

A person in a dark suit is shown from the chest up, holding a glowing digital world map in their hands. The map is composed of a grid of small white dots, with several larger, bright blue dots scattered across it. The person's face is partially visible, looking towards the camera. The background is a dark, solid blue color.

International Taxation - perspectives and recent developments

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20 August 2016

WIRC DTAA Refresher Course

Tax Treaty - Application and Issues



International Taxation

-- *Meaning and Basis*

▪ **Meaning**

- Taxation of cross-border transactions
 - A transaction between two or more persons in two or more tax jurisdictions
 - A transaction involving a person in one tax jurisdiction with property or income flows in another tax jurisdiction

▪ **Basis of taxation**

- Basis of apportionment of income:
 - Person - based on the tax residence
 - Property - based on the situs of property
 - Income flows - based on the source of income
- Situs rule is broadly settled; but determination of tax residence or source of income varies across jurisdictions
- Triangular cases more complicated

Concept of Double Taxation

Double Taxation can be defined as imposition of taxes in two or more states on the same / different tax payer in respect of the same subject matter in identical periods of time

Juridical Double Taxation

Same person taxed on same income in different jurisdictions

- Worldwide income taxable in more than one state



Economic Double Taxation

Different persons taxed on same income in different jurisdictions

- Partnership entity as separate taxable entity in COS, Partners of such partnership taxable on pass through principles in COR

Tax Treaties and Model Conventions generally address Juridical Double Taxation and not Economic Double Taxation

Tax Treaty

-- *Meaning and Objectives*

Meaning

- International Double Taxation Avoidance Agreements concluded between two or more sovereign nations
- International agreement, in a written form, comprising of various titles (Treaty, Convention, Protocol, Explanatory Notes, Memorandum of Understanding)
- Multilateral (Many Countries) v. Bilateral (Two Countries)
- Comprehensive v. Limited

Objectives

- Avoidance of Double Taxation
- Promotion of cross border trade and investment
- Rational / equitable allocation of income between two countries
- Exchange of information to combat tax avoidance and tax evasion
- Definition of uniform principles, rules, procedures etc. to facilitate recovery of tax dues

Tax Treaty

-- *Model Conventions*

OECD

- Emphasis on **residence based taxation**
- Developed countries adopted this model in case of treaties with other developed countries
- Started from 1963 draft convention, Regularly updated / amended – latest version is 2014

UN

- Emphasis on **source based taxation**
- Developing countries adopted this model in case of treaties with developed or developing countries
- OECD Model convention has been used as a main reference document, started in 1980 and latest version is 2011

US

- **Used by USA** for all its treaty negotiations
- This model had influence on existing Treaty between India and USA
- Notable features – Limitations on Benefits; No Tax sparing

Andean

- Almost exclusive taxation in **country of source** except in cases of international traffic
- PE concept is not adopted
- Regional level model convention developed in 1971 and adopted by **Latin American** countries namely Bolivia, Columbia, Chile, Ecuador, Peru and Venezuela
- Not a very popular model

Tax Treaty

-- Contents

SCOPE PROVISIONS

- Article 1 - Personal Scope
- Article 2 - Taxes covered
- Article 30 - Entry into Force
- Article 31 - Termination

MISCELLANEOUS PROVISIONS

- Article 26 – Non discrimination
- Article 29 – Diplomatic Agents

ANTI-AVOIDANCE

- Article 9 - Associated Enterprises
- Article 24 – LOB
- Article 28 - Exchange of Information

DEFINITION PROVISIONS

- Article 3 – General definitions
- Article 4 – Residence
- Article 5 – PE

ELIMINATION OF DOUBLE TAXATION

- Article 25 – Relief from Double Taxation
- Article 27 – MAP

SUBSTANTIVE PROVISIONS

- Article 6 - Immovable property
- Article 7 - Business Profits
- Article 8 - Shipping, Air Transport, etc.
- Article 10 - Dividends
- Article 11 - Interest
- Article 12 - Royalties and FTS
- Article 13 - Capital gains
- Article 14 – PE Tax
- Article 15 – Independent Personal Services
- Article 16 – Dépendent Personal Services
- Article 17 – Directors Fees
- Article 18 - Artistes & Sports persons
- Article 19 – Pensions Government service
- Article 20 – Private Pensions
- Article 21 - Students
- Article 22 – Professors / Teachers
- Article 23 – Other Income

Tax Treaty Application

-- *Distributive Rules*

Contained in Articles 6 to 22 of the OECD Model Convention (in form of Active and Passive Income) – Classify and assign the taxing rights to one or both contracting states

Income classification Rule

Initially classifies the taxable income under different classes or categories

Treaty Source Rule

Decide source of income for treaty purposes, regardless of the domestic tax rules of each state

Assignment Rule

Taxing rights for each source of income are allocated to either source or residence state, or to both states

Interpretation of Tax Treaty

-- *Relevant Material*

Public International Law

- Vienna Convention on Law of Treaties (A treaty is binding on parties and to be performed in good faith, Ordinary meaning of words, etc)

Commentary on Model Convention

- OECD
- UN
- Technical Explanation (USA)
- Eminent jurists such as Prof. Klaus Vogel, Philip Baker, Arvid Skaar

Protocols / Exchange of Notes

- Amend, clarify or explain provisions of treaties
- Bilateral in nature
- Specific to treaty in question (may be relied upon to interpret other similar treaties)

Other Sources

- Mutual Agreement Procedure
- Judicial decisions
- Advance Rulings
- CBDT Circulars

