1)**
 - Taxability of Dividends in the Country of Residence
- **Article 10(2)**
 - Taxability of 'Beneficial Owner' of Dividends in the Country of Source
- **Article 10(3)**
 - Meaning of the term 'Dividends'
- **Article 10(4)**
 - Taxation of Dividends in the case of a Permanent Establishment ('PE')
- **Article 10(5)**
 - Prohibition on extra-territorial taxation of dividends / undistributed profits
- **US MC / OECD Commentary**
 - Special provisions - dividends paid by Real Investment Company / Real Estate Investment Trust

India Domestic Income Tax Law – Dividends Tax Exempt for all shareholders pursuant to levy of Dividend Distribution Tax on the Indian Company (except Deemed Dividend under Section 2(22)(d))

Article 11 – An overview

- **Article 11(1)**
 - Taxability of Interest in the Country of Residence
- **Article 11(2)**
 - Taxability of Interest in the Country of Source
- **Article 11(3)**
 - Meaning of the term 'Interest'
- **Article 11(4)**
 - Taxation of Interest in case of a Permanent Establishment ('PE') ('force of attraction in UN MC)
- **Article 11(5)**
 - Source Rule extended to PEs of Third Country Residents in the Country of Source
- **Article 11(6)**
 - Treated benefit restricted for excessive 'interest' in cases of related parties transaction

India Domestic Income Tax Law – Interest income is Taxable for Non-Residents on Gross Basis

Article 13 – An overview

- **Article 13(1)**
 - Gains from immovable property taxable in the Country of Source
- **Article 13(2)**
 - Gains from movable property forming part of PE's business taxable in the Country of Source
- **Article 13(3)**
 - Gains from alienation of ships / aircraft, etc operated in international traffic - taxed on basis of POEM
- **Article 13(4)**
 - Gains from sales of immovable property company taxable in the Country of Source (UN MC extends this treatment to such alienation of Partnership , Trust and Estate with certain exemption)
 - Article 13(5) of UN MC 2011 also stipulates source taxation of gains from sale of companies where shareholding exceeds prescribed threshold , held directly or indirectly, at any time during preceding 12 month period
- **Article 13(5) of OECD MC / 13(6) of UN & US MC**
 - All other gains taxable in the Country of Residence

India Domestic Income Tax Law – Capital Gains is taxable income deemed to accrue / arise in India and ambit further widened by the FA 2012

Recent Updates – Beneficial Ownership



OECD Model Tax Convention – Revised Discussion Draft - Proposals concerning meaning of ‘Beneficial Owner’ in Article 10, 11 and 12

- Public discussion draft earlier released on 29 April 2011
- Revised draft makes changes pursuant to comments received from various sections of the public / professional fraternity and invites further comments
- Key points:
 - ‘BO’ to have an autonomous treaty meaning as per OECD MC rather than recourse to domestic tax meaning / definition , if any
 - Affirmation of view – Trustees of discretionary trust construed as BO
 - Right to use and enjoy the income unconstrained by a legal / contractual obligation
 - BO of dividend is different as opposed to owner of shares
 - In the context of companies, it is inappropriate to relate BO to individuals who exercise ‘ultimate effective control’ over a legal person

Recent Updates – Article 11



New Section 194LC read with Section 115A and CBDT Circular No. 7 dated 21 September 2012

- Lower withholding tax of 5% on interest payments by Specified Indian Companies on borrowings made in foreign currency from a source outside India between 1.7.2012 to 30.6.2015
- Overseas Borrowing as per Loan Agreement or Long Term Infrastructure Bonds
- Lower WHT to be at the rate of interest approved by Government (inferring approval of Agreement as well as Rate)
- CBDT Circular No. 7 dated 21 September 2012
 - Loan - RBI ECB policy compliance sufficient (agreement, LRN, End-use, etc) and no restructuring for reduced WHT
 - Bonds: RBI ECB policy compliance sufficient + Long term = bond should have original maturity of 3 years or more + Proceed to used only in infrastructure sector as per ECB policy
- Specified Indian Company – Finance Bill 2012: eight specified sectors to Finance Act 2012 any Indian Company

