



TRANSFER PRICING / GAAR / POEM

BUDGET ANALYSIS 2017-18

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TRANSFER PRICING



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✓ Specified Domestic Transactions Coverage - Report in Form 3CEB w.e.f. AY 2013-14 if the aggregate of transactions exceeds Rs.5 crores

Particulars	Current	Proposed
✓ Transactions involving payments covered under Section 40A(2)(b)	✓	×
✓ Transaction referred to in section 80A	✓	✓
✓ Transfer of goods or services under Section 80-IA(8)	✓	✓
✓ Transactions with person referred to in Section 80-IA(10)	✓	✓
✓ Transactions referred in other section under Chapter VI-A / Section 10AA to which provisions of Section 80-IA(8) or 80-IA(10) apply	✓	✓
✓ Any other transaction as may be prescribed	✓	✓



TRANSFER PRICING

- ✓ **New Section 92CE - Secondary Adjustments - adjustments in books of accounts of the assessee and its associated enterprise to reflect effect on allocation of profit due to primary adjustments arising out of:**
 - ▶ **Suo motu declaration by the assessee in his return of income or**
 - ▶ **Assessment by Assessing Officer and accepted by the assessee or**
 - ▶ **Advance pricing agreement entered into by the assessee or**
 - ▶ **Safe harbour rules or**
 - ▶ **Resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A.**
- ✓ **Removes the imbalance between cash account and actual profit of the assessee.**
- ✓ **Required to be made if the amount of primary adjustment exceeds Rs.1 crore.**
- ✓ **Applicable from Assessment year 2018-19.**
- ✓ **Excess money with associated enterprises arising out of primary adjustment shall be deemed to be an advance if not repatriated to India.**
- ✓ **Interest on such advance needs to be computed.**



GAAR



BACKGROUND GAAR

Supreme Court Judgement dated 20th January 2012 in case of Vodafone International Holdings B.V. shares acquisition deal dated 11th February, 2007 with CGP Investments (Holdings) Ltd in Cayman Islands for acquisition of controlling interest in Hutchison Essar Limited:

- ▶ **Sale of CGP share to Vodafone does not amount to transfer of capital asset as per Section 2(14)**
- ▶ **Authorities in India have no jurisdiction to tax this offshore transaction**
- ▶ **Government should include its policy in law and the tax treaties**
- ▶ **Section 9 of the Income-tax Act, 1961 has to be given a literal interpretation and no “look through” is permitted**
- ✓ **Foreign Investments in India:**
 - ▶ **Legal Structure of the entity**
 - ▶ **FDI Policy**
 - ▶ **Direct Taxation**
 - **Tax Treaties**
 - **Capital Gains**
 - **Transfer Pricing - Advance Pricing Agreement / Safe Harbour Rules / Other**
 - **Place Of Effective Management**
 - **General Anti Avoidance Rule / Specific Anti-Avoidance Rules**
 - ▶ **Indirect Taxation - Special Valuation Branch (Customs)**



UNDERSTANDING GAAR

- ✓ Introduced in Budget 2012 by then Finance Minister, Pranab Mukherjee
- ✓ Implementation deferred by 2 years during the 2015 Budget presentation, by Finance Minister Arun Jaitley
- ✓ Will be implemented w.e.f. 1st April, 2017 (i.e. AY 2018-19)
- ✓ Applicable Provisions Chapter XA – Section 95 to Section 102
- ✓ GAAR - 5Ws with a H
 - ▶ What is GAAR?
 - ▶ Why is it needed?
 - ▶ Who is impacted?
 - ▶ When is it applicable?
 - ▶ Where is it applicable?
 - ▶ How will it be implemented?
- ✓ General anti-avoidance rule (GAAR) - substance should be preferred over the legal form while interpreting the tax legislation
- ✓ GAAR helps determine:
 - ▶ whether an arrangement is an impermissible avoidance arrangement
 - ▶ consequence in relation to tax arising therefrom