Interpretation of Treaty

-- *Interplay between Tax Treaties and ITA*

Indian Context – Authority to enter into Tax Treaties

- List I of 7th Schedule to Constitution of India
- Section 90 of the ITA

Fundamental Rules

- ITA or Tax Treaties – More Beneficial provisions apply
- Section 90(2) of ITA (and earlier Circular No. 333 dated April 2, 1982)
- Section 94A – Notified Jurisdiction if lack of exchange of information

Unilateral Tax Credit

- Section 91 of the ITA

An India Perspective

As on 1 June 2016, India has Comprehensive DTAA's with over 90 countries and Limited Agreements with 8 countries *

India's Tax Treaties are based on combination of OECD and UN Model Conventions with higher emphasis on source country taxation

Indian Courts reliance on OECD Model Convention

- CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)
- Union of India v. Azadi Bachao Andolan (2003) 263 ITR 706 (SC)

India's reservations to OECD Model Convention as an Observer Member

- Wide ranging and restrictive
- Need to be favored in while relying on OECD Commentaries

Indian Courts reliance on Vienna Convention on Law of Treaties

- Ram Jethmalani v. Union of India W.P. (Civil) No. 176 of 2009 (2011) (SC)
- AWAS Ireland v. Directorate General of Civil Aviation W.P.(C) 871/2005 (2015) (Del.)

* Source - <http://www.incometaxindia.gov.in>

Tax Treaty Application

-- Important Concepts

(1/2)

Limitation of Benefit

- Intended to prevent misuse of Tax Treaties by third countries
- Condition is satisfied where certain objective criteria's are met (Listing, business activity, minimum expenditure, etc.)
- India - USA DTAA is India's first DTAA with LOB article
- BEPS Action Plan 6 - Treaty abuse recommends LOB article to be included in DTAA, objective rule plus subjective Principal Purpose Test

Beneficial Ownership

- Term not defined in Tax Treaties
- Critical condition for availing benefit of DTAA in case of income by way of interest, dividend, royalties, and FTS
- As per 2014 OECD update, the recipient of said incomes is BO when:
 - He has right to use and enjoy such income;
 - Unconstrained by a contractual / legal obligation to pass on the income to another person
- CBDT Circular No.789 dated 13.04.2000 states that the Certificate of Residence issued by the Mauritian authorities is sufficient evidence of beneficial ownership. (followed by SC – Azadi Bachao)

Tax Treaty Application

-- Important Concepts

(2/2)

Most Favored Nation

- Found in Protocols and EON to Tax Treaties
- A Country agrees to extend benefits to residents of the Other Country which it promised/ agreed with any third Country
- Benefit generally restricted to Group Countries e.g. OECD Countries
- Benefit could be either lower rate or narrowing of scope e.g. India - France DTAA
- Benefit could be automatic or to be notified by Contracting State

Mutual Agreement Procedure

- Agreement of CAs of both States
- Notwithstanding remedy under domestic tax law of source state
- No obligation of CAs to reach mutual agreement
- Generally in case of:
 - **Specific Provisions** where taxation is not in accordance with the DTAA
 - **General Interpretation issues** such as those under Article 4 – Resident
 - **Issues not covered under DTAA** such as economic double taxation, including TP adjustments

Tax Treaty Application

-- *Force of Attraction - Business Income Taxation*

“Principle under which a country may tax a foreign enterprise in respect of income it derives in the other country if the enterprise maintains a PE in the other country irrespective of whether that income is derived through or otherwise economically connection with the PE...”

- IBFD International Tax Glossary

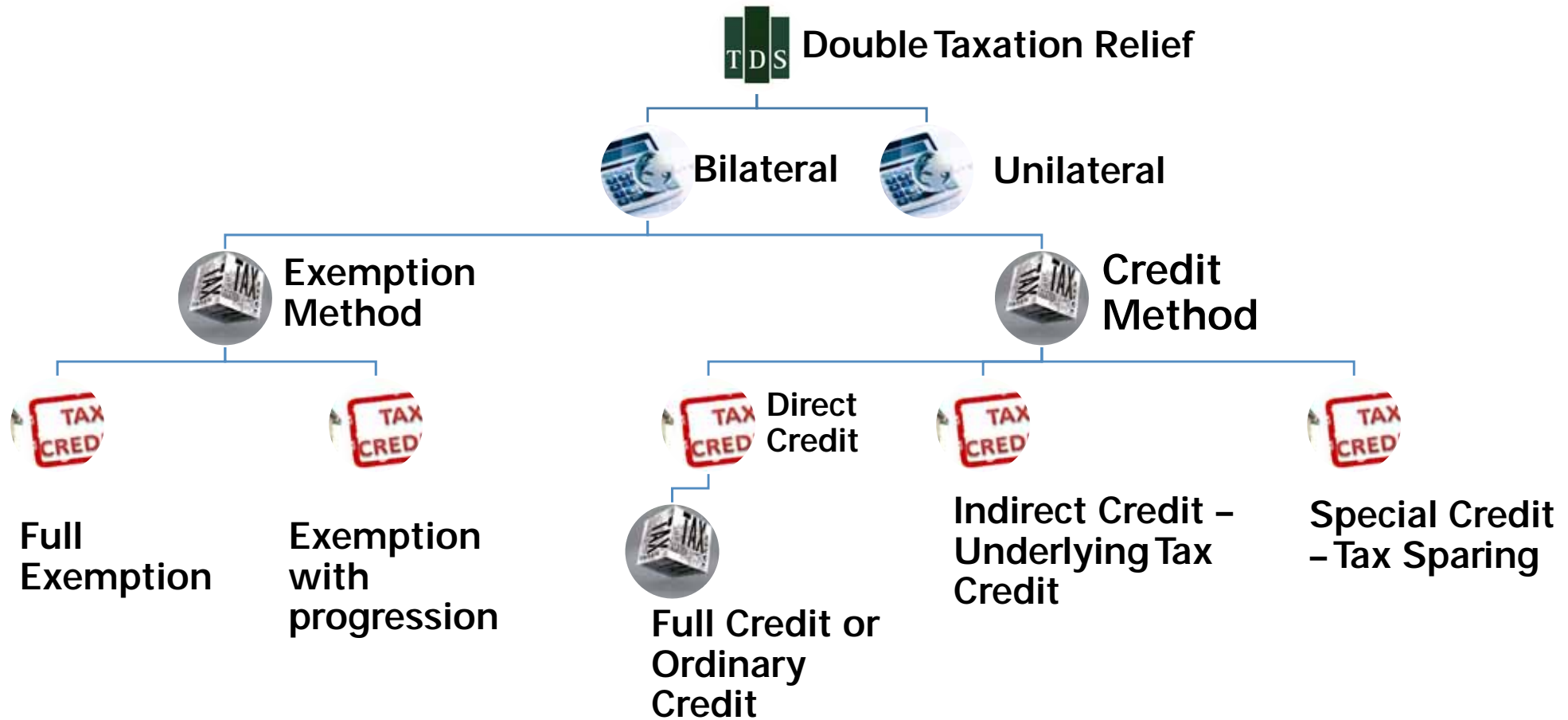
‘Force of attraction’ rule not present in OECD Model Convention but does exist in the US and UN Model Convention

