INTERNATIONAL TAXATION IN INDIA – RECENT DEVELOPMENTS &OUTLOOK FOR 2017

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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 note has been divided in two sections; Section 1 provides an overview of recent developments at India in calendar year 2016 & Section 2 outlined outlook for 2017.

Recent developments are further bifurcated under three parts dealing with Regulatory developments, Treaty Negations & Recent Judgement respectively.

We are also 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. 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.

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RECENT DEVELOPMENTS

This section shall highlight developments in India during the year 2016. 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”[1]. Few of the important regulatory development of year 2016 are summarised below:

A.1. FATCA[2] & Common Reporting Standard[3]

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

[1] Indirect Transfer Provisions were first introduced as a reaction to the landmark ruling of the Supreme Court in Vodafone International Holdings BV v. Union of India, where the Supreme Court held that the transfer of shares of a Cayman Islands company would not be subject to capital gains tax in India

[2] India and USA signed on 9th July, 2015, an agreement to implement FATCA to promote transparency between two nations on tax matters. Under this agreement, each party (India and US) shall obtain specified information with respect to ‘Reportable Accounts’ and shall annually exchange this information with other party on automatic basis. It is an important step towards achieving tax transparency and to address offshore tax evasion and avoidance. The FATCA compliance would require every Financial Institution to report a Reportable Account, unless specifically exempted

[3] CRS implementation was slightly ahead of the FATCA IGA signing wherein India joined the Multilateral Competent Authority Agreement on 3rd June, 2015. Common Reporting Standard (CRS) is a globally accepted standard for the automatic exchange of financial account information, set forth by the Organization for Economic Cooperation and Development (OECD).

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;

Rule	Particular
	• 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[4]. 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	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

[4]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

Particulars	Section	Rule	Explanation
Tribunal (Tribunal)			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 “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 6[5]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 7[6]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 5[7]. 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

[5]Explanation 6 - Explanation 5 will be applicable, if on the specified date the value of such assets exceeds the amount of INR 10 crore and represents at least 50 per cent of the value of all the assets owned by the company/entity

[6]Explanation 7 carves out the applicability of Explanation 5 to small investors holding no right of management or control of such company/entity and holding less than 5 per cent of the total voting power/share capital/interest of the company/entity that directly or indirectly owns the assets situated in India.

[7]Explanation 5 - An asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

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 satisfiesExplanation6 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[8]. 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.

[8]The 2005 Protocol provides that the capital gain tax benefit should be available subject to LOB clause, the LOB article provided that in order for a Singapore entity not to be deemed a shell/conduit company, such company would have to either be listed company in the recognized stock exchange of Singapore or incur annual operating expenditure of at least SGD 200,000 or INR 5 million as the case may be in immediately preceding period of 12 month from the date on which the gains arise.

Impact	Analysis
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 31stMarch 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.

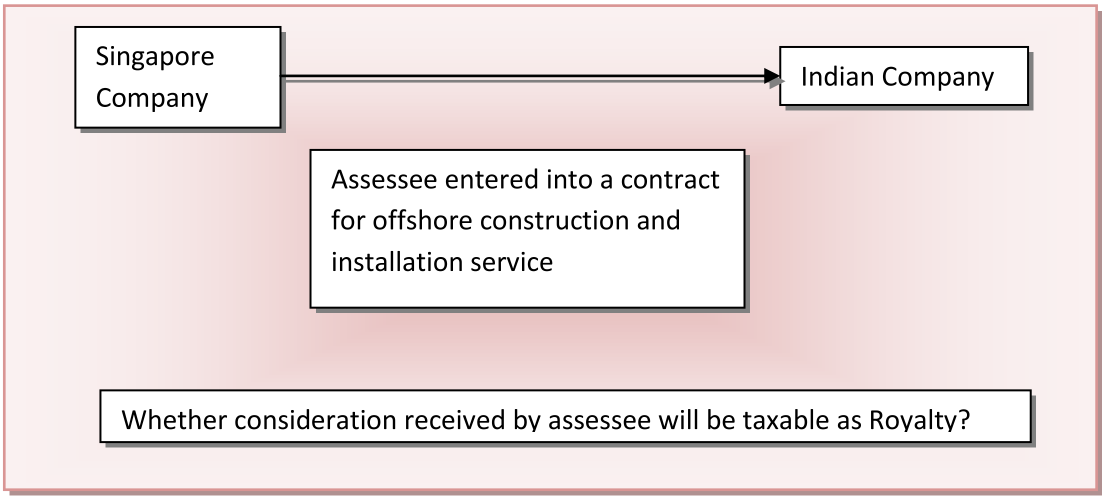
B.3.3. India – Japan

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:

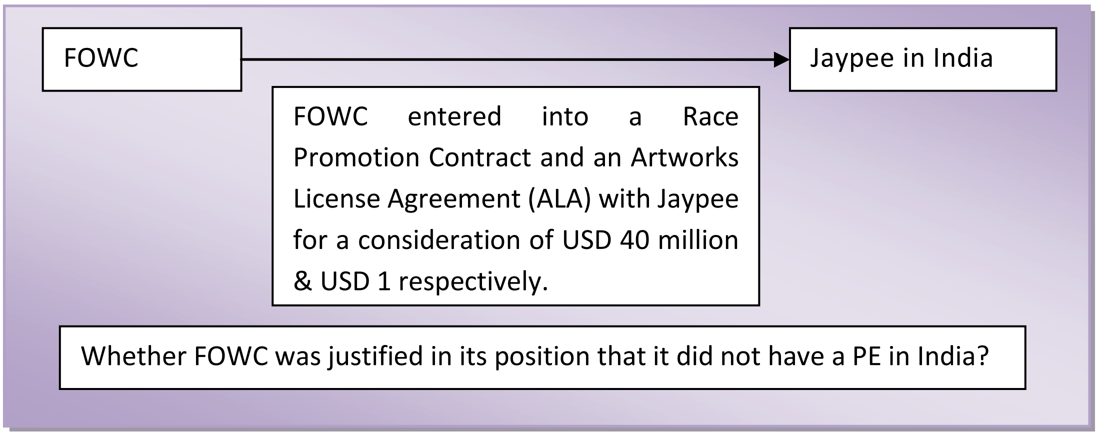
- **Technip Singapore Pte Ltd v DIT - TS-301-HC-2016 (Del) [India - Singapore DTAA]**



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.