IMPERMISSIBLE AVOIDANCE AGREEMENT

✓ An arrangement may be declared as an Impermissible Avoidance Agreement when:

- ▶ **Main purpose is to obtain a tax benefit**
- ▶ **Contains any of the following tainted elements**
 - **creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length**
 - **results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act**
 - **lacks commercial substance or is deemed to lack commercial substance in whole or in part**
 - **is carried out by means / in a manner not ordinarily employed for bona fide purposes**
- ▶ **Even if part of the arrangement is to obtain a tax benefit unless it is proved to the contrary**



COMMERCIAL SUBSTANCE

✓ An arrangement shall be deemed to lack commercial substance if:

- ▶ substance or effect of the arrangement is inconsistent / differs significantly with the form of its individual steps or a part
- ▶ it involves or includes:
 - round trip financing
 - an accommodating party
 - elements that have effect of offsetting or cancelling each other
 - a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction
- ▶ it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose, except for tax benefit to a party
- ▶ it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement, except for tax benefit to a party



GAAR – DRAFT GUIDELINES

✓ Draft Guidelines issued for implementation of the GAAR provisions as specified in law:

- ▶ **Monetary Threshold for invoking GAAR**
- ▶ **Prescribed statutory forms for Assessing Officer to make a reference to the Commissioner , Commissioner to make a reference to the Approving Panel, Commissioner to return the reference to the Assessing Officer**
- ▶ **Time limits during which the various actions under the GAAR provisions are to be completed**
- ▶ **Recommendations regarding setting up of the Approving Panel**
- ▶ **Recommendations for the Circular on GAAR explaining:**
 - **Provisions of GAAR**
 - **Special provisions for Foreign Institutional Investors,**
 - **Clarity regarding retrospective / prospective operations of the GAAR provisions**
 - **Interplay between Specific Anti-Avoidance Rules (SAAR) and General Anti-Avoidance Rules (GAAR) and such other issues.**
- ▶ **Tax Avoidance / Tax Evasion / Tax Mitigation**



RECENT CLARIFICATIONS ON GAAR

GAAR will not interplay with right of taxpayer to select or chose method of implementing a transaction

- ✓ **Provisions of GAAR and SAAR (Specific Anti Avoidance Rules) Provisions can co-exist**
- ✓ **Grandfathering:**
 - ▶ **Available to compulsorily convertible debentures, compulsorily convertible preference shares, foreign currency convertible bonds, global depository receipts, bonus issuances or split / consolidation of holdings in respect of investments made prior to 1st April 2017 in the hands of same investor**
 - ▶ **Not applicable to Lease contracts / loan arrangements as they do not qualify as investments as per Accounting Standard**
- ✓ **Proposal to apply GAAR will be vetted first by the Principal Commissioner of Income Tax / Commissioner of Income Tax and at the second stage by an Approving Panel headed by a judge of High Court. Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner**
- ✓ **Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor to determine whether an arrangement lacks commercial substance**



RECENT CLARIFICATIONS ON GAAR

- ✓ **Assessment of notional income / disallowance of real expenditure covered in an arrangement under Section 96 will attract GAAR provisions**

- ✓ **GAAR will not be invoked under following situations:**
 - ▶ **If the jurisdiction of Foreign Portfolio investor is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit**
 - ▶ **If a case avoidance is sufficiently addressed by Limitation of Benefits (LOB) in the Treaty**
 - ▶ **if an arrangement is held as permissible by the Authority for Advance Rulings**
 - ▶ **If at the time of sanctioning an arrangement, the Court has explicitly and adequately considered the tax implications**
 - ▶ **Admissibility of claim under treaty or domestic law in different years is not to be determined through GAAR provisions**
 - ▶ **If an arrangement has been held to be permissible in one year by the PCIT / CIT / Approving Panel and the facts and circumstances remain the same, GAAR will not be invoked for that arrangement in a subsequent year**



RECENT CLARIFICATIONS ON GAAR

- ✓ If a particular consequence is applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in hands of other participant will not be made
- ✓ GAAR is w.r.t. an arrangement or part of the arrangement and limit of Rs.3 crores cannot be read in respect of a single taxpayer. Tax benefit enjoyed in an assessment year in Indian Jurisdiction will be examined
- ✓ No blanket exemption from penalty proceedings for 5 years can be granted and the same will depend on facts and circumstances of the case



POEM



Why POEM?