Recent Updates – Article 11



New Section 194LB introduced by FA 2011 w.e.f 1 June 2011 read with Section 115A

- Lower withholding tax of 5% on interest is payable to a non-resident by an infrastructure debt fund referred to in clause (47) of section 10
- Rule 2F Notified on 30 April 2012
 - Infrastructure Debt Fund to be a NBFC as RBI DNBS Guidelines / Directors
 - Funds to be invested only in PPP infrastructure projects which have completed at least one year of satisfactory commercial operations under a tripartite agreement with the concessionaire / project authority
 - Bonds could be INR or Foreign Currency Denominated with minimum original maturity of 5 years
 - Individual project investment not to exceed 20% corpus of the fund
 - Sponsor / Associate or Group not to have any substantial interest in project as stipulated

Article 11 – Selected Recent Decisions



Head Office and Branch Office – Interest

- **Sumitomo Mitsui (2012) 136 ITD 66 (Mum SB)**
 - Interest paid by PE / BO to HO is not deductible under the Act as it is transaction with self – However, it would be deductible if specific provision exists in Tax Treaty (E.g. Japan and Belgium as relevant for this decision)
 - On the same analogy, interest received by HO from PE / BO is not taxable under the Act – provisions of Tax Treaty not relevant to be examined
 - In view of above, no withholding tax obligation exists under Section 195 on payment of interest by PE / BO to HO

Note: Calcutta HC in ABN AMRO (2012) 343 ITR 81 (Cal) earlier held that PE / BO and HO are separate for all purposes so had upheld taxability of interest paid by PE/ BO to HO
- **Shinhan Bank (2012) 54 SOT 140 (Mum)**
 - Followed Sumitomo (supra) and allowed deductibility of interest relying on protocol to the Tax Treaty (MFN Clause)

Article 11 – Selected Recent Decisions



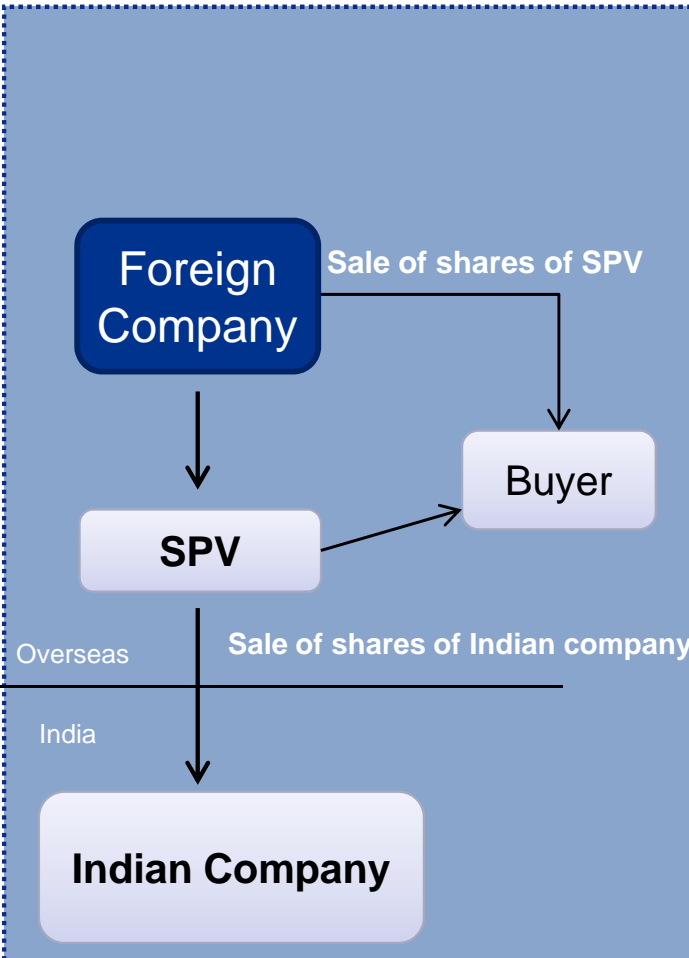
- **Cargill Global [2012] 21 taxmann.com 496 (SC)**
 - SC dismissed SLP against Delhi HC decision in CIT v Cargill Global Trading (P) Ltd [2011] 11 taxmann.com 219 (Delhi)
 - The Delhi High Court held that discounting charges paid to get export sale bills discounted is not 'interest' as defined in section 2(28A) of the Act and does not attract TDS u/s 194A.
- **Uniflex Cables [2012] 19 taxmann.com 315 (Mum.)**
 - Usance interest relating to letter of credit = interest deemed to accrue or arise in India under the Act and taxable
 - Treatment under Tax Treaty not examined and matter referred back
- **In re Z [2012] 249 CTR 225 (AAR)**
 - Put option attached to Zero per cent CCDs issued to Mauritius Company
 - AAR lifted the corporate veil to held that premium on sale of CCD paid by Resident Purchaser relates to debt taken by the Resident Issuer and in the nature of interest taxable in India under the Act as well as Tax Treaty