Scope

- (a) Sale of same or similar Goods in the Source State as those sold through PE
- (b) Other business activities in Source State of the same or similar kind as those affected through PE
- (c) ‘Directly and indirectly attributable to PE

Tax Treaty Application

-- Double Taxation Relief



Two contracting states in DTAA's can agree to follow different methods for eliminating double taxation

Tax Treaty Application

-- Foreign Tax Credit

CBDT recently notified the Foreign Tax Credit Rules

FTC allowed in the year in which corresponding income is offered to tax

Aggregate of credit from each source of income in each particular country computed in prescribed manner

FTC allowed subject to furnishing of prescribed documents

Not available in cases where foreign tax is disputed



Foreign tax credit will be available against tax, surcharge and cess payable under the Act, including minimum alternate tax.

Though intention of FTC Rules is to bring clarity but certain issues remain unanswered

Bilateral Investment Promotion and Protection Agreement

- Meaning and Need

- BIPA aim to promote and protect the interests of investors of either country in the territory of other country and increase the comfort level of the investors by assuring a minimum standard of treatment in all matters and provides for justifiability of disputes with the host country.
- BIPAs allows foreign investors to be treated at par with domestic companies even before they invest in India.
- BIPA provide for international arbitration for disputes in Investor Country including on Tax matters
- Transition to Bilateral Investment Treaties (BIT)
 - After witnessing an increase in arbitration cases, India had in December 2015 amended the draft of model BIT that makes it mandatory for foreign investors to exhaust local judicial remedies before seeking arbitration
 - Foreign Investor on par with local counterparts only after setting up in the Country
 - Taxation to be kept out of ambit of BIT
 - Government is making an attempt to replace BIPA with BIT

Exchange Of Information (Eoi)

- *Meaning and Update*

- India has Tax Information Exchange Agreements (TIEAs) with 17 countries *
- India has also signed the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information with about 60 countries
- New India Treaties / Amendments include robust Article on Eoi
- EOI aims to dig out information on non-compliances and cases where tax has been evaded
- EOI specifies the details of what information will be exchanged and when