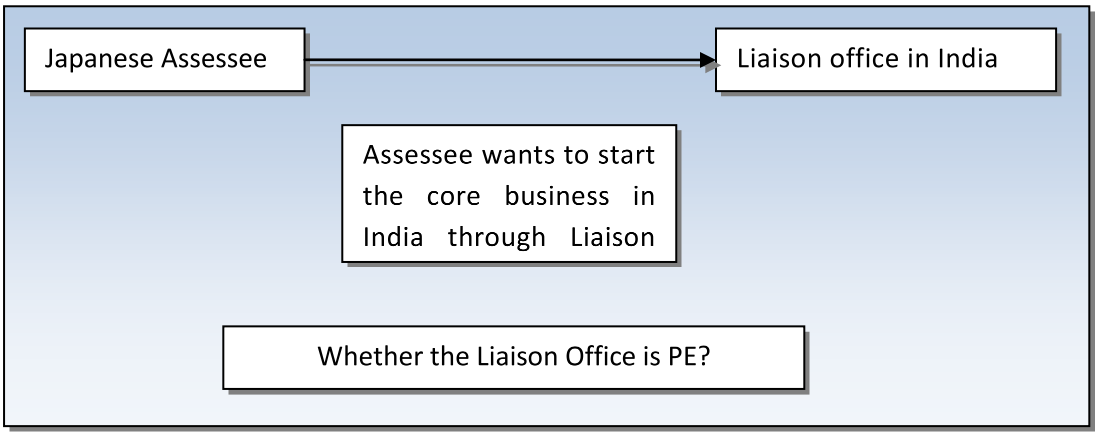
It held that since the equipment used by the assessee while providing services to IOCL were in the exclusive control of the assessee and IOCL did not have any dominion or control over the same, the payment received by the assessee could not be taxed as equipment royalty under Article 12(3) of the India 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**



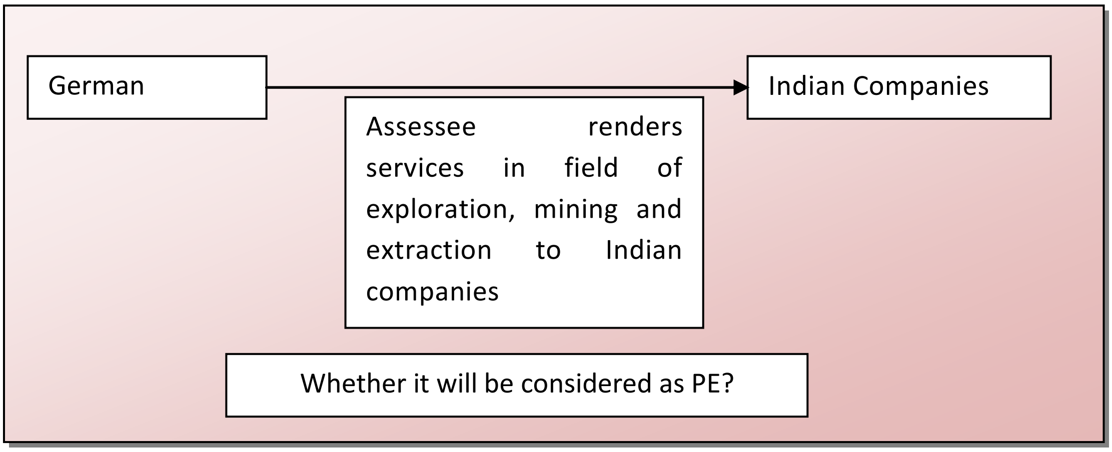
The Court discussed various illustrative examples across jurisdictions on the interpretation of a fixed place PE, such as Universal Furniture Ind AB v Government of Norway, the Swiss Server decision and Joseph Fowler v Her Majesty the Queen. No conclusive rule could be laid down as to the number of days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

- **Kawasaki Heavy Industries Ltd. vs. ACIT - [2016] 67 taxmann.com 47 (Delhi-Trib)**



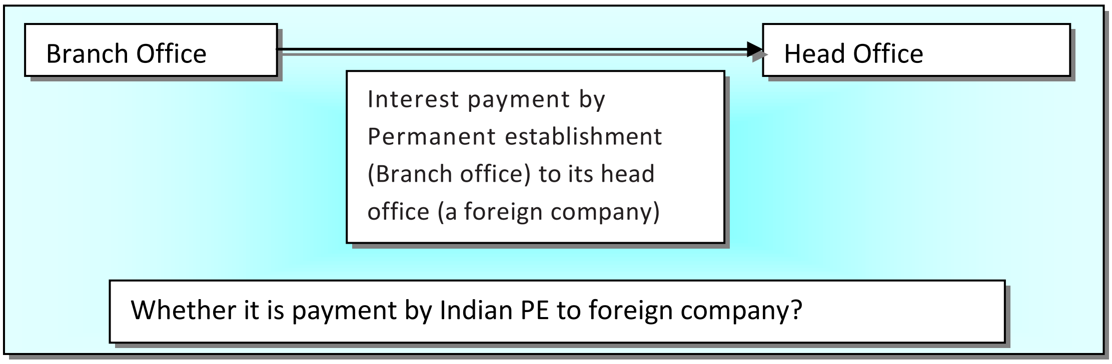
The Tribunal held that where the assessee, a Japanese company engaged in business of manufacturing consumer products, opened a liaison office in India, since power of attorney did not authorize employee of LO to do core business activity or to sign and execute contracts etc., on behalf of assessee, it could not be regarded as assessee's PE in India.

- **Rheinbraun Engineering Und Wasser GmbH v DDIT - (2016) 68 taxmann.com 34 (Mumbai- Trib.) [India - Germany DTAA]**



The Tribunal considered continuous period of stay of its employees in India and not entire contract period. On that basis it was held that an assessee, a German company had PE in India.

- **BNP Paribas SA v. ADIT - [2016]**



The Tribunal held that as interest payment by Permanent establishment (Branch office) to its head office (a foreign company) was a payment by a foreign company's Indian PE to foreign company itself; it could not give rise to any income, in the hands of foreign company.

