International Taxation
Recent Developments in India

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1. INTRODUCTION

Through this paper, we are providing a broad macro outlook on the tax challenges which select activity will face having regard to the identified parameters of Income tax provision/rules. This note will enhance your understanding economic activity shall be an indicator of the likely tax disputes/controversy which MNEs will have to manage for the year 2020.

Budget 2020 would offer one such opportunity for Government in this regard. In the post BEPS environment, MNEs would welcome unambiguous, transparent & clear tax rules and policy from the government. Such positive steps by the Government will further support its ambitious and inclusive growth-oriented schemes like Make in India, Digital India, etc.

In India, the international tax system also changed rapidly as a result of coordinated action by OECD and unilateral measures designed by individual countries, intended to tackle concerns over base erosion and profit shifting (BEPS) and perceived international tax avoidance techniques of high-profile multinationals. This note provides ***selected Action Plans*** as mentioned below for quick reference.

Also, in the year 2019, the Government of India had amended few treaties with the intent to avoid treaty abuse and tax evasion. The developments during 2019 were in the backdrop of efforts made by India in order to keep transparency and have an exchange of information with other jurisdictions.

OECD introduced 'Action Plan 15 – Development of MLI to implement the tax treaty related BEPS measures' to bring changes to the existing treaties in such a way that over 1500 tax treaties across the world between more than 193 nations would change within a year.

During the year 2016 and 2017, the erstwhile double taxation avoidance treaties entered into by the Government of India with Singapore, Cyprus and Mauritius were re-negotiated.

Thereafter, the Government of India notified the amended India-Singapore tax treaty in March 2017 pursuant to which tax on capital gains on sale of shares was subject to tax in India for any gains arising from sale of shares acquired on or after 1st April, 2017, subject to the transition provisions provided in the said treaty.
Given that India and Singapore have submitted their consent for Multilateral instruments (MLI) in 2019; India-Singapore treaty will now be referred to as a Covered Tax Agreement (CTA) with effect from 2020.

The India-Mauritius tax treaty was modified in 2017, after 33 years since it had come into force. The modifications were similar to those proposed in the India-Singapore treaty, wherein the gains earned by a resident of Mauritius on transfer of shares of an Indian Company acquired post 1st April, 2017 would be subject to tax in India, subject to the transition provisions. Since Mauritius has notified its existing treaty with India as a CTA, the extant India – Mauritius treaty would not be modified pursuant to the applicability of MLI. Further, it is understood that India and Mauritius would mutually modify the extant treaty in light of the minimum standards proposed under the MLI framework.

Apart from above, General Anti Avoidance Rules ("**GAAR**"), an anti-tax avoidance legislation, is effective from 1st April, 2017. GAAR can be invoked by the Indian revenue authorities in case a transaction or an arrangement is undertaken with the main purpose of obtaining a tax benefit. However, prior to invoking GAAR, the tax authorities have to obtain a prior approval of the Approving Panel, comprising of 3 members.

2. MLI - Amendment to Tax Treaties

India has deposited an instrument of ratification to OECD on 25th June, 2019 along with its final positions for the CTAs. As such the MLI will modify many of the existing tax treaties signed by India. Around 22 DTAAs signed by India, would be amended from FY 2020-2021.

To understand the impact of MLI on DTAA, one could refer Synthesized Text (CTA) on the Income Tax website. (https://www.incometaxindia.gov.in/pages/international-taxation/dtaa.aspx).

Treaty benefit (in case of treaties which have amended pursuant to MLI) can be claimed subject to fulfilment of minimum standards prescribed in the MLI framework. One of minimum standards is that treaty benefit can be denied, having regard to all relevant facts and circumstances, if it is reasonable to conclude that obtaining treaty benefit was one of the principal purposes of an arrangement or a transaction that directly or indirectly resulted in a tax benefit. This is referred to as the Principal Purpose Test (PPT).

Two treaties are explained below:

(i) Amendment to India-Mauritius tax treaty

- Article 13 was amended to give India the right to charge tax on Capital Gain on transfer of Indian Share acquired on or after 1st April, 2017.
- A two-year transition period upto 31st March, 2019 was provided during which the tax rate was 50% of the prevailing tax rates, subject to satisfaction of the Limitation of Benefit (LOB) Clause.
- 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.
- Capital gain on derivates and fixed income securities will continue to be exempted even after 1st April, 2019.
- The above amendment effectively nullified the benefit earlier taken by investors from third jurisdictions by using Mauritius as an intermediate jurisdiction for making investments in India.
- **Interest on Debt Instruments:** 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.
- As per Sec 56 of the Income Tax Act, shares acquired for a consideration lower than the fair value is liable to tax in the hands of the recipient. However, earlier given that Other income clause in Article 22 of India-Mauritius DTAA was too restrictive, the said gains were not taxable in India. But as per amendment in Article 22, it will be taxed under Other Income in the country of Source.
- Moreover, while both India and Mauritius are signatories of MLI, Mauritius has not included its DTAA with India within the scope of its MLI compliance. As a result, anti-abuse provisions such as PPT are not applicable to India-Mauritius DTAA.

(ii) Amendment to India-Singapore Treaties

- Amendment gives India the right to charge tax on Capital Gain on transfer of Indian Share acquired on or after 1st April, 2017.
- A two-year transition period upto 31st March, 2019 is provided during which the Tax rate will be 50% of the prevailing tax rates, subject to the satisfaction of Limitation of Benefit (LOB) Clause.
- 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.

