INTERNATIONAL TAXATION IN INDIA - RECENT DEVELOPMENTS & OUTLOOK (PART - I)

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INTRODUCTION

In the midst of the slowdown in major developed economies across the globe and general anti - establishment sentiments in major trading partners, India continued to remain an important jurisdiction for global trade as well as with regard to regulatory developments & jurisprudence concerning international taxation. India played significant role at OECD and UN for the formulation on global consensus on various international tax policies. India continued to support the action also on the area of transparency and exchange of information.

India's commitment to the area of international tax also gets reflected in various regulatory developments taking place during the year 2016, including vide Finance Act 2016.

Year 2016 also witnessed the conclusion of much controversial & talked about treaty negotiation between India - Mauritius, Singapore& Cyprus. With GAAR coming into play effective 1st April 2017, we can expect tremendous activity and interest of all the stake holders in the field of cross border transactions & India's participation in global M&A activities.

This article has been divided into two sections; Section 1 provides an overview of recent important developments at India. Recent developments are further bifurcated under three parts dealing with Regulatory developments, Treaty Amendments and Negotiations & Recent Judgement respectively. The Section 2 provides Outlook for 2017-18.

AN outlook on the tax challenges which select activity will face having regard to the identified parameters of Income tax provision/rules has also been provided. The table summarising sensitivity analysis of select economic activity shall be an indicator of the likely tax disputes/controversy which MNEs will have to manage for the year 2017 and in 2018.

The developments during the year 2016 were in the backdrop of the release of BEPS reports by OECD, effort by developed economies on transparency & exchange of information and various tax challenges/issues surrounding cross border transactions. The ongoing treaty negotiations by India of its controversial and much talked about round tripping concern was one of the significant developments in India on international tax matter.

A. Regulatory developments

The Indian parliament passed requisite Bill in June 2016, which resulted into the amendments to the Income-tax Act, 1961 vide Finance Act 2016. Subsequent to the same, Government also released further clarifications on subject of "Indirect Transfer" Few of the important regulatory development of year 2016 are summarised below:

A.1. FATCA & Common Reporting Standard

It may be recalled that reporting requirements under section 285A for implementation of the Common Reporting Standard (CRS) and the US Foreign Account Tax Compliance Act (FATCA)was introduced in the Finance Act 2015 and further, the new rules were inserted w.e.f. 7 August 2015.

On this basis, a guidance note on the implementation of reporting requirements under Rule 114F to 114H of Income - tax rules, 1962 was issued on 31 December 2015 on implementation of FATCA and CRS reporting requirements. The brief summary of Income tax rules for compliance of maintaining and reporting of information under FATCA and CRS is as follows:

Rule	Particular
Rules 114F	Definitions of the various terms referred to in the rules • Financial account, Financial asset, Financial institution, Non- participating financial institution, Non-reporting financial institution, Financial institution with only low - value accounts, Reportable account, Controlling person, Passive non financial entity, Reportable person, Specified U.S. person

Rules 114G	Information to be maintained and reported
	
	• The Reporting Financial Institution (RFI) is expected to maintain and report the following information with respect to each reportable account:
	• The name, address, taxpayer identification number [TIN (assigned in the country of residence)] and date and place of birth [DOB, POB (in the case of an individual)];
	• Where an entity has one or more controlling persons that are reportable persons:
	    ○ the name and address of the entity, TIN assigned to the entity by the country of its residence; and
	    ○ the name, address, DOB, POB of each such controlling person and TIN assigned to such controlling person by the country of his residence;
	• Account number (or functional equivalent in the absence of an account number);
	• Account balance or value (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value) at the end of the relevant calendar year;
	• In the case of any custodial account:
	    ○ the total gross amount of interest or dividends or other income generated with respect to the assets held in the account during the calendar year; and
	    ○ the total gross proceeds from the sale or redemption of financial assets during the calendar year with respect to which the reporting financial institution acted as a custodian, broker, nominee, or otherwise as an agent for the account holder
	• In the case of any depository account, the total gross amount of interest paid or credited to the account during the relevant calendar year;
	• In the case of any account other than that referred above, the total gross amount paid or credited to the account holder with respect to the account during the relevant calendar year; and
	• In case of any account held by a non - participating financial institution (NPFI), for the calendar years 2015 and 2016, the name of NPFI and aggregate amount of such payments.
	
	The above are reporting requirements became applicable from F.Y. 2015-16

Rules 114H	Due diligence procedures for identifying reportable accounts • These rules provide for specific guidelines for conducting due diligence of reportable accounts, viz. US reportable accounts and other reportable accounts.

A.2. Equalisation Levy

OECD BEPS Action Plan 1 dealt with the subject of 'Digital Economy'. The said Action Plan 1 highlighted various challenges on taxation of the transactions carried in digital economy and suggested alternative approaches for taxing such transactions. It was felt that concrete action could be concluded for taxation of the transaction of digital economy by year 2020.

Finance Act 2016, taking cue from the BEPS Action Plan 1, inserted a separate Chapter VIII titled "Equalisation Levy". The said levy came into effect from 1st June 2016.

- Applicability of Equalisation Levy Rules

  The applicability & scope of Chapter VIII has been briefly tabulated below:

Sr. No.	Payer	Recipient	EQL Not Applicable	EQL Applicable
1	Resident	Resident	✔	
2	Non-Resident	Non-Resident	✔	
3	Non-Resident	Resident	✔	
4	Resident	Non-Resident (having PE with the specified service effectively connected to PE)	✔	
5	Resident (carrying on B&P)	Non-Resident (other than at Sr. No. 4 above)		✔

- The summary of the Equalisation Levy Rules is as under:

Particulars	Section	Rule	Explanation
Computation and payment	Section 165 &166	Rule 3 and Rule 4	Equalisation levy of 6% to be deducted from amounts paid to a non-resident not having any permanent establishment in India, on specified services*. Amount deducted during a month is to be deposited with RBI or SBI before seventh day of the following month.
Furnishing of statement of specified services / annual return	Section 167	Rule 5 and Rule 6	The statement of specified service is required to be furnished electronically in Form No. 1 on or before 30th June immediately following that financial year.
Processing of statement of specified services	Section 168	Rule 7	Where any levy, interest or penalty is payable under the provisions, a notice of demand specified in Form No. 2 shall be served upon the taxpayer.
Filing of appeal against the penalty order before the Commissioner of Income-tax (Appeals) [CIT(A)]	Section 174	Rule 8	An appeal against the penalty order shall be electronically filed before the CIT(A) in the prescribed Form No. 3 within 30 days of receipt of the penalty order. Further, a sum of INR 1,000 is required to be deposited as appeal filing fee.
Filing of appeal before the Income-tax Appellate Tribunal (Tribunal)	Section 175	Rule 9	An appeal against the order of the CIT(A) has to be filed in triplicate with the Tribunal within 60 days of date of receipt of the order of CIT(A) in the prescribed Form No. 4. Further, a sum of INR 1,000 is required to be deposited as appeal filing fee.