- **KrishakBharati Cooperative Ltd v ACIT - (2016)**

Assessee Society ← Omani Company

KrishakBharati Cooperative Ltd received dividend from a company in Oman

Whether dividend would be liable to tax?

The Tribunal held that where the assessee society received dividend income from an Omani company, which was offered to tax in India, it would be liable to credit of tax paid under the India - Oman DTAA, in spite of the fact that the Omani tax laws exempts tax on such income, as the term 'tax payable' in Article 25(4) of the DTAA includes tax which would have been payable but not paid due to certain tax incentives under laws of the contracting State.

- **DIT v. B4U International Holdings Ltd - (2016) 71 taxmann.com 182 (SC) – SPECIAL LEAVE TO APPEAL (C) NO. 10482 OF 2016**

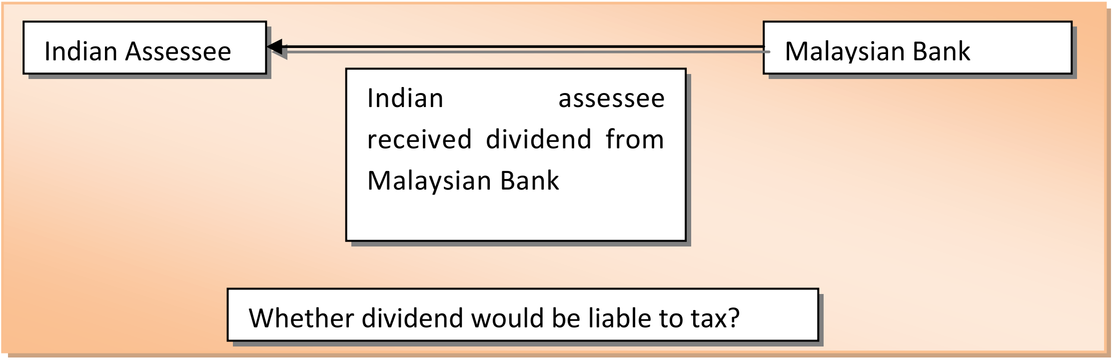
Mauritius → Agents in India

Assessee carried out its activities of telecasting of TV channels from Mauritius through its Agents in India

Whether Agents in India will be considered as PE ?

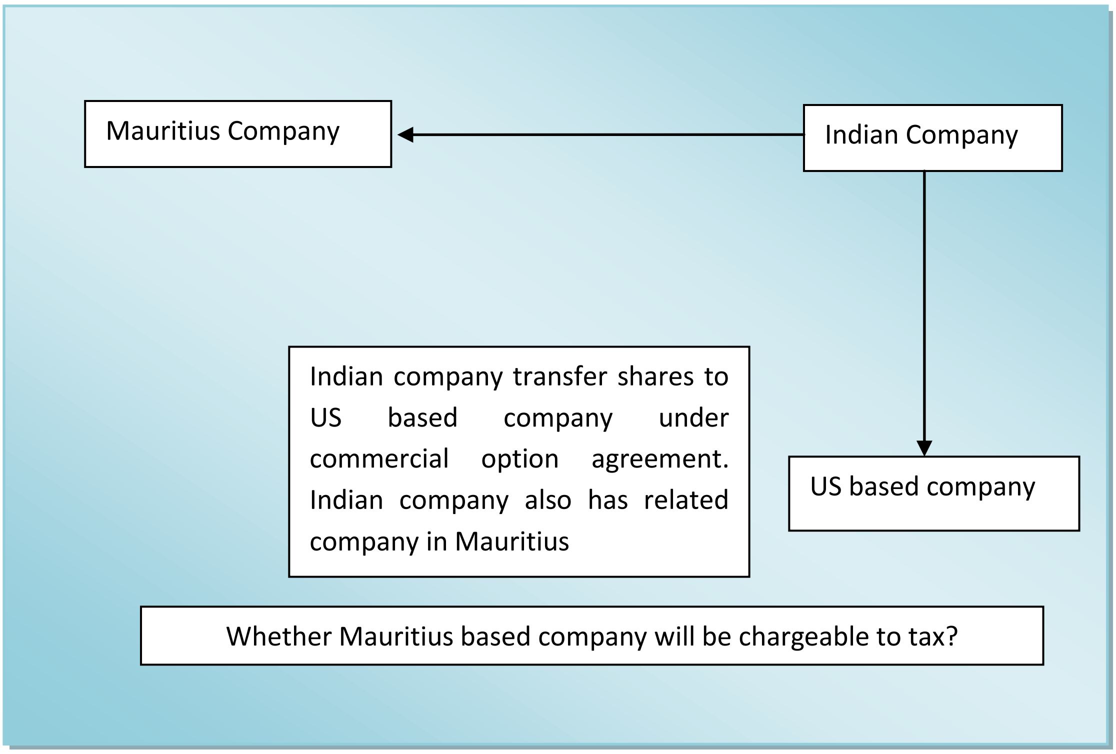
The Apex court granted leave to the departments SLP against High Court's ruling that where assessee, its affiliates/agents in India who were remunerated on arm's length basis for carrying out only routine functions in India, did not constitute assessee's PE in India.