Information Flow Begins

GOVT HAS RECEIVED FINANCIAL INFORMATION FROM VARIOUS SOURCES, INCLUDING FATCA, TIEA

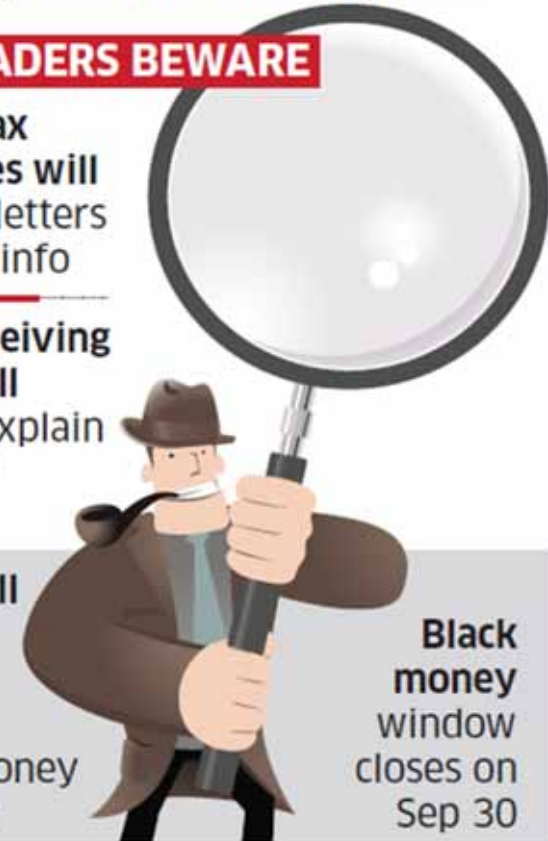
TAX EVADERS BEWARE

Income-tax authorities will send out letters based on info

Those receiving letters will have to explain source of income

They will be able to avail of new black money window

Black money window closes on Sep 30



International Tax Planning - Principles and Issues



Tax - Planning / Avoidance / Evasion

- *Meaning*

TAX PLANNING

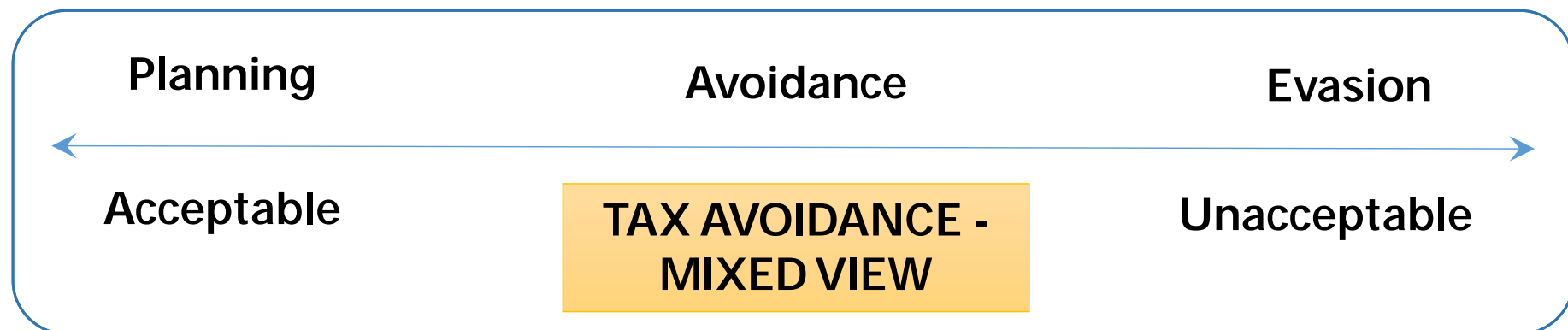
- Arrangement of financial activities in a way to maximise tax benefits by making full use of beneficial provisions in the tax laws

TAX AVOIDANCE

- Minimising incidence of tax by adjusting the affairs in a way that seems to be within the four corners of the law but the advantage is taken by finding out the loopholes in the tax laws

TAX EVASION

- Unethical / illegal means of reducing tax bills



Inbound Structuring



Inbound Structuring *- Key Considerations*

**Choice of
Entity /
Jurisdiction**

**Use of
Holding
Companies**

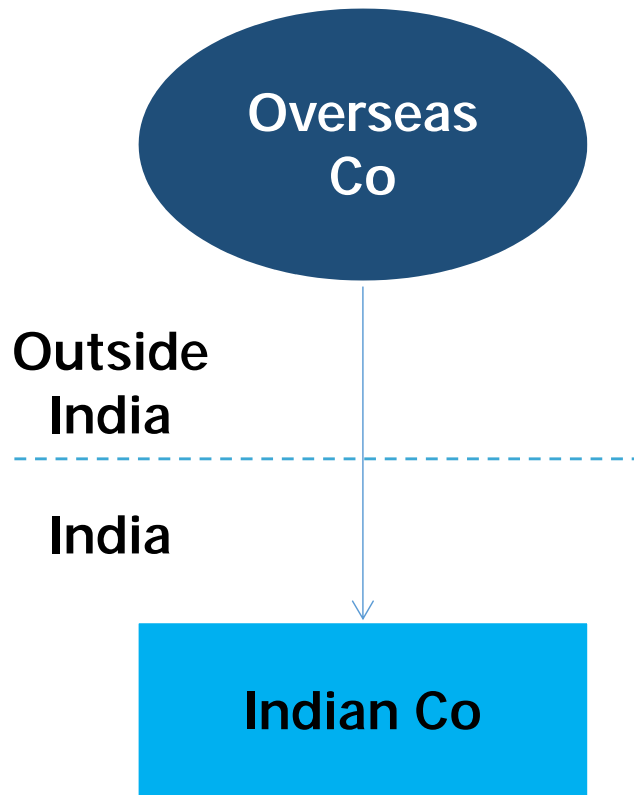
**Availability
of FTC**

**Cash
Extraction**

**Exit
Strategy**

Inbound Structuring

- *Direct Acquisition*



▪ Pros

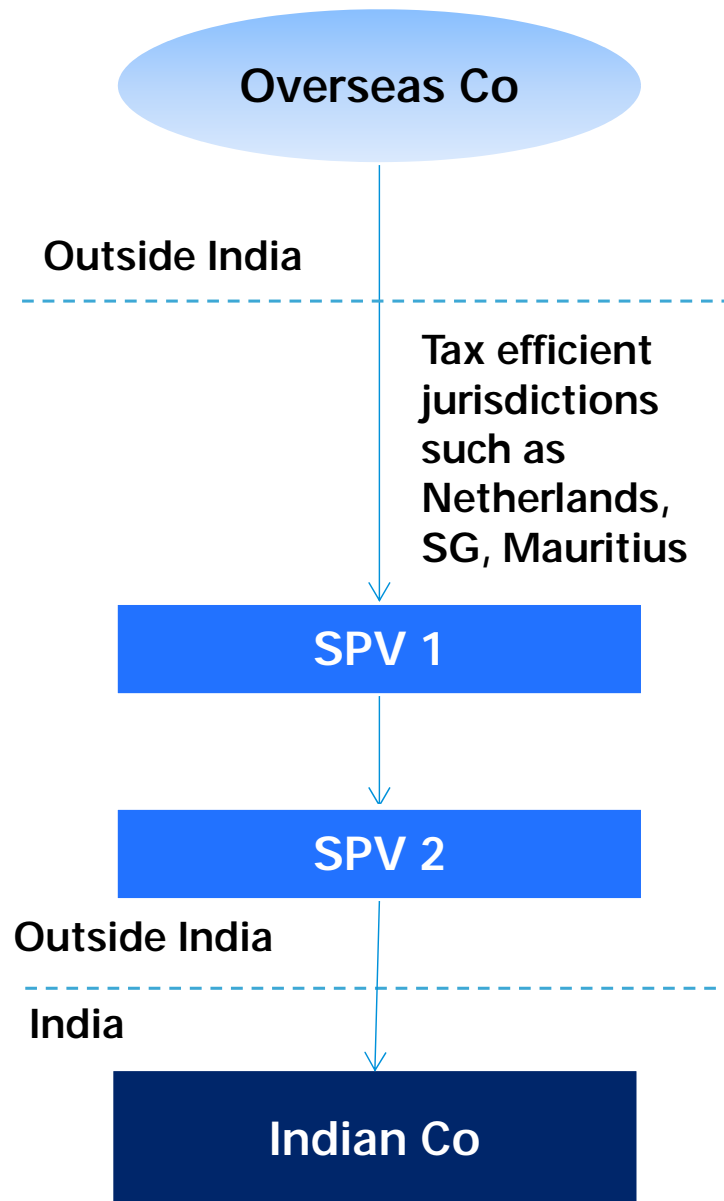
- Easy and quick to implement
- Simple structure, fewer complexities and reduced set-up / administrative costs
- DTAA benefit available in respect of Capital Gains in select countries