- The provisions of Chapter VIII have not surprisingly invited lot of criticism & attention from various stakeholders. Few of the issues which were debated by the stakeholders are summarised below:

    - Is imposition of EQL constitutional?

      Article 248 of the Constitution of India grants power to Parliament to make laws in respect of matters not enumerated in Concurrent & State list. Having regard to the same, question on constitutionality of EQL was raised.

    - Is EQL in the nature of income tax or indirect tax?

      As the Equalization Levy is not imposed on income, it does not fall within the scope of

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*Specified service is defined as follows:

- Online advertisement
- Any provision for digital advertising space or any facility/ service for the purpose of online advertisement.
- Any other service as may be notified by the Central Government

"income-tax" or "tax on income" or "any identical or substantially similar taxes", which typically define the scope of taxes covered within the tax treaties. Thus, the inherent concept of 'Equalization Levy' as suggested in the BEPS Report on Action 1 keeps it outside the purview of the limitations imposed by tax treaties, a feature, which makes it the only option that can be adopted without violating or in any other way affecting the treaty obligations of the Contracting States in a tax treaty.

- Will imposing EQL be a breach of India's treaty obligations?

  The BEPS Report on Action 1 recognizes that imposition of equalisation levy may not be compatible with the Source State's obligations under existing bilateral tax treaties. Accordingly, the Report points out that countries may introduce, inter alia, equalisation levy in their domestic laws "as additional safeguards against BEPS, provided they respect existing treaty obligations, or in the bilateral tax treaties. Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments." Thus as acknowledged in the BEPS Report on Action 1, imposition of equalisation levy as unilateral measure under the Source State's tax law may lead to protracted litigation in tax treaty situations. As the Indian equalisation levy seems to be in the nature of a tax on income, and since that tax is levied only in case of incomes not attributable to a PE in India, Art. 7(1) of an applicable tax treaty is likely to preclude imposition of the equalisation levy. Indeed, it appears that the objective behind introduction of the equalisation levy is to overcome this hurdle. But, in the author's view, with due respect, bilateral amendments through renegotiation of the existing treaties is the only legitimate way forward. Else, again with due respect, imposition of equalisation levy in tax treaty situations may amount to treaty dodging.

A.3. Relaxation to Non-Residents from higher withholding tax – PAN not required

- The earlier provisions of section 206AA of the Act, inter alia, provide that any person who is entitled to receive any amount on which tax is deductible at source, shall furnish his PAN to the deductor, failing which a higher withholding tax rate will be applicable.
- In order to reduce compliance burden, the Finance Act, 2016 amended the provisions of section 206AA of the Act (w.e.f. June 1, 2016) to provide relaxation from higher withholding tax rate while making payment to non-residents in the absence of PAN.
- Rule 37BC of the Rules provides that the provisions of section 206AA of the Act shall not apply on following payments made to non-residents who do not have PAN in India:
  a. Interest;
  b. Royalty;
  c. Fee for Technical Services; and
  d. Payments on transfer of any capital asset
- In respect of the above specified payments, the non-residents shall be, however required to furnish following details and documents:
  a. Name, e-mail id, contact number;
  b. Address in the country of residence;
  c. Tax Residency Certificate (TRC), if the law of country of residence provides for such certificate; and
  d. Tax Identification Number (TIN) in the country of residence. Where TIN is not available, a unique identification number is required to be furnished through which the deductee is identified in the country of residence.

A.4. Place of Effective Management (PoEM)

- The Finance Act, 2015 amended the provision of section 6(3) which provides the rule for determination of residential status of a foreign company. The effect of this amendment is that a company would be resident in India in any previous year if it is an Indian company or its PoEM in that year is in India. The PoEM was defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made.
- Implementation of PoEM based residence rule has given rise to various issues on applicability of current provisions of the Act to the foreign company. Determining the PoEM is a subjective issue and this fact was also accepted by the lawmakers when section 115JH was introduced to provide transitional relaxations to the foreign companies to whom PoEM applies for the first time. In order to provide clarity in respect of implementation of PoEM based rule of residence and also to address

concerns of the stakeholders,the government had issued draft guidelines in December, 2015. However, the same guidelines couldn't be finalised by the government for variety of reasons. Consequently, vide Finance Act, 2016, the implementation of PoEM was deferred by the government by one year. It is pertinent to note that till December 2016, the government has not issued any clarification, circular or guidelines for implementation of amended PoEM rules. It is felt that implementation of PoEM shall therefore may get deferred again by one year vide ensuing Finance Bill 2017.

A.5. Tax Issues for income arising through 'Indirect Transfer'

- Post the retrospective amendment introduced by the Finance Act, 2012, India taxes the capital gains arising to a non-resident on transfer of shares of a foreign company if such shares derives its value substantially from the assets located in India (i.e. the fair market value (FMV) of assets located in India exceeds Rs. 10 crores; and FMV of assets located in India represents at least 50% of FMV of total assets of the foreign company or entity).
- The CBDT has released rules specifying the method for determination of FMV of the Indian assets vis-a-vis global assets of the foreign company (Rule 11UB), way of determination of proportionality of capital gain taxable in India (Rule 11UC), and the manner of reporting requirement on the Indian concern in which the foreign company holds the assets in India (Rule 114DB).
- CBDT issued Circular No. 41 of 2016 providing clarification on various issues surrounding indirect transfer directly having effect on Foreign Portfolio Investors (FPI).The said circular was in FAQ structure &it dealt with broad subjects concerning:
    a. Tax issues arising from the redemptions by Investors in Offshore Funds registered as FPIs
    b. Master-Feeder Structures
    c. India specific Sub-Funds
    d. Offshore Listed Funds
    e. Valuation Considerations
    f. Corporate Reorganizations
    g. Retrograde positioning on retrospectively

- The clarifications provided by said FAQ/ circular are as follow

    a. Redemptions by Investors in Offshore Funds registered as FPIs

    In order to get exposure to Indian capital markets, various offshore funds are registered as FPIs with the Securities and Exchange Board of India ("**SEBI**") and are accordingly, investing directly in listed Indian companies. Such funds are typically open-ended allowing for frequent subscriptions and redemptions by investors in the fund on the basis of periodic net asset value ("**NAV**") calculations. In this context, a clarification was sought as to whether indirect transfer provisions would apply to redemptions made by investors in such a fund when the fund has been paying applicable taxes on its transactions in listed securities. The CBDT has clarified that where Explanation Conditions are satisfied, redemption by investors of their shares in the fund will be taxable in India unless the investors are covered by the Explanation Carve Out. Further, in Circular No.4 of 2015 dated March 26, 2015, CBDT clarified that an offshore distribution of dividends would not result in a tax liability under Section 9(1)(i) read with Explanation . Therefore, even in a situation where an investor is not covered by the Explanation 7 Carve Out, distributions made out of accumulated profits to such investor may not be subject to tax in India.

    b. Master-Feeder Structures

    Master-feeder structures represent another prevalent model for global platforms accessing Indian listed opportunities. In such structures, monies from the offshore investors are pooled in feeder funds set up in different offshore jurisdictions which in turn pool monies in a master fund set up in an offshore jurisdiction.