- **DCIT v UCO Bank - (2016) 46 CCH 0313 (KolTrib) [India - Malaysia DTAA]**



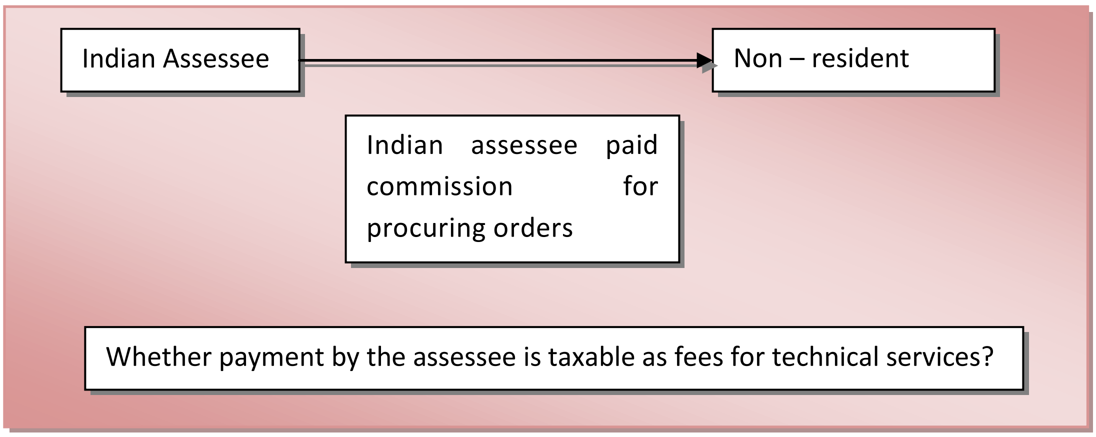
The Tribunal held that for AY 2004-05, dividend received by the assessee from a Malaysian Bank would be governed by the old DTAA between India and Malaysia and therefore would not be liable to tax in India. Post AY 2004-05, the dividend income would be taxable in both states and subject to tax credit under section 91 of the Act

- **Mahindra-BT Investment - TS-479-AAR-2016 - A.A.R. No 991of2010 [India - Mauritius DTAA]**



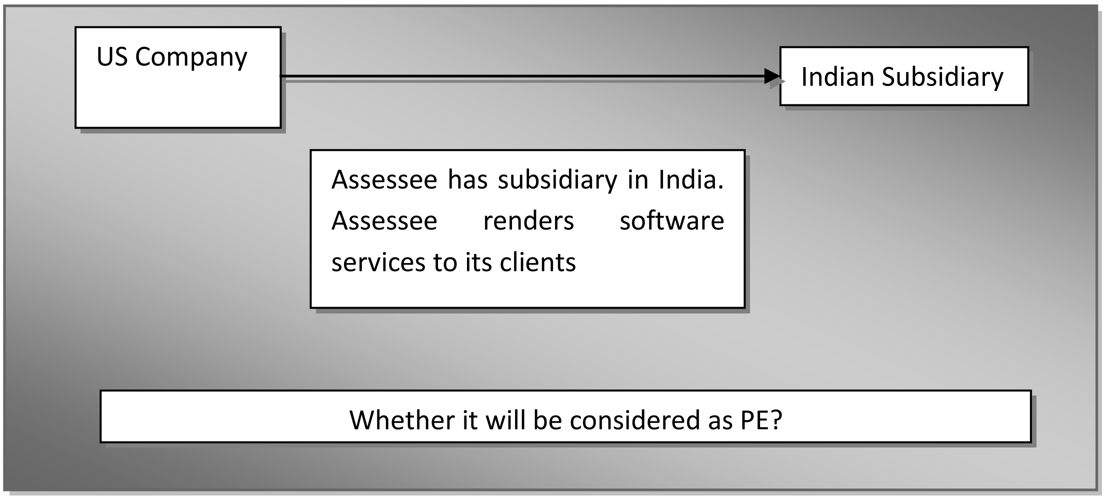
The AAR held that as per Article 13(4) of the India-Mauritius DTAA, the assessee, Mahindra-BT, Mauritius, was not liable to tax in India in respect of the transfer of shares in Tech Mahindra Ltd ('TML') to AT&T International USA ('AT&T'). It rejected the Revenue's contention that the applicant was incorporated without any economic substance and that its sole purpose was to hold shares to facilitate a tax neutral share transfer noting that there was a commercial option agreement between TML and AT&T, whereby AT&T was to be offered an opportunity to hold shares in TML only once AT&T had provided TNML was a certain level of business and that there was nothing wrong if the Applicant held the shares in TML and transferred them to AT&T subsequent to the fulfilment of conditions prescribed in the Options Agreement. It further rejected the stand of the Revenue that the control and management of the Applicant was situated in India under section 6(3) of the Act since the condition of control and management being wholly situated in India was not satisfied as various important decisions on financial matters were taken by the Applicant's Board of Directors in Mauritius.

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



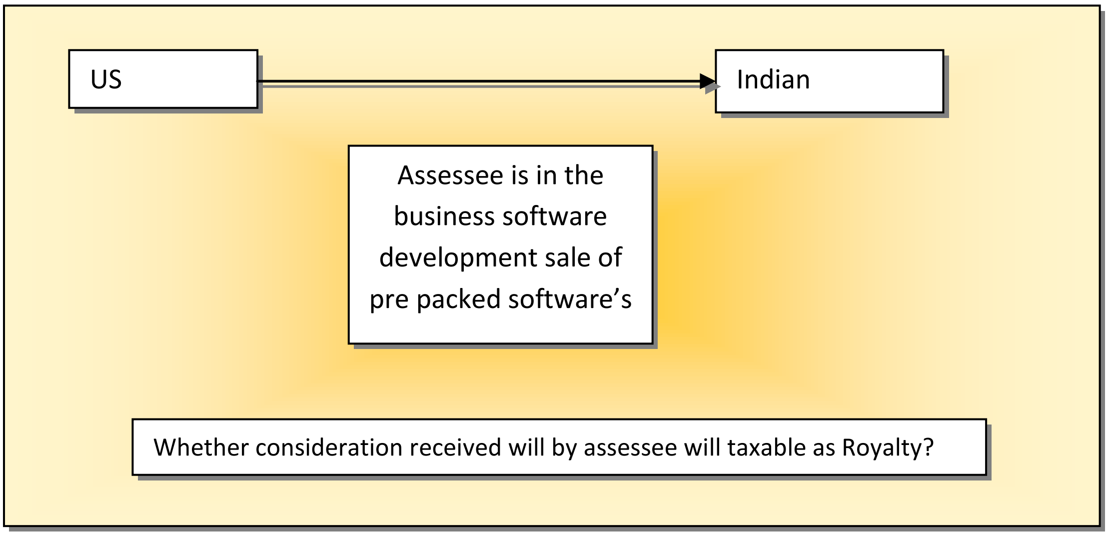
The Court held that agency commission paid by the assessee to non- resident agents for procuring orders for the assessee outside India, would not be taxable as fees for technical services under section 9(1)(vii) of the Act and therefore section 195 of the Act would not be applicable, since obligation 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]**