Article 11 – Selected Recent Decisions



- **Credit Suisse First Boston (Cyprus) - [2012] 23 taxmann.com 424 (Bom HC)**
 - Taxpayer (FII) offered interest on Government Securities on accrual basis (per specified dates) and claimed exemption on capital gains arising on sale
 - AO taxed interest accrued but not due at the end of the financial year and also reclassified capital gains as coming within the ambit of interest
 - The Bombay High Court held that interest on instruments payable at the specified date does not accrue before that date and in absence of debtor / creditor relationship, sale proceeds cannot be re-characterized as interest
- **Idea Cellular Ltd - [2012] 20 taxmann.com 53 (AAR - New Delhi)**
 - Followed AAR in Poonawalla Aviation (P.) Ltd. [2011] 16 taxmann.com 120, and held that guaranteeing a loan is not same as extending a loan or endorsing a loan
 - In view of MFN Clause of the India-Swedish Tax treaty, ECB from a Swedish Bank Guaranteed by Swedish Export Credits Guarantee Board is not taxable in India – re MFN: similar beneficial provisions imported from India Tax Treaty with Ireland

Taxing Indirect transfer of shares in Indian Company – Overturning Vodafone



These amendments do not override Tax Treaty

Several retrospective amendments w.e.f. 1.4.1962

- S. 2(14) - Property: To include rights in or in relation to an Indian company including rights of management / control / other rights
- S. 2(47) Transfer: disposing of or parting with an asset or creating any interest therein in any manner, directly or indirectly, notwithstanding its flowing from transfer of shares of a foreign company
- S. 9(1)(i) Expl 4: Through: to include 'by means of, in consequence of or by reason of'
- S. 9(1)(i) Expl 5: Share / Interest in foreign company deemed to be situated in India if, directly or indirectly, value is derived substantially from assets located in India
- S. 195: WHT obligation even on non-residents who have no place of business / business connection / other presence in India
- 'validation clause' in Memorandum – inter alia upholds validity of tax demand notice irrespective of any Court Order, etc

Shome Committee Report on Taxation of Indirect Transfers



▪ Key recommendations

- Amendments not clarificatory - ought to be prospective
- Retrospective amendment only after consultation with public / stakeholders and cannot be used to expand tax base
- No interest / penal consequences to arise pursuant to the retrospective amendments
- Substantially = threshold of 50% of value
- Proportionate basis of taxation
- Fair Market Value = DCF
- Minority shareholder / FII Investment threshold and benefit for listed company transaction
- Intra-group restructuring to be excluded
- No additional obligation – cascading effect, dividend, etc.