    The Circular has clarified that in case the ultimate shareholder satisfies the Explanation 7 Carve Out requirements, he would not be subject to taxation on indirect transfers. By implication, the large investors could be subject to tax. Moreover, in order to satisfy the request of such a shareholder, the feeder and master funds may be required to undertake capital redemptions and be subject to multiple levels of taxation on indirect and direct transfers respectively, although the initial request arose from an investor satisfying Explanation 7 Carve Out conditions.

The Circular does little to relieve the funds from multiple levels of taxation that may be suffered at

- The time of sale of Indian shares by the master fund,
- The time of redemption of shares of the master fund by the feeder funds,
- The time of redemption of shares by investors (holding 5% or more in the master fund) in the feeder fund and taxation of investors on gains arising from redemption of units of the feeder fund in the investor's home jurisdiction.

c. India specific Sub-Funds

The Circular discusses a situation where an offshore fund allocates 10% of its corpus for India investments and sets up an India focused sub-fund for investing exclusively in Indian securities where none of the investors hold more than a 5% stake in the parent offshore fund. The Circular concludes that the indirect transfer rules will apply to the gains derived by the fund on sale / redemption of shares of the sub-fund since the value of shares in the sub-fund substantially derive their value from Indian assets. The Circular further states that such will be the case irrespective of the shareholding of the ultimate investors.

The Circular does nothing to address the primary concern of investors, which is the possibility of economic double taxation. The response ignores the practical and commercial realities of fund structuring, which require multiple considerations from various jurisdictions to be reconciled, and essentially subjects portfolio investors to an additional level of tax due to the structure adopted to invest in the Indian market. In other words, had the investors directly invested into the sub-fund, gains made by investors satisfying Explanation 7 Carve Out conditions on redemption of their shares should not have been subject to the indirect transfer tax. Another way to look at this would be if the offshore fund had directly invested into India, then the Explanation 6 Condition would likely not have been met and again the investors, including the larger investors, would not have been subject to indirect transfer tax on redemption of their shares in the fund. However, merely because the investment is routed through a sub-fund that has an India focus (which may have been done for several commercial reasons), gains arising on the redemption by the parent offshore fund of shares in the sub-fund would be subject to tax in India under the indirect transfer rules. This goes against the grain of the legislative intention behind the indirect transfer provisions and the recommendations of the Report.

d. Offshore Listed Funds

The Circular deals with a scenario involving an offshore fund listed on a foreign stock exchange which satisfies the Explanation 6 Conditions, and where the investors in such offshore fund keep changing due to regular trading on the foreign stock exchange. The Circular clarifies that the investors in the offshore fund would be liable to tax on the gains arising from sale of their shares in the offshore fund due under the indirect transfer provisions unless they can avail of the Explanation 7 Carve Out. Again, the rigid approach adopted here by the CBDT is extremely disappointing and one that disregards the commercial considerations behind the entities being listed outside India. There has previously been discussion, including in the Report, about excluding listed companies from the ambit of the indirect transfer provisions; however, the CBDT has chosen to disregard any such recommendations. Although the above clarification was in the context of funds, the Indian revenue will likely adopt the same interpretation in case of offshore listed corporates which satisfy the Explanation 6 Conditions. Further, in case of listed entities, while CBDT may choose to adopt a technical approach, practical enforcement is questionable. Interestingly, Indian rules also impose obligations on foreign buyers to withhold tax where the foreign seller may be subject to tax in India. Considering how these trades are undertaken, it is practically impossible for these obligations to be imposed. An effort on CBDT's part to take a deeper dive into some of these aspects would have been appreciated.

e. Valuation Considerations

The Circular has discussed a case where a fund satisfies the Explanation 6 Conditions on the 'specified date' but the value derived from Indian assets falls to 47% of the fund's total asset value on the date of the actual transfer. The Circular clarifies that that the indirect transfer provisions would still apply owing to the definition of 'specified date'. The clarification provided by the CBDT brings along with it levels of absurdity. In a M&A situation where the shares of an Indian company are sold and the gains are subsequently up-streamed by the Seller company post the sale, even such up-streaming can be brought within the Indian tax net, even though at the time of such up-streaming, there were no Indian

assets held by the Seller and in fact, the Seller may have discharged taxes in respect of the sale of shares of the Indian company.

Another important valuation-related issue pertains to the reporting obligations imposed on Indian companies under Section 285A of the Income Tax Act read with the recently introduced Rule 114DB of the Income Tax Rules, 1962. These provisions impose onerous reporting obligations on the Indian company with foreign investors, in respect of reporting indirect transfer transactions. A specific clarification was sought in respect of Indian public companies with investments from various FPIs (some of whom may be listed) whose shares witness frequent churn and whose India exposure can vary with investments in multiple investee companies, and how the Indian investee company can be required to assess and comply with the provisions mentioned above. The CBDT has responded stating that the practical implementation of the newly introduced Section 285A and Rule 114DB is first to be seen. This amounts to an absolute shirking of responsibility of the regulator in respect of the issues created by it in the first place. It also points to an implicit acceptance of the immense practical difficulties that the industry faces by virtue of the onerous obligations imposed by the provisions. The response of the CBDT is highly discouraging and offers little in the way of guidance to real problems faced by businesses. Greater clarity on this aspect should be forthcoming from the revenue authorities.

f. Corporate Reorganizations

Under Section 47 of the Income Tax Act, certain corporate re-organization transactions specified therein are not regarded as transfers for the purpose of charging capital gains tax. For instance, Sections 47(via) and 47(vic) exempt, upon satisfaction of certain conditions, transfer of Indian assets as part of overseas amalgamations and demergers involving foreign companies. Similar to these, Section 47(viab) and 47(vicc) exempt the indirect transfer of Indian assets as part of an overseas amalgamation or demerger, provided certain conditions are satisfied. In this regards, the Circular clarifies that the exemption under Section 47(viab) only applies to foreign amalgamating companies holding shares of an offshore company substantially deriving its value from shares of an Indian company. The exemption does not extend to shareholders of an amalgamating foreign company. As such, in case of an offshore fund which satisfies Explanation 6 Conditions, merge into another offshore fund, the investors of the former fund may not rely on Section 47(viab) and could be subject to indirect transfer provisions. Similar would be the case in any other corporate re- organization. The Circular also states that the exemption available to amalgamations under Section 47 is restricted to foreign corporate entities and does not extend to foreign non-corporate entities. Therefore, both foreign non-corporate entities and their investors can be subject to indirect transfer provisions. It is counterintuitive to state that in case of foreign corporate re-organizations, resulting in an indirect transfer of assets, there is an exemption extended to the entities undergoing re-organization, but not for the shareholders. Further, it is even more absurd if placed against the fact that a direct transfer in case of corporate re-organization can be exempt for both the entities and the shareholders, but the same situation does not arise for an indirect transfer.