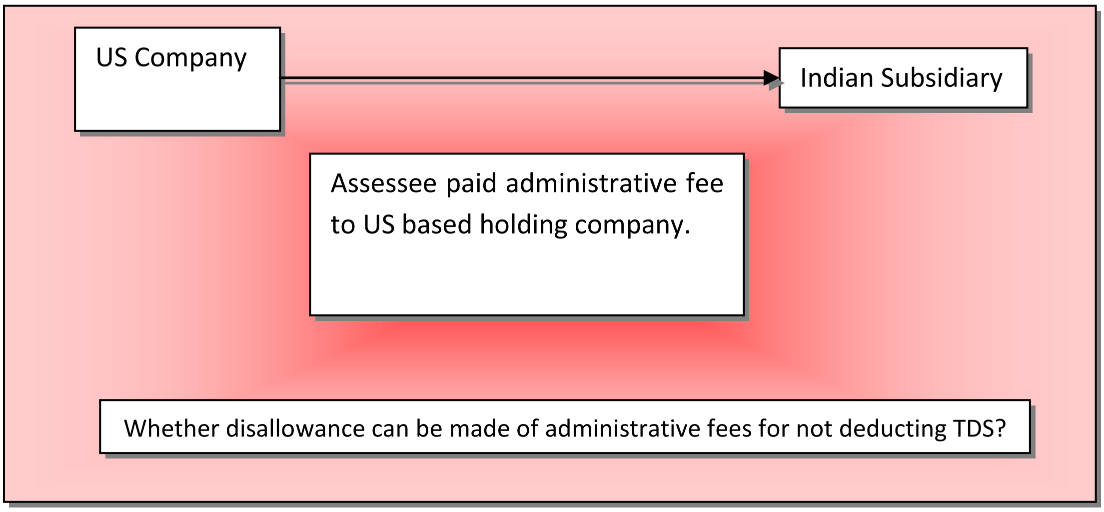
The Court held that where the subsidiary company of the assessee was compensated at ALP for international transactions with the assessee (its AE), assuming that the subsidiary company was the PE of the assessee, no further profits could be attributed to the assessee's operations in India. Without prejudice 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 could 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.

OUTLOOK FOR 2017

Introduction

Necessary steps have been taken in the recent past to gain confidence of the investors over Indian tax system and implementation of tax laws. The tax issues are foremost in the mind of the investors, both domestic/international, and confidence in the Indian economy will get dampened by adverse tax environment in the country.

Over the past few years, the government has improved its engagement with taxpayers and have also provided clarity on various controversial issues. The present economic and global environment offers huge opportunity to the government and the budget for 2017 can be a platform for the government to announce and implement long term systematic reforms that could also assure stability, certainty and predictability in the Indian regime. There are various controversial issues which can be revisited and revised in order to provide taxpayer friendly and effective policy implementation.

In the backdrop of developments of year 2016, both at India and outside India, economic activities in year 2017 will have many tax issues that would require adequate consideration. We have provided in the subsequent paragraphs, a broad overview of tax issues and challenges for selected activities/transactions.

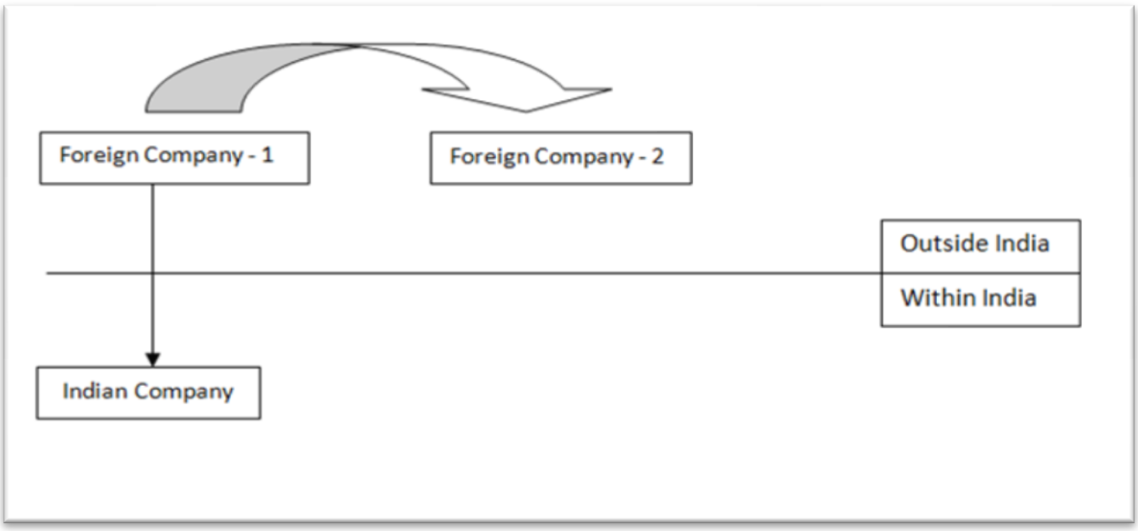
A. Cross Border M&A

Introduction

- Tax issues arise in cross border deals when two different jurisdictions seek to tax the same sum of money or income or the same legal person thereby resulting in double-taxation. Many countries are aware that double taxation acts as a disincentive for engaging in any cross border trade or activity. Therefore, with the primary view to encourage mutual cooperation, trade and investment, the countries enter into bilateral Double Taxation Avoidance Agreements ("DTAA") to limit their taxing jurisdictions voluntarily through self-restraint.
- The availability of such benefits and the ultimate tax liability often drives or breaks cross border transactions. Particularly in the Indian context, where the tax administration is perceived to be aggressive and the laws uncertain, any protection offered by a treaty jurisdiction is important. It is important for the buyer in the context of whether there is any withholding obligation while making a remittance to the seller.

Diagram Explaining Cross Border M&A

- The Diagram below depicts a Cross Border M&A where a Foreign company and domestic company expands its operations by merger/acquisition



Provisions for Cross-border Mergers

- The merger of two foreign companies involving the transfer of shares of an Indian company, is normally tax exempt provided that the merger satisfies the criteria for an amalgamation and, at least 25% of the shareholders of the merging company remain shareholders in the merged company, and such transfer does not attract capital gains tax in the country in which the merging company is incorporated.
- The demerger involving the transfer of shares of an Indian company by a demerged foreign company to the resulting foreign company is also tax exempt provided that,
  - The shareholders holding not less than 3/4 of the shares in the demerged foreign company remain shareholders in the resulting company and
  - Such transfer does not attract capital gains in the country in which the demerged foreign company is located. The merger of an Indian company with a foreign company is also tax exempt, provided the resulting company is an Indian company.