Article 13 – Selected Recent Decisions

Eligibility of Tax Treaty Benefits



- **Castleton Investment (2012) 348 ITR 537 (AAR) / Smithkline Beecham (2012) 348 ITR 556 (AAR)**
 - Investments through Mauritius Holding Company acceptable arrangements
 - Treaty shopping not a taboo – Azadi Bachao / Vodafone
 - Department has not rebutted presumptions in this case
 - Sale of listed shares outside stock exchange cannot be construed as avoidance of STT (Castleton)
 - Section 115JB applies to foreign company and will apply to capital gains even though exempt
 - Issues not dealt by AAR
 - Section 115JB on Capital Gain is under the Act and not under Tax Treaty
 - Thus, comparison should be taxation under Act (including if any under Section 115JB) v. Tax Treaty and Beneficial of the two provisions under Section 90(2) should apply

Article 13 – Selected Recent Decisions

Buyback of Shares

▪ **RST [2012] 348 ITR 368 (AAR)**

- Applicant contended that the buyback of shares by an Indian WOS (held with nominees) from its German parent was not taxable in view of exemption under Section 47(iv)
- AAR held that gains arising from buyback of shares taxable under Section 46A read with Section 48 and recourse to Section 45 / 47(iv) is not warranted and thus gains was taxable in India

▪ **A - [2012] 343 ITR 455 (AAR)**

- Buyback of shares held to be a colorable device as:
 - Neither US nor Singapore shareholders opted to avail the scheme
 - No dividends declared in the past
 - Intention of buyback is to repatriate large sum to Mauritius shareholder without tax in India
- Transaction treated as dividend in terms of Section 2(22) / Article 10(4) of India-Mauritius Tax Treaty

▪ **Armstrong World Industries Mauritius [2012] 349 ITR 303 (AAR)**

- AAR accepted the buyback scheme is not a device for avoidance of tax and also allowed India-Mauritius Tax Treaty benefit to Holding Company

Article 13 – Selected Recent Decisions

Sanofi Pasteur Holding SA (Feb 2013)

- Appeal by the Petitioner to the AP HC post Advance Ruling as held eligible by SC in Columbia Sportswear under Article 226 / 227 of the Constitution
- AAR had ruled that capital gains arising to French Companies (F1 & F2) on sale of F3 (also a French Company) is taxable in India under Article 14(5) of the India- France Tax Treaty – Underlying value of F3 being derived from its investment in an Indian Company (ICo) and the purchaser French Company (F4) is liable to withhold tax
- Reversing the Advance Ruling, the AP HC held as under:
 - F3 is an independent corporate entity registered and tax resident in France
 - F3 and the arrangement has commercial substance - F3 participated in various steps for acquiring stake in the Indian Company over number of years including obtaining regulatory approvals
 - F3 is not a nominee of F1 or F2 but a JV company between two groups
 - Gain arising from the transaction was taxable in France and at higher rate
 - Even after transfer F3 continues albeit owned by F4
 - Retrospective amendments to the Act do not override the provisions of the Tax Treaty

Tax Residency Certificate for Claiming Relief under Tax Treaty

- **Sub-Section (4) of Section 90 as inserted by FA 2012** w.e.f AY 2013-014 - Restricts the treaty benefit to Non-Residents, unless the Non-Resident obtains a tax residency certificate (TRC) from the Tax Authorities in the Home Country containing the specified particulars.
- **Income Tax Rules / CBDT Notification No. S.O. 2188(E), dated 17 September 2012** - With effect from 1 day of April 2013, Details required to be submitted in the TRC:
 - Name of the assessee
 - Status (individual, company, firm etc.) of the assessee;
 - Nationality (in the case of an individual);
 - Country or specified territory of incorporation or registration (in the case of others);
 - Assessee's tax identification number in the country or specified territory of residence or in the case there is no such number, then a unique number on the basis of which the person is identified by the Government of the country or the specified territory;
 - Residential status for the purposes of tax;
 - Period for which the certificate is applicable; and
 - Address of the applicant for the period for which the certificate is applicable.
- Several issues arise especially – date of commencement of Rule, LLPs which are pass through, countries which issue TRC in their own format only or after the year end, etc.

Questions



&

Answers



Thank You!

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