g. Retrograde positioning on retrospectively

Another concern on which a clarification was sought in the Circular and which has gone unheeded relates to FPIs being treated as 'representative assessees' or 'assessees in default' for failure to withhold tax when such FPIs, in accordance with the position of law as existing at the time of redemption / transfer, did not withhold tax on payments to meet redemption requests. The Shome Committee had recommended that (i) no person should be treated as an assessee in default or a representative assessee of a non-resident, on account of the retrospective nature of the amendments to Section 9, for relying on the existing position of law at the time of a transaction involving the transfer of shares of a foreign company having underlying assets in India, to not withhold tax; and (ii) that in all cases where a demand of tax is raised on account of the retrospective amendment, no interest should be charged in respect of such demand and no penalty should be levied in respect of the income brought to tax. These recommendations were made on the basis that any alternate course of action would result in the imposition of a burden of impossibility of performance and cause undue hardship to the taxpayer. Unfortunately, the CBDT has failed to address real and problematic issues relating to retrospective amendment, merely stating the provisions of the ITA shall apply. Such clarifications by the CBDT are retrograde and at odds with the Government's much touted "non-adversarial" and "business friendly" approach to taxation.

After receiving representations of various stakeholders regarding concern in relation to the possible multiple taxation on the same income, CBDT vide a Press Release dated 17th January 2017 has decided keep the above circular in abeyance.

A.6. Multilateral Instrument

- The multilateral instrument of BEPS Action 15 is a key part of the OECD's effort toward implementation of the recommended measures. The instrument will implement the tax treaty related BEPS measures into existing bilateral or regional tax treaties. Governments are currently preparing their lists of treaties to be covered by the multilateral instrument and are considering which options to select and reservations to make. They will have to notify this to the OECD, who will be the depositary of the multilateral instrument and will support governments in the process of its signature, ratification and implementation. The multilateral instrument was open for signature as of 31 December 2016 and a first high-level signing ceremony will take place in the week beginning 5th June 2017, with the expected participation of a significant group of countries.

B. Treaty Amendments and Negotiations

B.1. Introduction

In the year 2016, the Government of India has amended few treaties with the aim of avoiding treaty abuse and curbing the evasion of taxation. The developments during 2016 were in the backdrop of efforts made by India with the object of transparency and exchange of information with other jurisdictions.

The year 2016 also witnessed conclusion of much talked about treaty negotiation between India and Mauritius, Singapore & Cyprus. There was a reasonable apprehension that India's DTAA's with Mauritius, Singapore &Cyprus were misused for round tripping and bringing money back in India through this route. India has amended its tax treaty with Mauritius, Cyprus & Singapore, a significant milestone in plugging round-tripping of funds. These Amended treaties will help India to curb black money.

The table below summarizes few of the important tax treaties amended/renegotiated/revised by India during the year 2016.

Amended/Renegotiated/ Revised Treaty	Effective Date	Stated Purpose of the Treaty
Singapore *	April 1, 2017	DTAA, Effective Exchange of Information on Tax matters, Eliminating Double Non Taxation
Mauritius *	April 1, 2017	DTAA, Effective Exchange of Information on Tax matters, Eliminating Double Non Taxation
South Korea *	April 1, 2017	DTAA, Effective Exchange of Information on Tax matters, Eliminating Double Non Taxation
Cyprus	April 1, 2017	DTAA, Effective Exchange of Information on Tax matters, Eliminating Double Non Taxation
Japan	April 1, 2017	Internationally accepted standards for Effective Exchange of Information on Tax matters
Tajikistan	Not yet notified	DTAA, Prevention of Fiscal evasion & Effective Exchange of Information on Tax matters
Kazakhstan	Not yet notified	DTAA, Prevention of Fiscal evasion & Effective Exchange of Information on Tax matters

* New Limitation of Benefits Clause introduced and taxing rights of capital gain on alienation of shares has now been given to the source country\

On a broad review of the above table it can be observed that India's treaty policy has kept its focus on treaty shopping and ill effects of the treaty shopping (like giving rise to double non taxation).

B.2. Treaty Specific Analysis

It appears clear from the spate of amendments to India's tax treaties in the recent years, that the Indian government is making a concerted effort to bring the era of tax free investments in India to a close, and is consciously moving towards a source based taxation regime which factor should be considered by investors looking to invest in India. We have provided further analysis of few of the above mentioned treaties

B.2.1. India – Singapore Treaty

The Government of India and the Government of Singapore, on **30 December, 2016,** signed a Protocol amending the Double Taxation Avoidance Agreement (tax treaty) between India and Singapore (India - Singapore tax treaty).

Key highlights of amendments

Following are the key highlights of the signed protocol between India and Singapore.

Taxation of capital gains on shares

- India will have the right to tax capital gains arising from alienation of shares acquired on or after April 01, 2017 by a Singapore resident. Capital Gains will be taxed at 50% for 2 years post April 2017, subject to LOB clause. Earlier DTAA of the countries gave complete exemption from payment of tax on profits made through capital gains as there was no such levy in the host country. Capital gains on derivatives and fixed income securities will continue to be exempt. After 2 years i.e. post March 31, 2019, it will be taxed at 100% in India.

Taxation of interest income of banks

- Withholding tax on interest income earned by Banks @ 15% in case of debt claims or loans made after 31st March 2017

Anti-avoidance measure

- The 2016 Protocol introduces a new article which explicitly provides that the India - Singapore tax treaty shall not prevent either of the countries from applying its domestic laws and measures concerning the prevention of tax avoidance or tax evasion.

Limitation of benefits

- The LOB conditions provided in the 2016 Protocol are similar to the conditions prescribed in the 2005 Protocol. For the specific information, in respect of capital gains arising from transfer of shares acquired prior to 1 April, 2017, the LOB conditions are same as in the 2005 Protocol. However, in respect of investments acquired after 1 April, 2017 and sold before 31 March, 2019, the expenditure test needs to be met for the twelve month period immediately preceding the date of transfer.