Current/Likely Tax Issues

- India now levies a tax on the gains arising on the transfer of shares or an interest in a foreign company, if the share or interest derives its value substantially from assets (tangible or intangible) located in India. This tax on indirect transfers of Indian assets is one of the most important tax challenges that investors will have to factor.
- **Withholding Tax**

  The Finance Act, 2016 has introduced a tax at the rate of 10% on dividends in excess of INR 1 million (approx. USD 15,000) declared by a domestic company and received by a resident individual, LLP or partnership firm. This is in addition to the DDT paid by the distributing company. Such tax will affect the ability of non-residents to claim foreign tax credit in its home jurisdictions on DDT paid by the distributing company. The normal withholding tax rate on royalties and fees for technical services is 10%, and lower rates may apply if provided for in a tax treaty.

  Under Section 195 of the ITA, any person making a payment of a sum to a non-resident that is chargeable to tax under the ITA (read with relevant provisions of the applicable DTAA) would be required to withhold tax on such sum at the appropriate rate. Such withholding is required to be made either at the time of payment or at the time of credit of income to the account of the non-resident. However, if the amount paid is not taxable in India, there is no requirement to withhold tax on such payments. However, if the amount paid has an element of income that is taxable in India, then even a non-resident who making such remittance is obligated to withhold as per the ITA.

- **Credit for Taxes**

  The normal withholding tax rate on interest is 40%. However, more beneficial rates (ranging from 5% – 20%) of withholding are available to non-resident creditors depending on the nature of the security involved, the status of the non-resident creditor, etc.

- **Treaty Benefits**

  India levies a tax on capital gains arising from the transfer of an asset located in India. In the case of capital gains arising from the transfer of shares of an Indian company, the tax on such gains is typically eliminated through the use of structures involving a Mauritian or Singaporean holding company, since under the provisions of erstwhile DTAAs in place between India and the aforementioned countries, subject to certain criteria being fulfilled (e.g., absence of a permanent establishment in India) only the country of residence of the transferor is entitled to levy a tax on capital gains arising from the transfer of shares of an Indian company, and importantly, these countries do not tax capital gains.

- **LOB Article**

  In certain scenario, eligibility to claim relief under a DTAA may be conditional upon the satisfactions of certain "substance" requirements. For example, the India-Mauritius/Singapore DTAA incorporates a "Limitation on Benefits" clause, which requires a Mauritius/Singapore resident company to demonstrate the following, before it can claim benefits under the DTAA. The primary purpose of its incorporation in Mauritius/Singapore should not be to take advantage of the treaty benefits. It should not be a shell/conduit company and it must have bona fide business activities. It will be deemed not to be a conduit company if: Its total annual expenditure on operations in Singapore is at least $200,000 during 2 years prior to share transfer, or it is listed on a stock exchange in Singapore.

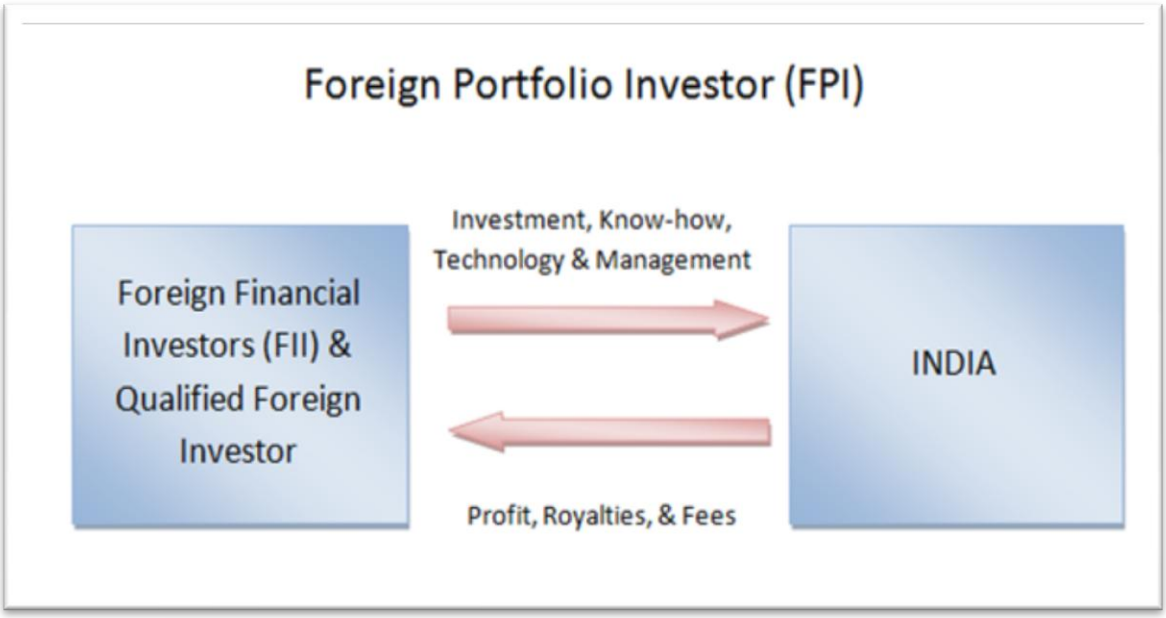
B. Foreign Portfolio Investor (FPI)

Introduction

- In the year 2016, considerable developments have taken place on the Foreign Portfolio Investors ("FPI") front. There have been changes to the norms governing FPIs that have impacted the permitted investments by them in India.
- The changes/amendments made in DTAAs & Indirect Transfer rules, the Foreign Portfolio Investors are expected to face challenges, whereby making them liable to pay higher tax.

Diagram Explaining how Foreign Portfolio Investor (FPI) invest in India

- Foreign Portfolio Investors (FPI) makes investments in India by acquiring shares/assets of the Indian company, Know-how, Technology & Management etc and earns by the way of Profit, Royalty & Fees.



