International Taxation
Recent Developments in India

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1. INTRODUCTION

This paper will provide a key tax developments in International Taxation from an Indian perspective.

G20/BEPS arena driven landscape is significantly different from decades of treaty shopping and structuring investments. Money could be stashed in low tax or no tax jurisdictions without any underlying economic activity. India has kept speed with the OECD actions and even been a vehement voice at those discussions. India has unilaterally taken measures to address base erosion and profit shifting. The menace of numerous well known MNEs resorting to tax avoidance is coming to a close with the Multilateral Instruments about to get signed in June 2017 in Paris.

This note provides in about five pages the changes that have taken place in 2016. The government has taken important steps to reduce base erosion. India has amended 3 main tax treaties with Mauritius, Singapore & Cyprus. Some of these treaties served as highways of tax avoidance for decades and were used to be so, albeit as legitimate routes. Automatic Exchange of Information is another trigger pressed by India with several countries.

General Anti Avoidance Rules ("**GAAR**") is now a reality from April 1, 2017. With Multilateral Agreements about to get signed, we can expect 2000 treaties worldwide to undergo sweeping changes, the line between evasion, avoidance and planning will require a microscope.

2. Amendment to Tax Treaties

(i) Amendment to India-Mauritius Treaty

- Article 13 of this Treaty was amended to give India the right to charge tax on Capital Gain on transfer of Indian Shares acquired on or after 1st April 2017.
- As per the amended India – Mauritius treaty, FPIs (including P-note holders) who invest in securities listed on the Indian stock exchange but exit before 12 months from the date of purchase will be impacted since they will be required to pay short term capital gains tax in India @ 15%.
- A two year transition period up to 31st March 2019 is provided during which the Ttax rate will not exceed 50% of the Domestic tax rate in India, subject to an Limitation of Benefits (LOB) Clause.; i.e. 7.5% tax rate.
- After 31st March 2019 Tax will be charged at full domestic tax rates.
- The shares acquired before 1st April 2017 will enjoy the Treaty Benefit available to them under Article 13, and shall not be affected by this amendment.
- Capital gain on derivates and fixed income securities will continued to be exempt.
- The above amendment effectively nullifies the benefit earlier taken by other countries of taking Mauritius route for making investment in India.
- Reason for amendment was, major investment was done from Mauritius in India because of these treaties.
- Interest on Debt Instrument: Article 11 was amended such that the interest arising in India and paid to a Mauritius resident will be taxed at 7.5% in India and Fees for Technical Service (FTS) paid from India would be taxed at 10% in India if the beneficial owner of FTS is a resident of Mauritius.
- LOB requires the Mauritius resident to meet two test i.e.-
  a. Main purpose test
  b. Bonafide business test to avail 50% reduction in Tax rate
- As per Sec 56 of the Income Tax Act, if the Shares are transferred free of cost without any consideration; then the person receiving the shares is liable to pay tax.

(ii) Amendment to India-Singapore Treaty

- This amendment gives India the right to charge tax on Capital Gains on transfer of Indian Shares acquired on or after 1st April 2017 by a Singapore Resident.
- A two year transition period up to 31st March 2019 is provided during which the tax rate will not exceed 50% of the Domestic tax rate in India, subject to an Limitation of Benefits (LOB) Clause.; i.e. 7.5% tax rate.
- After 31st March 2019 Tax will be charged at full domestic tax rates.
- The shares acquired before 1st April 2017 are exempt from above amendment.
- Withholding tax on interest income earned by Banks will be 15% in case of debt claims or loans made after 31st March 2017.

3. Base Erosion Profit Shifting (BEPS)

Base erosion and profit shifting (BEPS) is a tax avoidance strategy used by multinational companies, wherein profits are shifted from jurisdictions that have high taxes (such as the United States and many Western European countries) to jurisdictions that have low (or no) taxes (so-called tax havens).

- **BEPS Action Plan 1,** the OECD had amongst the others, considered Equalisation Levy as one of the modes of taxing the Digital transactions: The Equalisation Levy would be applicable at 6% on gross consideration payable for a 'Specified Service'.

  'Specified Service' is defined as follows:
  (1) Online advertisement;
  (2) Any provision for digital advertising space or facilities/ service for the purpose of online advertisement;
  (3) Any other service which may be notified later.

  This will need to complied by: Every resident person and a non resident (having a PE in India) to withhold "Equalisation Levy" while making payment to a non-resident service provider. (with effect from 1.6.2016).

- **BEPS Action Plan 4** In order to combat the cross border shifting of profits through excessive payments and to protect the tax base; Government of India via Finance Bill, 2017 has proposed to introduce a new section, section 94B in the Income Tax Act, 1961 to overcome loss of revenue by way of thin capitalization.

  Interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortisation (EBITDA) or interest paid or payable to associated enterprise, whichever is less,

  In order to target only large interest payments, it is proposed to provide for a threshold of interest expenditure of Rs 1 crore exceeding which the provision would be applicable.

- **BEPS Action Plan 5** Harmful Tax Practices: India has introduced a concessional regime for taxation of royalty income from patents @ 10% gross income, in respect of a patent developed and registered in India by a person resident in India. (with effect from 1.4.2016)
  (Refer Patent Box Regime below).

  BEPS Action Plan 6 Preventive Treaty Abuse: India has introduced a general anti-avoidance rule as part of domestic tax law. (with effect from 1.4.2017). *(Refer GAAR - General Anti Avoidance Agreement provisions below).*

  <u>GAAR</u> as applicable from 1st April, 2017 confers broad powers on the tax authorities to deny tax benefits (including tax benefits applicable under tax treaties), if the tax benefits arise from arrangements that are 'impermissible avoidance arrangements.'

- **BEPS Action Plan 13**, the three-tiered transfer pricing documentation structure consisting of the following is introduced:
- a master file containing standardized information relevant for all multinational enterprises (MNE) group members;
- a local file referring specifically to material transactions of the local taxpayer; and
- A Country-by-Country (Cubic) report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

4. Automatic Exchange of Financial Information

- On 3rd June 2015 , India signed the Multilateral Competent Authority Agreement (MCAA) on Automatic Exchange of Financial Account Information(AEOI) and on exchange of Country by Country (CbC) Reports.
- Section 285BA was amended and Rules 114F & 114H and Form 61B was inserted to enable implementation of reporting requirement under FATCA & CRS.
- Guidance note on implementation of FATCA & CRS issued in December 2015.
- From 2017 onward, 54 countries will start exchanging information automatically.
- If any person is resident of more than 1 country, and such person is a registered tax payer and only if the person has informed the bank that he is resident of more than 1 country in KYC , than it is possible that the financial detail will be passed to all the country where the person is resident.
- 1st exchange of Information of 2016 is going to take place in 2017 and that information will be processed by the tax authorities in 2018 and revenue office will issue notice to tax payer/s in 2018.
- Standard format has been prepared for exchange of information: -
  Name, address, TINs, Date and place of birth of each Reportable Person, Account No., Name and identifying number of Reporting FI, Account Balance, Any Depository account, Any custodial account, Any Other account not mentioned above.

5. Financial Account Tax Compliant Act (FATCA)

- In July 2015 India-USA signed an Inter-Government Agreement (IGA) to implement FATCA.
- Under the IGA , the USA will provide certain information to India which includes:
  a. The name, address and Indian TIN of any person that is resident of India and holds a reportable financial account in USA
  b. Account Number
  c. Gross amount of internet, US source dividends or other income paid or credited
- On the similar lines India will also provide the information to USA.
- The main difference between AEOI and FATCA in the AEOI there is no Financial Limit so every transaction is reportable In FATCA there is a financial Limit.

6. UK's Diverted Tax Profit (DTP)

- UK diverted profits tax applicable from 1st April 2015.
- Tax will be charged at a rate of 25% on diverted profit relating to UK activity.
- The charge will arise if either of two rules apply – avoidance of a UK Permanent Establishment (PE), or involvement of entities or transactions lacking economic substance.

7 Patent Box Regime

- Finance Act 2016 introduced the patent box regime in India.
- Gross amount of royalty from patents developed and registered in India will be taxed at 10% u/s 115BBF.
- Such rate is optionally available to Patentee resident in India.
- If bills provided are for 100% expenses on patent which are to be incurred in India- The Act allowed 75%.
- No carry forward of set off & losses will be allowed.

8. Controlled Foreign Corporation (CFC)?

The above respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC.

9. POEM- Place of Effective Management

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.

In January, 2017; The Central Board of Direct Taxes (CBDT) has issued a Circular 6/2017 laying down the final guidelines for determination of the Place of Effective Management (POEM) of a company. The final guidelines take forward the concept laid down in the draft guidelines for POEM determination based on the bifurcation of companies engaged in active business outside India and other companies.

10. What you may want to do?

- Identify key tax issues at the time of structuring of the transaction.
- Provide guidance for approach to potential tax controversies.
- Advice Companies implement international growth strategies, business models.
- Bring to clients leading expertise on all tax issues critical to their companies with overseas operations or those planning global initiatives.
- Develop and implement methodologies that are analytically sound, flexible and fully compliant with the transfer pricing regulations.

Important Note:

This communication is intended to provide a general introduction and guidance on the subject matter and should not be regarded as a basis for taking decisions on specific matters. In such instances, separate advice should be taken.

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