Promotion of bilateral investments

- As per the media release issued by the Government of Singapore, both the countries have agreed to conclude an agreement in the second half of 2017 laying down new joint, initiatives to be undertaken for promotion of bilateral investments. This is a welcome development, and may give an impetus to future cross border investments.
- Settlement of cross-border tax issues, especially transfer pricing, will be easier under the amended India-Singapore tax treaty

Impact and Analysis

- This amendment will have far reaching impact across all the sectors and investors; however we have provided impact and analysis for Private Equity Fund Companies, FPIS, and P-Notes.

Impact on shares held by Foreign Portfolio Investors ("FPIs")	• Under the Indian income tax law, shares of listed Indian companies held by FPIs are deemed to be capital assets irrespective of the holding period or the frequency of trading equity carried out by the concerned FPI. As such, income from sale of shares results in capital gains and at present, FPIs enjoy the benefits of the capital gains provisions under the Singapore Treaty. • While the Protocol should provide some relief to FPIs based out of Singapore as regards the tax regime to be applicable to their investments after March 31, 2017, they will find themselves in a similar position to FPIs based out of Mauritius. The signing of the Protocol will no doubt result in an increase in tax costs, especially where short term capital gains are earned.
Impact on private equity funds and holding companies	• As mentioned earlier, while investments by a Singapore resident in shares of an Indian Company made before April 01, 2017 should continue to be eligible to avail of the benefits of the erstwhile provisions of the 2005 Protocol, such benefits shall be subject to fulfilling the requirements of the Revised LOB clause. • Such investments shall be subject to tax in India at the rate of 50% of the tax rate prevailing in India provided the investments are realized before March 31, 2019. All investments made after April 01, 2017 which is also realized after March 31, 2019 shall be subject to full taxation as per the domestic tax rate in India. • Investments made through hybrid instruments such as compulsory convertible debentures should continue to be exempt from tax in India and Singapore should have the right to tax gains from such instruments. • Quick implementation may allow companies to avail benefit of the grandfathering provisions. However, with the GAAR set to come into force, and a concerted effort by the Indian authorities to introduce source based taxation in those treaties which do not already provide for it, offshore investors may also need to carefully reconsider their choice of intermediate jurisdiction and the overall value of investing through intermediate jurisdictions.
Impact on P-Note issuers and Derivatives	• The Protocol will have a significant impact on P-Notes issued against underlying shares of Indian companies. This will have an impact on P-Note investments, especially in issues relating to tax pass through to the P-Note holders on the taxes payable by the FPI. • The Protocol should not adversely impact derivatives, which should also continue to enjoy exemptions from Indian capital gains taxes. The gap that is created between the tax treatment for equity shares vis-à-vis derivative instruments may lead to a shift in strategies that are dominated by exposure to derivative instruments as opposed to investments in equity shares.

B.2.2. India – Mauritius Treaty

The Government of India and the Government of Mauritius, on **10 May, 2016**, signed a Protocol for amending the Double Taxation Avoidance Agreement (tax treaty) dated 24 August, 1982 between India and Mauritius. (India - Mauritius tax treaty). The Protocol is the outcome of an extensive and long drawn-out negotiation process that has been going for more than a year and a half. The revised position shall only be applicable to investments made on or after April 1, 2017.

Key highlights of amendments

Following are the key highlights of the signed protocol between India and Mauritius

Taxation of capital gains on shares

- Under Article 13 (4) of the India-Mauritius DTAA, capital gains derived by a Mauritius resident from alienation of shares of a company resident in India ("Indian Company") were taxable in

Mauritius alone. However, the Protocol marks a shift from residence-based taxation to source-based taxation. Consequently, capital gains arising on or after April 01, 2017 from alienation of shares acquired on or after 1st April 2017 of a company resident in India shall be subject to tax in India.

- The Protocol provides for a relaxation in respect of capital gains arising to Mauritius residents from alienation of shares between April 01, 2017 and March 31, 2019 ("Transition Period"). The tax rate on any such gains shall not exceed 50% of the domestic tax rate in India ("Reduced Tax Rate").

Grandfathering of investments made before April 01, 2017

- The Protocol states that capital gains arising out of sale of shares of an Indian Company that have been acquired before April 01, 2017 shall not be affected by the Protocol. Such investments shall continue to enjoy the treatment available to them under the erstwhile Article 13(4) of the DTAA.

Taxation of interest income of banks

- The Protocol revises the tax rate on interest arising in India to Mauritius resident banks to state that such streams of income shall be subject to withholding tax in India at the rate of 7.5% in respect of debt claims and loans made after March 31, 2017. At present such streams of income are exempt from tax in India under the India-Mauritius DTAA.

Exchange of information

- The text of the Protocol states that the exchange of information article (Article 26) has been amended to bring it at par with the international standards. Provisions such as assistance in collection of taxes and assistance in source-based taxation of other income have been introduced.

Limitation of benefits

- As per the Press Release, the benefit of the Reduced Tax Rate shall only be available to such Mauritius resident who is (a) not a shell/conduit company and (b) satisfies the main purpose and bonafide business test. Further, a Mauritius resident shall be deemed to be a shell/conduit company if its total expenditure on operations in Mauritius is less than INR 2,700,000 (approximately 40,000 US Dollars) in the 12 months immediately preceding the alienation of shares.

Other changes

- Withholding tax on interest income earned by Banks @ 7.5% in case of debt claims or loans made after 31st March 2017.
- Where the debts-claims exist on or before 31 March 2017, shall be exempt from tax in India.
- Article 12A to deal with Fees for Technical Services has also been included. The rate of withholding tax is 10%

Impact and Analysis

- This amendment will have far reaching impact across all the sectors and investors; however we have provided impact and analysis for Private Equity Fund Companies, FPIS, and P-Notes.

Impact	Explanation
Impact on private equity funds and holding companies	• As mentioned above, while investments in shares of an Indian Company made before April 01, 2017 shall receive the benefit of the erstwhile provisions of the India-Mauritius DTAA, such benefits shall be curtailed for investments made during the Transition Period. • Such investments shall be subject to tax in India at the rate of 50% of the tax rate prevailing in India provided the investments are realized before March 31, 2019. All investments made after April 01, 2017 which is also realized after March 31, 2019 shall be subject to full taxation as per the domestic tax rate in India.