Current/Likely Tax Issues

- **Clarification on Indirect Transfer of Shares:**

  A High Level Committee to be constituted which would be chaired by Revenue Secretary and will consist of CBDT chairman and an expert from outside to oversee fresh cases where assessing officer applies retrospective amendment in relation to indirect transfer of shares.However, the CBDT constituted a working group on 15 June 2016, after it received queries about indirect transfer provisions raised by offshore funds registered as FPIs. After considering the comments of the working group, CBDT issued clarification through a set of 19 questions and answers depicting various scenarios under which offshore funds may have invested in companies in India. For example, in case a fund is set up in an offshore jurisdiction pools money from retail/institutional investors and invests in shares of Indian listed companies, if the fund on request of its unit holders/shareholders, redeems their units/shares, then CBDT clarified that it will be liable to pay taxes in India.

- **Treaty Amendments:**

  Recently India has also amended the DTAA with Mauritius and Singapore. While this allows India to tax capital gains on investments in the nature of shares, made by an FPI, this will not impact investments made by them in debentures & derivatives in India.

  However, further rationalization can be done by the government with respect to the taxation of derivatives; FPIs should be given the option of categorizing their income from derivative transactions as business income, if this is more beneficial to them. The short-term capital gain tax on derivatives should be made on a par with that on equities.

  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. Since investments until March 31, 2017 have been exempted from capital gains tax, there is no risk of an immediate outflow of funds. However, the amendment impacts all prospective investments with effect from April 1, 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%. During the transition period (i.e. during 01.04.2017 to 31.03.2019), and subject to the satisfaction of the limitation of benefits clause, this rate may be reduced to 7.5%. However, gains accruing to the investors who invest in listed securities for more than 12 months will continue to remain exempt since long-term capital gains tax from sale of listed securities is exempt in India, where the transaction is effected on Stock Exchange in India.

- **General Anti-Avoidance Rules:**

  The Finance Minister announced in his budget speech that General Anti-Avoidance Rules (GAAR) will be effective from April 1, 2017. The current Rules contain subjective tests around commercial substance, main purpose, misuse / abuse, etc.. As per the Memorandum to the Finance Bill, 2015, investments made up to March 31, 2017 would be protected from the applicability of GAAR provisions.

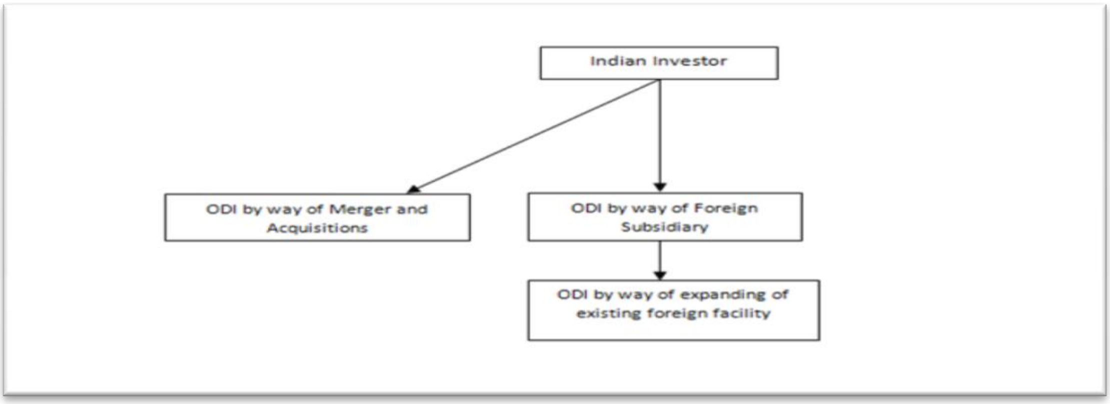
C. Outbound Investments

Introduction

- Outbound investments from India have undergone a considerable change not only in terms of magnitude but also in terms of geographical spread and sectoral composition. Analysis of the trend in direct investments over the last decade reveals that while investment flows, both inward and outward, were rather muted during the early part of the decade, they gained momentum during the latter half.
- There has been a perceptible shift in Overseas Investment Destination (OID) in last decade or so. While in the first half, overseas investments were directed to resource rich countries such as Australia, UAE, and Sudan, in the latter half, OID was channelled into countries providing higher tax benefits such as Mauritius, Singapore, British Virgin Islands, and the Netherlands.
- Indian firms invest in foreign shores primarily through Mergers and Acquisition (M&A) transactions. With rising M&A activity, companies will get direct access to newer and more extensive markets, and better technologies, which would enable them to increase their customer base and achieve a global reach.
- For countries like India, which have exchange control restrictions and tax their residents on worldwide income, the relevance of an Offshore Holding Company (OHC) is very significant. An OHC gives an Indian company sufficient amount of flexibility and speed in structuring and expanding its overseas operations by setting up subsidiaries or joint ventures in other jurisdictions.

Diagram depicting Outbound Direct Investments

- The Diagram below depicts a typical Outbound Direct Investment where a domestic firm expands its operations to a foreign country either via a Foreign Wholly Owned Subsidiary, merger/acquisition and/or expansion of an existing foreign facility.



Current/Likely Tax Issues

- **Credit for Foreign Tax**

  From taxation point of view, direct investment from India completely distorts the dividend repatriation back into India. In many cases, only 40 to 45 percent of the earnings of the foreign company are available to the Indian parent. There is double taxation of the same income: once in the hands of the foreign company and then in the hands of Indian company. In order to address such situation, many countries and tax treaties allow tax credit for the corporate taxes paid on profits in the country of source against taxes payable on dividends in the country of residence of the recipient company. Under these provisions, the recipient of dividend could claim tax credit, for taxes paid in the other countries by the subsidiary companies on profits from which such dividends are distributed. Such tax credit is known as "underlying tax credit". Underlying tax credit is over and above tax credit for taxes withheld on dividend distributed by the subsidiary companies. It reduces the final tax incidence by eliminating double taxation of the same income in the country of source as well as residence. Since underlying tax credit is not available in India, except under some tax treaties like India - Mauritius, the net result is higher incidence of tax.