- **The concept of Place of Effective Management (POEM) is used to determine a foreign Company's Residential Status.**

- **Importance of POEM**
 - ❑ **Taxability of Income generated outside India**
 - ❑ **Tax Compliances**
 - ❑ **Applicability of provision of Income Tax Act as well as Black Money Law**

- **'Place of effective management' (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction.**



RESIDENTIAL STATUS - COMPANY

✓ Resident in India - Section 6(3)

Particulars	Prior to amendment	Post amendment – Finance Act 2015
Company is said to be resident in India in any previous year if:	<ul style="list-style-type: none"> ✓ It is an Indian company ✓ Control and management of its affairs is situated wholly in India during that year 	<ul style="list-style-type: none"> ✓ It is an Indian company ✓ Its place of effective management in that year is in India

- ✓ Place of effective management: place where key management and commercial decisions necessary for the conduct of the business of an entity as a whole are, in substance, made
- ✓ Amended definition effective from AY 2017-18 i.e. 1st April 2017.
- ✓ Tax treaties recognise the concept POEM for determination of residence of a company to avoid double taxation



POEM – ACTIVE BUSINESS OUTSIDE INDIA

- ✓ **Guiding principles dated 24th January, 2017 are issued for determining the place of effective management**
- ✓ **Substance would be conclusive rather than the form**
- ✓ **Companies will be treated as engaged in active business outside India if:**
 - ▶ **Passive income (Income from specified transaction with associate enterprise) is not more than 50% of its total income.**
 - ▶ **Less than 50% of its total assets are situated in India.**
 - ▶ **Less than 50% of total number of employees are situated in India or are resident in India.**
 - ▶ **The payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.**
- ✓ **Average of the data of the previous year and two years prior to that shall be taken into account for determining active business outside India (or shorter period as applicable)**
- ✓ **POEM for company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India**



Two stage process:

- ▶ identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole
 - ▶ determination of place where these decisions are in fact being made
- ✓ **POEM will be determined based on primary factors:**
- ▶ location where a company's Board regularly meets and makes decisions
 - ▶ If Board delegates authority to one or more Committees, location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies
 - ▶ location of a company's head office
 - if single location, place where senior management and their staff are based
 - if decentralized, then place where senior management is predominantly based / normally return to post their travel / meet when formulating strategies, policies
 - Other situations - location where the highest level of management and their direct support staff are located
 - ▶ place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor considering use of modern technology



POEM – OTHERS

- ▶ In case of circular resolution or round robin voting, place of location of the person who has the authority and who exercises the authority to take decisions
 - ▶ Decisions made by shareholder on matters which are reserved for them are not relevant for determination of POEM
 - ▶ If shareholder's involvement turn into effective management, to be determined on case to case basis
 - ▶ day to day routine operational decisions not relevant for POEM
 - ▶ If same person is responsible for the key management and commercial decision, distinguish the two type of decisions and then assess location where the key management and commercial decisions are taken
- ✓ **Secondary factors for determining POEM**
- ▶ Place where main and substantial activity of the company is carried out
 - ▶ Place where the accounting records of the company are kept
- ✓ **If POEM is in India and also outside India, POEM shall be presumed to be in India if it has been mainly / predominantly in India**
- ✓ **Prior approval of the Principal Commissioner or the Commissioner is required for initiating any proceeding by AO.**
- ✓ **If AO proposes to hold a company incorporated outside India as resident in India based on POEM, prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners is required.**



THANK YOU

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