	• However, investments that are made through hybrid instruments such as compulsory convertible debentures may still be eligible to claim residence-based taxation as the Press Release only refers to allocation of taxation rights in respect of shares and the Protocol may restrict the shift to source based taxation only to such transactions. Having said that, clarity on this issue shall only be available once the text of the Protocol is released.
Impact on shares held by Foreign Portfolio Investors ("FPIs")	• Under the Indian income tax law, shares of listed Indian companies held by FPIs are deemed to be capital assets irrespective of the holding period or the frequency of trading equity carried out by the concerned FPI. As such, income from sale of shares results in capital gains • At present, FPIs enjoy the benefits of the capital gains provisions under the India-Mauritius DTAA. • Such investments will also be impacted by the amendment and as per the Protocol such investments shall be subject to tax in India after April 01, 2017. While there is a zero percent rate applicable on gains arising out of shares that are listed and sold on a recognized stock exchange if such shares are held for more than 12 months, capital gains arising out of investments are subject to a tax rate of 15% (exclusive of applicable surcharge and cess) if such shares are held for less than 12 months i.e. short term capital gains. • During the Transition Period, and subject to the satisfaction of the limitation of benefits clause, this rate may be reduced to 7.5%.
Impact on P-Note issuers	• Issuers of promissory notes ("P-Notes") may be adversely affected by the Protocol as the cost of taxation arising out of the changed position on taxation would have to be built into such arrangements. This would make such arrangements not only costly but also less lucrative for investors who seek synthetic exposure to Indian securities. • Considering that it is the FPI entity is issuing the P-Note which will be subject to tax in India, issues may arise with respect to the tax amounts that they will be able to pass on to the P-Note holders due to a timing mismatch on the taxability of the FPI entity (which is taxed on a FIFO basis and not on a one-to-one co- relation). It will have to be seen whether P-Notes can still prove to be attractive for investors, considering the incremental tax associated with the same
Impact on F&O transactions	• Similar to the position in respect of compulsory convertible debentures, Mauritius based entities that enter futures and options contract in India, may still be able to claim the benefits of residence based taxation since such contracts relate to capital assets other than shares.

B.2.3. India – South Korea Treaty

India and South Korea have signed a revised Agreement for Avoidance of Double Taxation (tax treaty) on 18 May, 2015, in Seoul. The revised tax treaty replaces the existing tax treaty signed between the two countries in 1985 and shall be effective in India from 1 April, 2017. The Central Board of Direct Taxes has issued a press release dated 26th October, 2016 to this effect.

Key highlights of amendments

Significant changes have been highlighted below:

Taxation of capital gains on shares

The existing DTAA provided for residence based taxation of capital gains on shares. India – South Korea treaty provides for source based taxation of capital gains arising from alienation of shares comprising more than 5 % of share capital.

Limitation of benefits

- The revised DTAA inserts new Limitation of Benefits Article i.e. anti-abuse provisions to ensure that the benefits of the Agreement are availed only by the genuine residents of both the countries.

Taxation of royalty income and Fees for technical service

- In order to promote cross border flow of investments and technology, the revised DTAA provides for reduction in withholding tax rates from 15% to 10% on royalties or fees for technical services and from 15% to 10% on interest income.

Permanent Establishment

- Service PE clause introduced – furnishing of services, including consultancy services, through employees or others would lead to a service PE, if such activities (same or connected project) continue for more than 183 days within any 12 - month period.
- Insurance PE clause introduced – collection of premiums or insuring risk through dependent agent (other than re - insurance) would be deemed as PE.
- Building site or construction, installation or assembly project, or supervisory activities in connection therewith, would constitute a PE if such site project or activities last more than 183 days within any 12 months period.
- Dependent Agent PE – The scope has been expanded to include the following additional activities of agent:
- Habitually exercising in that state an authority to conclude contracts in the name of the enterprise subject to activities mentioned in Article 4. Maintaining stock of goods or merchandise and regular delivery in the contracting state. Securing orders in the contracting state.

Dispute Resolution Changes

- The revised DTAA, with the introduction of Article 9(2), provides recourse to the taxpayers of both countries to apply for Mutual Agreement Procedure (MAP) in transfer pricing disputes as well as apply for bilateral Advance Pricing Agreements (APA). Further, as per understanding reached between the two sides, MAP requests in transfer pricing cases can be considered if the request is presented by the tax payer to its competent authority after entry into force of revised DTAA and within three years of the date of receipt of notice of action giving rise to taxation not in accordance with the DTAA.

Exchange of information

- The Article on Exchange of Information is updated to the latest international standard to provide for exchange of information to the widest possible extent. As per revised Article, the country from which information is requested cannot deny the information on the ground of domestic tax interest. Further, the revised DTAA contains express provisions to facilitate exchange of information held by banks. Information exchanged under the revised DTAA can now be used for other law enforcement purposes with authorization of information supplying country.

Other changes

- Assistance between India and South Korea for collection of taxes.

B.2.4. India – Cyprus Treaty

The Government of India and the Government of Cyprus, on 18 November 2016, signed a protocol amending the provisions of the double taxation avoidance agreement (tax treaty) between India and Cyprus (India- Cyprus tax treaty). The Government of India has issued a press release dated 18 November 2016 (press release) providing a gist of the key amendments.

Key highlights of amendments

Following are the key highlights of the signed protocol between India and Cyprus

Taxation of capital gains on shares

- Amendment shall result into source - based taxation of capital gains arising from alienation (disposal) of shares. In other words, India shall have the right to tax capital gains arising to Cyprus tax residents on transfer of shares of an Indian company.

- However, grandfathering clause has been provided for investments made before April 01, 2017.

Exchange of information

- The provisions related to exchange of information are updated as per international standards, which will enable exchange of banking information and allow the use of such information for purposes other than taxation (subject to prior approval of competent authorities).

Taxation of royalty income

- The tax rate on royalty in the country from which payments are made to 10% from the existing rate of 15%, in line with the tax rate under Indian tax laws.

Other changes

- Expanding the scope of the permanent establishment (PE), possibly to introduce the concept of service PE.
- Assistance between India and Cyprus for collection of taxes.
- Provisions of the India-Cyprus tax treaty in accordance with international standards and India's policy with respect with respect to tax treaties

B.3. Other Points

Besides concluding and renegotiating treaties, the government has also continued its dialogue with few countries and have carried out further amendment to the respective tax treaties by issuance of MOUs or Clarifications

B.3.1. India – Switzerland

The Central Board of Direct Tax has signed an agreement with Switzerland; it will now begin sharing with India from 2019 information on all investment or accounts maintained in its banks post-2018.

B.3.2. India - Sweden

The Competent Authorities of India and Sweden have signed a Memorandum of Understanding (MoU) regarding suspension of collection of taxes during the pendency of MAP. In terms of the MOU, the collection of outstanding taxes in case of a taxpayer whose case is pending in MAP before the Competent Authorities of India and Sweden, would be kept in abeyance for a period of two years (extendable to a maximum period of five years through mutual agreement between the Competent Authorities of India and Sweden) subject to furnishing of a bank guarantee of an amount equal to the amount of tax under dispute and interest accruing thereon, as per the provisions of the Income-tax Act.