3. Base Erosion Profit Shifting (BEPS)

BEPS is the terminology used for the tax avoidance strategy used by multinational companies, wherein profits are shifted from jurisdictions that have high taxes (such as 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 Equalization Levy as one of the modes of taxing the Digital transactions to deal with tax challenged emerging from the digital economy.
- This led to the introduction of Equalization Levy (EL) of 6% on online advertisements as a part of the Indian Finance Act, 2016 and now on e-commerce transactions at 2% by Finance Act, 2020:

"Equalization levy" means tax leviable on consideration received or receivable for any specified service, for e-commerce supply or services and on specified circumstances.

"Specified Service" means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and to include any other service as may be notified by the central government.

"E-commerce supply or services" means online sale of goods owned by the e-commerce operator; or online provision of services provided by the e-commerce operator; or online sale of goods or provision of services or both, facilitated by the e-commerce operator; or any combination of activities listed above.

"Specified circumstances" means sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.

"Online" means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.

Charge of Equalization Levy

Equalization levy @ 6% (2% in case of specified circumstances) of amount of consideration received or receivable by a Non-Resident for any consideration received or receivable for e-commerce supply or services, from:

- A person resident in India, and carrying business or profession; or
- A non – resident having permanent establishment in India.

Equalization levy not to be charged where:

- The non – resident providing specified services has a permanent establishment in India and the specified service is effectively connected with the permanent establishment.
- The aggregate amount of consideration received or receivable in a previous year by the non – resident from the person resident in India and carrying business or profession or non – resident having permanent establishment in India does not exceed Rs 1 Lakh.
- Payment made for specified service and/or e-commerce supply or services, is not for the purpose of carrying out business or profession.

Every resident service receiver and non – resident having permanent establishment to deduct the equalization levy @6% if the consideration for specified services exceed Rs 1 lakh in a previous year. The Equalization levy so deducted during the calendar month to be deposited with the Central Government by 7th of the immediately following calendar month.

The Income Tax Act, 1961 has inserted sub section 3A to section 9 pertaining to include the following as "income attributable to operations carried out in India". These are applicable from FY 2020-2021.

- Income from such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through IP address located in India,
- Income from sale of data collected from a person who resides in India or from a person who uses IP address located in India or
- Income from sale of goods or services using data collected from a person who resides in India or from a person who uses IP address located in India.

- **BEPS Action Plan 4**: To combat the cross border shifting of profits through excessive payments and to protect the tax base; OECD designed rules to prevent base erosion through the use of interest expense. based on a fixed ratio rule which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortization (EBITDA).

- Government of India via Finance Act, 2017 has introduced a new section, S. 94B in the Income Tax Act, 1961 to overcome loss of revenue by way of thin capitalization.

Under thin capitalization, interest expenses claimed as tax deductible by an entity, paid to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (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. Further Finance Act, 2020 provided that interest limitation would not apply to interest paid in respect of a debt issued by a lender which is a Permanent Establishment (PE) of a non-resident, being a person engaged in the business of banking, in India.

- **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 seeks to preventive treaty abuse through treaty shopping by setting out certain minimum standards. Treaty shopping typically involves the attempt by a person to indirectly access the benefits of a tax agreement between two jurisdictions without being a resident of one of those jurisdictions.

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 as follows).*

GAAR 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 *and Country-by-Country Reporting* structure introduced. *It* provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. This is to enable the countries to enable transfer pricing assessment on transactions between linked companies.

- 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. The threshold for applicability of CbC reporting has been specified as consolidated group revenue of INR 55,000 million in the preceding year.

4. Automatic Exchange of Financial Information

- On 3rd June 2015, India Multilateral Competent Authority Agreement (MCAA) on Automatic Exchange of Financial Account Information (AEOI) Under Common Reporting Standard (CRS).
- 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 is going to take place of 2016 in 2017 and that information will be processed by the tax authorities in 2018 and revenue office will issue notice to tax payer 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 interest, 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 is that in the AEOI there is no Financial Limit so every transaction is reportable. Under FATCA there is a financial Limit.

6. UK's Diverted Tax Profit (DTP)

- UK diverted profits tax are 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.
- The total income of eligible taxpayer must include income by way of royalty in respect of patent developed and registered in India and at least 75% of the expenditure is incurred in India by eligible taxpayer for invention
- No other expenditure is allowed under the tax provisions if concessional tax rate under section 115BBF is availed.
- No carry forward of set off & losses will be allowed.

8. Controlled Foreign Corporation (CFC)?

- CFC are foreign companies earning passive income which is controlled directly or indirectly by a resident in India. The income which is not distributed to the shareholders and taxes on such income are deferred is deemed to have been distributed.
- Such income shall be considered to be dividend received by the Indian resident from foreign company.
- A CFC can be a POEM (mentioned below) incase whether or not it is engaged in active business in India. To meet active business test, it's passive (non business) income should not be more than 50% & it should meet certain parameters in terms of employees, assets and payroll expenditure.

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 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.

PoEM guidelines shall not apply to companies having a turnover or gross receipt of Rs. 50 Cr or less in a financial year.

10. What can we do for you?

- Identify key tax issues at the time of structuring of the transaction.
- Provide guidance for approach to potential tax controversies.
- Advice Indian Companies implement international growth strategies, business models.
- Bring to clients leading expertise on all tax issues critical to Indian 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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