▪ Cons

- Repatriation attracts taxes in India
- Capital Gains on sale of shares of Indian Company taxable in India
- Risk of double taxation due to conflicting 'source' rules

Inbound Structuring

- Acquisition through SPV



▪ Pros

- Flexibility to evaluate various tax efficient jurisdictions
- Tax efficient exit
- Flexible structure for bringing in strategic investors at holding company level

▪ Cons

- More complex and higher set-up/administrative costs in managing all the entities
- Critical to prove substance
- Treaty shopping issues and GAAR implications
- Retrospective amendments to Section 9(1)(i) of ITA – Foreign Investor Company shares deemed to be situated in India if they derive value substantially from assets located in India

Key Amendments to India-Mauritius DTAA

The Fine Print

Amended India-Mauritius treaty only covers investments in shares



OTHER SECURITIES WILL CONTINUE TO ENJOY INCENTIVES UNDER EARLIER TAX REGIME

Interest earned in India by Mauritius entities to face only **7.5% tax**

PE rules tightened for services provided through employees sent via Mauritius



PACT WITH MAURITIUS AMENDED

CURBS ON ROUND-TRIPPING

- Capital gains tax will be levied on investments routed from Mauritius into Indian stock markets from next year
- Levy will be slapped on shares bought on or after April 1, 2017
- There will be a transition phase of two years — 2017-18 and 2018-19 — when the tax will be levied at half the rate

- India levies a 15% short-term capital gains tax on shares sold after a holding period of less than a year



- From 2019-20 onwards, full capital gains tax on investment from Mauritius will kick in
- Grandfathering of investment allowed, which means no capital gains on investments made before 2017

LIMITING TAX PACT'S BENEFITS

> India and Mauritius have agreed to include a 'limitation of benefit' (LOB) clause in a tax treaty they are renegotiating



> For long, India had been demanding the inclusion of the clause as it limits tax benefits for a third-country resident

Fees for Technical Services (FTS)

- Similar to definition as provided under domestic law – no make available
- FTS taxable at 10 per cent

India-Mauritius DTAA

- Impact on India - Singapore DTAA

Over To Singapore

Talks soon with Singapore on amending bilateral tax treaty

BENCHMARKED TO MAURITIUS

Treaty will be benchmarked to India-Mauritius tax treaty, which was amended on Tuesday

Investments routed through Mauritius will face capital gains tax from April 1, 2019



WAY AHEAD FOR SINGAPORE

India-Singapore treaty could be on the same lines as the Mauritius one

Govt does not see any problem in renegotiating treaty

It is keen to renegotiate the treaty at the earliest to avoid confusion

- India-Singapore DTAA co-terminus with India-Mauritius DTAA for Capital Gains on transfer of shares
- Talks on for re-negotiation of DTAA to bring it at par with India-Mauritius and to include:
 - Grandfathering of shares acquired upto 31 March 2017
 - Benefit of concessional rate of 50% during transition period
- Impact on other instruments such as debt securities, derivatives, units of mutual funds, G-sec, etc. to be seen?

India-Cyprus DTAA

- Recent developments

India-Cyprus DTAA to undergo following key changes:

- Source based taxation of Capital Gains for shares acquired on or after 1 April 2017
- Grandfathering of shares acquired upto 31 March 2017
- Withdrawal of Cyprus's classification as Notified Jurisdictional Area retrospectively from 1 November 2013

ON A NEW NOTE

- Cyprus will no longer be a 'non-cooperative jurisdiction'. It was the only country blacklisted by India
- The Mediterranean country is a popular tax haven, and there has been little exchange of financial information between the two countries
- This is despite the existence of a 1994 bilateral treaty mandating exchange of information
- Cypriots currently face higher withholding taxes, transfer-pricing provisions etc
- India's 2013 blacklisting had affected fund inflows from Cyprus



The fine print

- Source-based taxation on capital gains following sale of shares
- Grandfathering of investments made before April 1, 2017
- Capital gains to be taxed in the country of taxpayer's residence

WHY DOES THE TREATY NEED TO BE AMENDED?