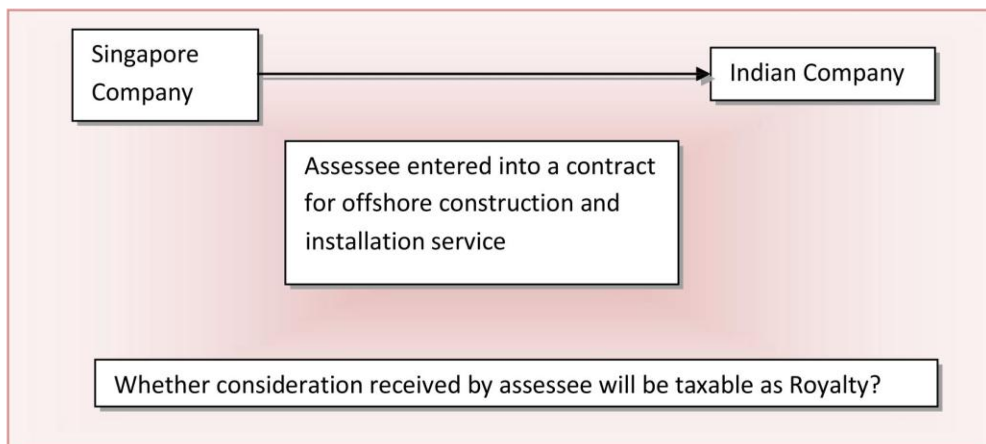
B.3.3. India – Japan

A protocol amending the Double Taxation Avoidance Convention between India and Japan has come into force. The Amended Protocol will provide for internationally accepted standards for effective exchange of information on tax matters. It further provides that the information received from Japan in respect of a resident of India can be shared with other law enforcement agencies with authorization of the competent authority of Japan and vice versa. The protocol provides for exemption of interest income from taxation in the source country with respect to debt-claims insured by the government/government owned financial institutions.

C. Recent Judgements

Summary of the most talked about and controversial judgement are given below:

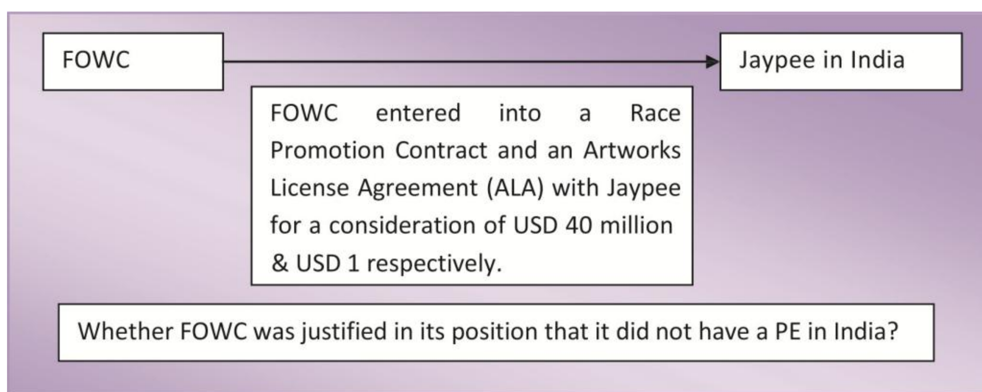
- **Technip Singapore Pte Ltd v DIT - TS-301-HC-2016 (Del) [India - Singapore DTAA]**



The Court held that where the assessee had entered into a contract with Indian Oil Corporation Limited (IOCL) for offshore construction work involving mobilization / demobilization and installation services, the Revenue was incorrect in separating the mobilization / demobilization services from the installation services since the payment made to the assessee was for the execution of a composite contract.

It held that since the equipment used by the assessee while providing services to IOCL were in the exclusive control of the assessee and IOCL did not have any dominion or control over the same, the payment received by the assessee could not be taxed as equipment royalty under Article 12(3) of the India Singapore DTAA. Further, it rejected the contention of the Revenue that the installation services were incidental to mobilization / demobilization services and therefore taxable under Article 12(4)(a) of the DTAA and held that since the demobilization / mobilization services were not taxable under Article 12(3), the installation services even if considered ancillary, would not be taxable. Further, it held that the said services were neither taxable under the DTAA since they didn't make available any technology nor under the Act since it fell under the exclusionary clause to Explanation 9(1)(vii).

- **Delhi HC: Racing Circuit Constitutes Permanent Establishment of Formula One**

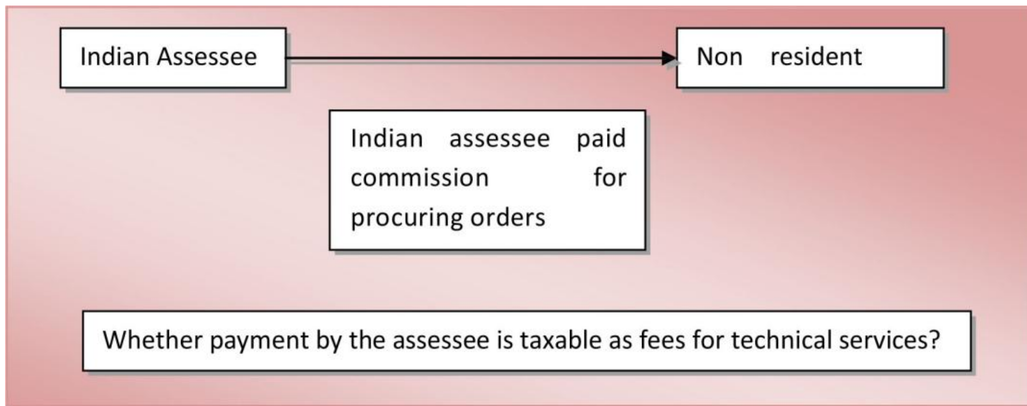


The Court discussed various illustrative examples across jurisdictions on the interpretation of a fixed place PE, such as Universal Furniture Ind AB v Government of Norway, the Swiss Server decision and Joseph Fowler v Her Majesty the Queen. No conclusive rule could be laid down as to the number of days which could impart a degree of permanence to a place of business to make it a fixed place. The AAR also noted that a place of business could constitute a PE even for a very short period of time because of the nature of the business. Therefore, even if the business was

done for a short duration with intermittent gaps, the existence of a fixed place of could not be ruled out.