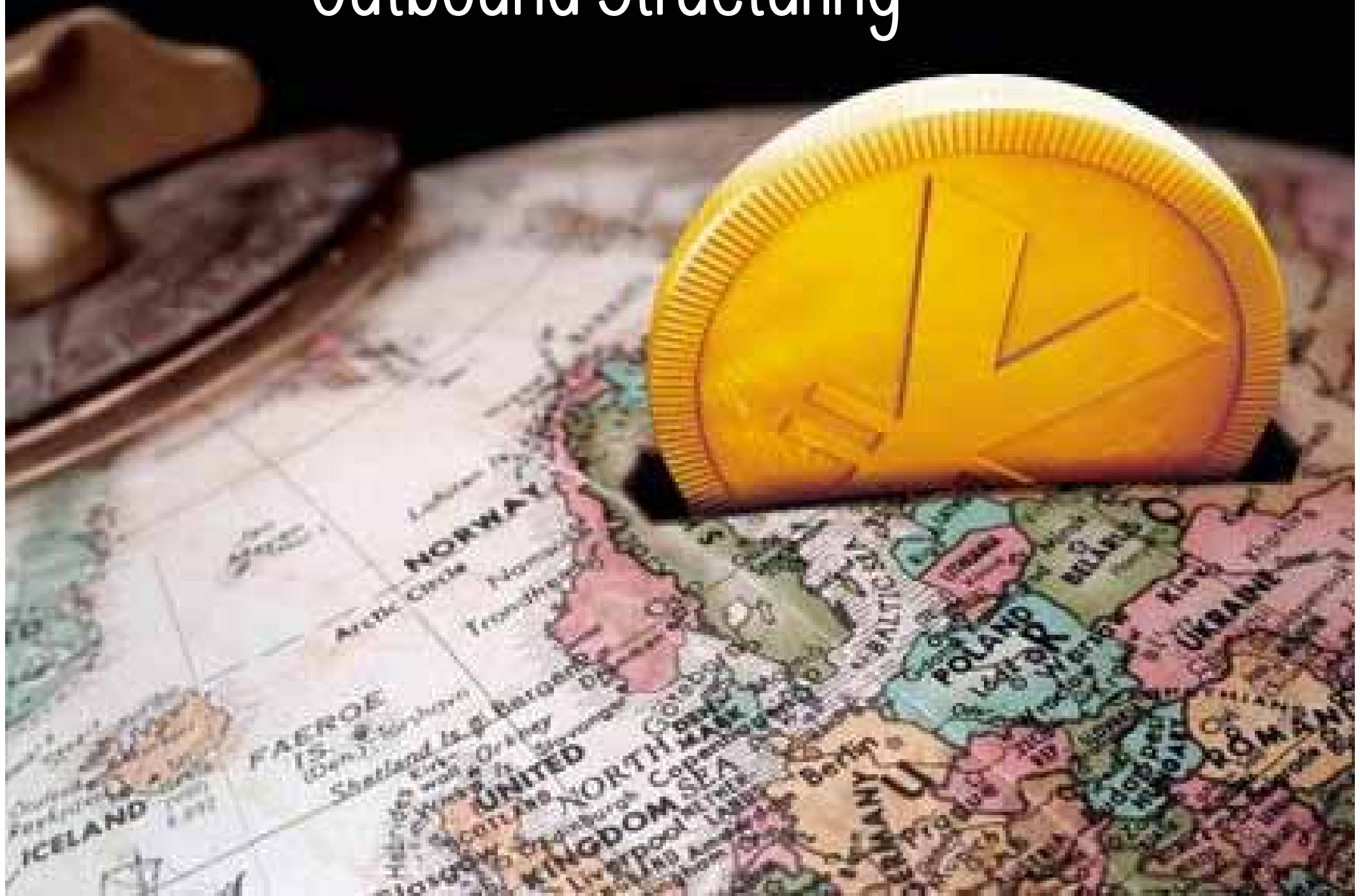
It creates opportunities for treaty shopping

Encourages round-tripping of funds

Promotes opaque multi-layered structures

Impacts India's internal policy on capital gains

Outbound Structuring



Outbound Structuring *- Key Considerations*

Need for
SPVs /
Holding
Company
Regimes

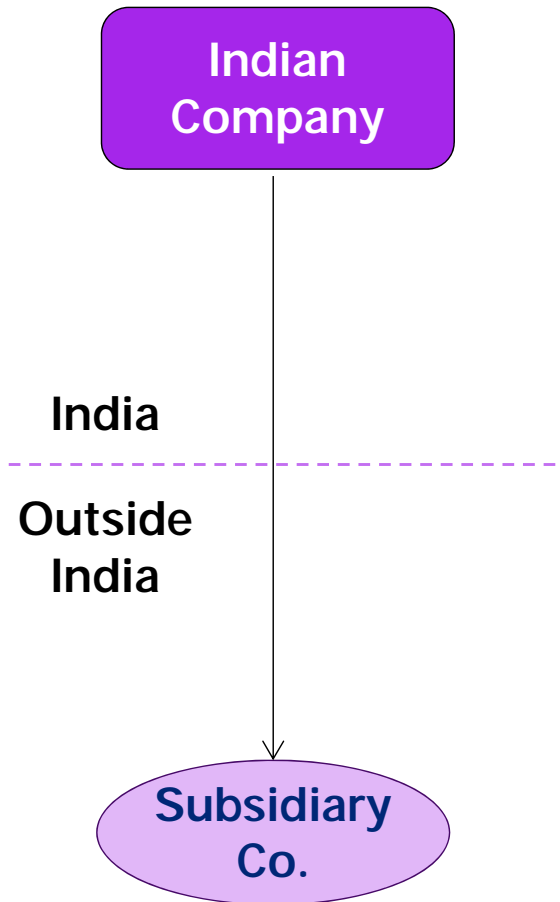
IPR Regime

FTC / Loss
Utilization

CFC/
Participation
Exemption /
Thin
Capitalization
Rules

Corporate Tax
and
Withholding
tax rate

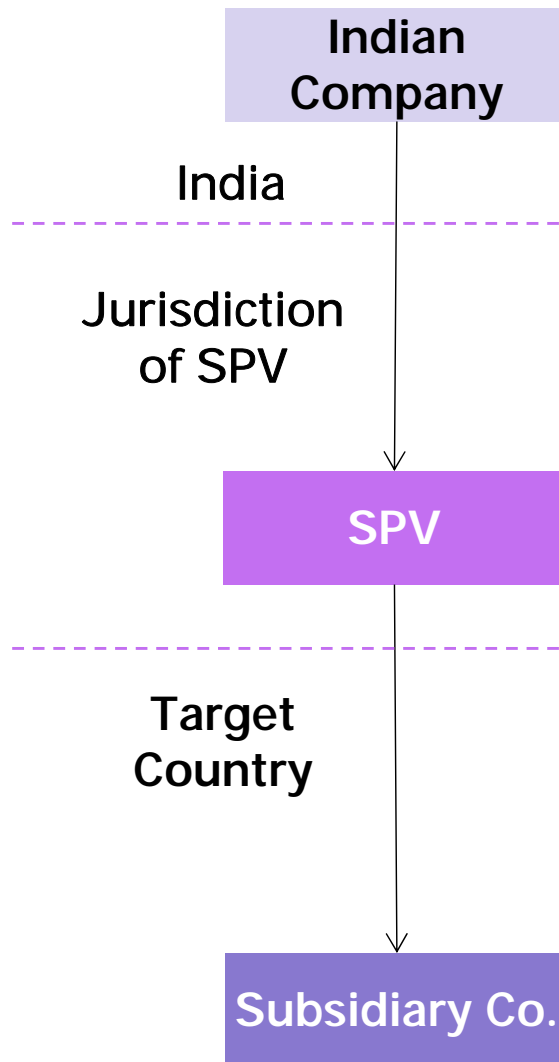
Outbound Structuring - *Direct*



- Direct investment leads to immediate taxation on distribution
- Dividend / Interest – Taxable in India, taxability in source state subject to DTAA benefits
- Capital Gains on sale of shares – Taxable in India, taxability in source state subject to DTAA benefits
- Increased tax burden if Target is in high tax jurisdiction
- Limited capacity to borrow

Outbound Structuring

- *Multi layered*



- Flexibility to up-stream returns
- Possibility of reducing withholdings on paybacks
- Reduce tax incidence on exit
- Deduction of funding costs at IHC level
- Enhanced ability to leverage on group strength to raise funds
- Reduce overall group tax rate
- Effective management of credit and currency risk

Inbound / Outbound Structuring

- Key Considerations

(1/2)

PARTICIPATION EXEMPTION

Exemption in SPV's jurisdiction for dividend income and capital gains from downstream investments upon fulfilment of certain conditions

Conditions typically pertain to shareholding pattern, jurisdiction of parent entity and percentage of holding

IPR REGIME

Specific incentives, deductions and exemptions available in some jurisdictions in relation to IPR holdings

Patent Box regime (i.e. concessional rate for royalty incomes from certain IPRs) and deduction for cinematographic films in UK

Accelerated Deduction allowed on R&D spends in Singapore, Ireland and Switzerland

GAAR

GAAR provisions are targeted at arrangements undertaken where the main purpose is to take tax benefit

The regulations empower the tax authorities to disregard residency of overseas Company, treating them as tax residents of India and the income so earned by them could be brought to tax in India

GAAR in India set to be applicable from 1 April 2017

Inbound / Outbound Structuring - Key Considerations

(2/2)

POEM

Foreign company shall be considered to be a resident in India if its place of effective management, in that year, is in India

Concept of POEM similar to those present in various tax treaties, CBDT has issued draft guidelines for determination of POEM

If considered as a resident, worldwide income of foreign company will be taxable in India

CFC

CFC rules are designed to limit artificial deferral of tax by using offshore low taxed entities not currently taxed to the owners of the entity.

CFC regimes used in many countries to prevent erosion of domestic tax and discourage residents from shifting income to jurisdictions with no or lower tax