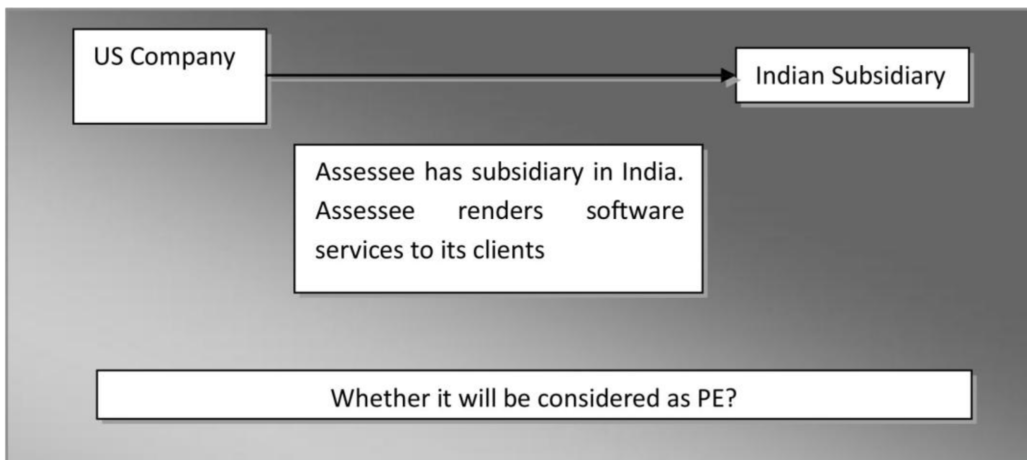
Further, relying on the OECD commentary and Klaus Vogel's commentary on the general principles applicable to a fixed place PE, the Court noted that as long as the presence was in a physically defined geographical area, permanence in such fixed place could be relative, having regard to the nature of the business.

- **CIT v Farida Leather Company - (2016) 66 taxmann.com 321 (Mad)**



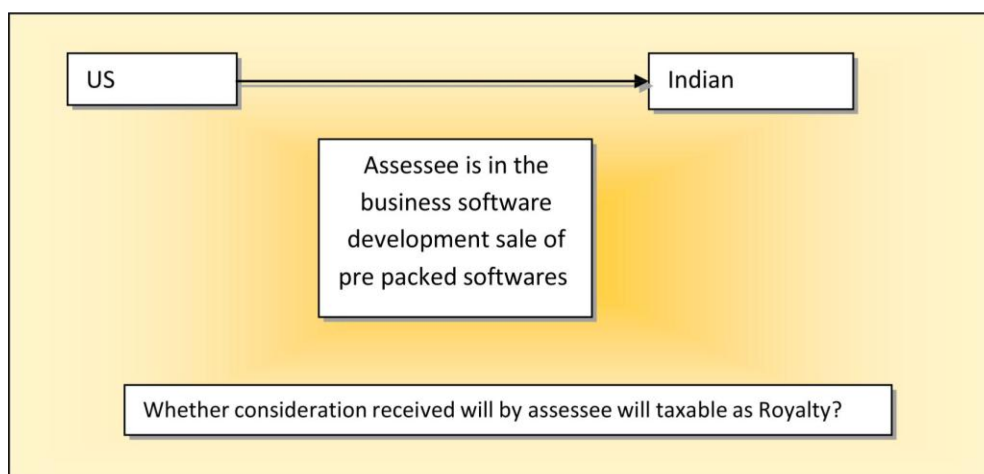
The Court held that agency commission paid by the assessee to non- resident agents for procuring orders for the assessee outside India, would not be taxable as fees for technical services under section 9(1)(vii) of the Act and therefore section 195 of the Act would not be applicable, since obligation to deduct tax at source under section 195 only arises if the payment is chargeable to tax in the hands of the non-resident recipient.

- **Adobe Systems Incorporated v ADIT - (2016) 96 CCH 0012 (Del) [India - US DTAA]**



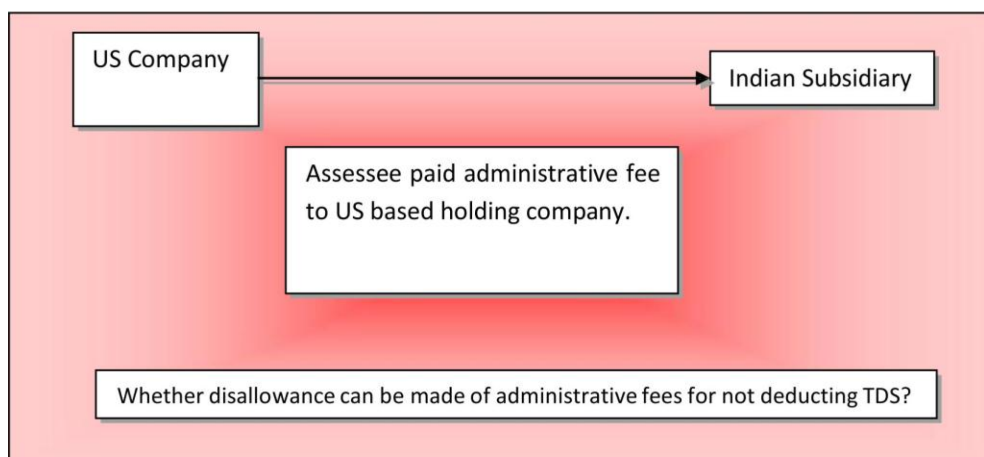
The Court held that where the subsidiary company of the assessee was compensated at ALP for international transactions with the assessee (its AE), assuming that the subsidiary company was the PE of the assessee, no further profits could be attributed to the assessee's operations in India. Without prejudice to the above, the Court held that the assessee's subsidiary in India did not constitute a fixed place PE since there was no evidence that the assessee had the right to use its premises or any fixed place at its disposal. The Court held that held that in the absence of any evidence that any of the assessee's employees provided services in India, there could be no Service PE and merely because the assessee had the right to audit the Indian subsidiary, it cou ld not be concluded that the employees of the assessee provided services in India. Further,it held that there was no allegation that the Indian subsidiary was authorized to conclude contracts on behalf of the Petitioner and therefore could not be considered as a Dependent Agent PE.

- **CIT & ANR vs. Halliburtion Export Inc. & ANR - (2016) 96 CCH 0060 (Del HC) - ITA 363/2016, 365/2016 [India - US DTAA]**



The Court held that consideration received by assessee on sale of pre packaged software was not royalty. It further held that there is a clear distinction between royalty paid on transfer of copyright rights and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright owner has is necessary to invoke the royalty definition. Hence the Court held that a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of India-USA DTAA.

- **CIT v Herbalife International India Pvt Ltd - (2016) 96 CCH 0007 (Del) [India - US DTAA]**



The Court held that for AY 2001-02, prior to the insertion of section 40(a)(ia) of the Act, disallowance of payments to non-residents on account of non-deduction of tax at source was discriminatory, since payments to residents were not subject to such disallowance arising out of non-deduction of tax at source and consequently assessee would be eligible to benefit of Article 26(3) of the India -US DTAA i.e. Non-discrimination, and therefore it held that the administrative fee paid by the assessee to its US based holding company was allowable in spite of non-deduction of tax at source.

The Outlook for 2017-18 would be continued in the next Bulletin.