THIN CAPITALIZATION RULES

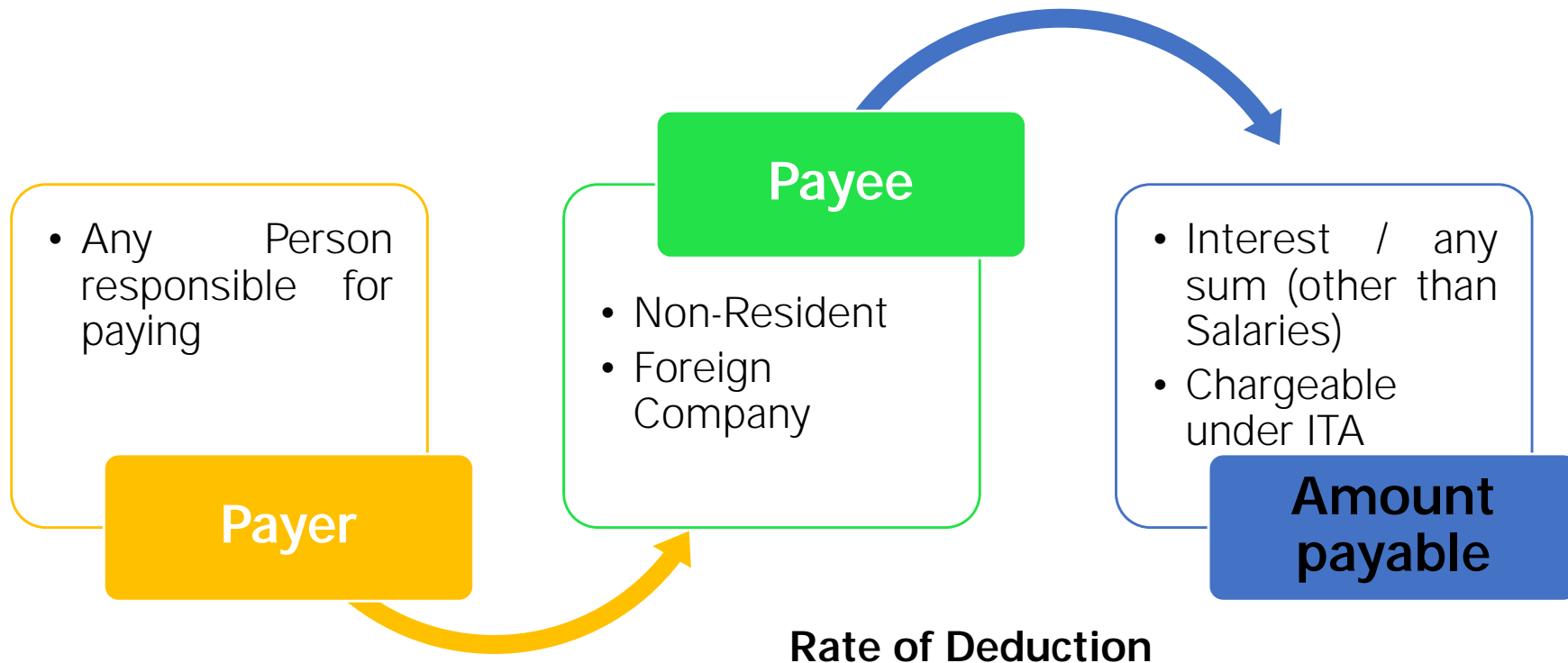
Companies said to be thinly capitalized when its capital is made up of a much greater proportion of debt equity

Tax efficient cash repatriation possible by claiming tax deduction on interest on debt

Corporate Tax Compliance for Double Tax Relief

COMPLIANCE

Section 195 - Liability for deduction



Rate of Deduction

Time of Deduction

Rates in Force

Payment or Credit whichever is earlier

Rule 37BB and Form 15CA / Form 15CB

Whether TDS liability can be on payment / receipt basis under DTAA – 'Paid'

Section 195(2), 195(3) and 197

Particulars	195(2)	195(3)	197
Application by	Payer	Payee (subject to Rule 29B)	Payee
Purpose	To determine appropriate WHT rate for a specified payment	For claiming 'Nil' WHT rate for specified receipt	For claiming Nil / lower rate of WHT for all receipts
Applicability	All payments to NR	Specified receipts of NR	All receipts of NR
Appealable	Yes, under section 248 by the payer bearing the tax and claims that no tax was deductible	No	No
Revision in favor u/s 264	Yes	Yes	Yes

Section 206AA

- Overview and Key Issues

(1/2)



Obtaining of PAN by NR

- FA 2016 introduced sub-Section (7) in Section 206AA and Rule 37BC has relaxed condition of obtaining PAN by NR, subject to furnishing certain details viz. name, email id, contact number, address of home country, TRC, TIN, etc.
- These details to be reported to the Indian tax authorities by the payer by including it in the TDS returns



Whether provisions of Section 206AA overrides the DTAA?

- Literal reading suggests that it shall override provisions of ITA and DTAA
- Section 206AA deals with rates of withholding taxes - Not a charging Section
- NR can file a return and claim refunds of additional TDS amount
- Serum Institute of India Limited (ITAT Pune) ITA No. 792/PN/2013 – in absence of PAN of NR, payer not required to deduct TDS at 20 per cent if case covered by DTAA

Section 206AA

- Overview and Key Issues

(2/2)



Section 195A vis-à-vis Section 206AA

- Section 195A requires grossing up of the rate in case of 'net of tax' contract
- Applicable rate for grossing up to be 'rates in force'
- In cases where rates in force is 10 per cent as per DTAA and PAN not obtained – Whether grossing up should be on 10 per cent being rates in force or 20 per cent?



Whether Surcharge or Education cess on maximum rate of 20% as per Section 206AA shall be levied

- Finance Act does not include Section 206AA in its ambit for levy of surcharge / education cess on maximum rate of 20%

Non-Residents - Key Compliances

DOCUMENTS FOR CLAIMING DTAA BENEFIT

- TRC containing prescribed particulars along with Form 10F
- Relevant DTA / No PE declaration

FILING OF RETURN / FORM 3CEB BY NR

- ITA mandates filing of ROI by every Company and Firm
- Company includes a foreign company, so every foreign company having India source income is liable to file Income-tax return in India in all cases
- If the income consists of specified income on which appropriate TDS has been deducted (primarily interest) then Foreign company will not be required to file ROI
- Filing of an Accountant's Report (Form No. 3CEB)
- NR having PAN and not filing Income-tax return can be easily tracked by Tax Authorities
- Liaison Office of Foreign Company required to file Form No. 49C
- Onerous obligation surround PE Returns – Accounting, Audit, WHT, etc.

CONSEQUENCES OF NON-COMPLIANCE

- Levy of Interest and Penalty

Thank you

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