  As per existing provisions of the Income Tax Act, 1961 (“ITA”), income of an Indian company is subject to tax at the rate of 30% in addition to 3% cess, subject to 12% surcharge if income exceed 1 crore.. Therefore dividends received by an Indian company from an overseas company will be subject to tax in India at the rate of 30% in addition to 3% cess, subject to 12% surcharge if income exceed 1 crore. ITA does not provide for underlying tax credits, however, an Indian company could claim such underlying tax credit if the double taxation avoidance agreement (“DTAA”) that India has entered into with the country of residence of the company paying such dividends provides for the same. Indian company can claim tax credit in India for the taxes that have been withheld by the foreign company on such distribution. Long-term capital gains realized by an Indian company from sale of shares of a foreign company will be subject to tax in India at the rate of 21%, whereas short-term capital gains would be subject to tax at normal corporate tax rates of 30% in addition to 3% cess, subject to 12% surcharge if income exceed 1 crore. As such, there is no golden rule for a preferred structure for outbound investments as it depends on the country in which the investment is sought. However, countries like Mauritius, U.K., and Netherlands etc. are close contenders for location of OHC out of India for holding investments worldwide.

- **Place of Effective Management**

  The parties most impacted by theamended PoEM rule shall be Indian individuals and companies which have set up foreign JV's and or WOS and routinely take decisions for such entities from India, also affected will be groups where the executives of the Indian entity are also on the board of the foreign subsidiary. These companies shall soon see that their legitimate foreign companies are now deemed to be Indian residents and are subject to taxation in India, this imposes a huge cost in the form of taxes (incomes of foreign companies are taxable at 40% in India) on such companies and the group as a whole.

  The consequence of this provision, unless amended or clarified, is going to be a large uptick in tax disputes, where the department will invariably look at a foreign entity owned by Indians and tax it at the maximum marginal rates. That there is no established jurisprudence on this matter in India also means that litigation on this matter will only increase. Start-ups and established Indian players have few options by way of recourse, one option would be to decouple ownership and management/Control and ensure that such management is situated only outside of India and no overlaps exist. This is easier said than done and will certainly be a challenge for all businesses looking to go global.

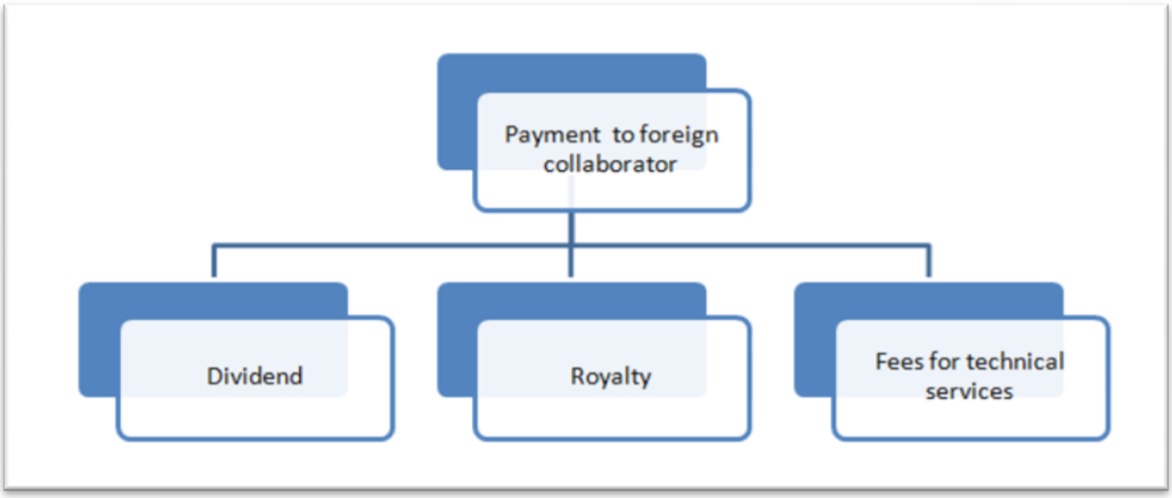
D. Payment to Foreign Collaborator

Introduction

- The globalisation of economic reforms throughout the world has led to an increasing degree of inter-dependence between countries in the field of technology, manpower, finance, etc. The Indian economy too has been and is continuing to be liberalised by successive Governments through the mode of reducing custom duties and of other levies, relaxing foreign exchange regulations and by encouraging boost in exports.
- The survival and growth of the industrial sector depends to a great extent upon technological advancement. This is possible through collaborations with developed countries to import their expertise and aid. While drafting foreign collaboration agreements both parties have to necessarily take into consideration the tax laws in the respective countries.
- This is necessary so as to ensure, on the one hand, that the statutory requirements under the various tax laws in India and the other country are met, as also, on the other hand, to minimise the burden of tax which falls on the income, profits and gains arising from the collaboration.

Diagram explaining payment to foreign collaborator

- The Diagram below depicts the different type of payments to be made to the foreign collaborator:



Provisions for payment to foreign collaborator

- The below given table is the summary of the relevant provisions of Income Tax Act applicable to the likely payments to foreign collaborator:

Income	Tax rates %	Explanation
Dividends	Nil	Dividend income distributed by domestic corporations (on which DDT has been paid by the company distributing the dividend) is exempt from tax in the hands of the recipients (including foreign corporation)
Royalty[9] from patents & fees for technical services[10]	10%	Royalties and fees for technical services received by non-residents (not being company) or a foreign company (provided income is not attributable to a permanent establishment in India) from an Indian concern or the Government are taxed at a uniform rate of 10%. The date of agreement under which such income is received will

[9] Section 9(1)(vi) of the Act defines the taxability of royalty income in India and had defined royalty to include transfer of all or any rights (including the granting of license) in respect of patent, invention, model, design and secret formula or process or trademark or similar property.

[10] Section 9(1)(vii) of the Act defines FTS, as fees for rendering of Managerial, Technical or Consultancy services. It is interesting to note that these three categories of services do not include ‘commercial services’ such as services provided by Commission Agents, Freight & Forwarders, Transportation services and similar other services.

		henceforth be irrelevant [Sec 115A(1)(b)] . Non-resident earning income in the nature of Royalty & FTS is required to file Return of Income u/s. 139(1). The relaxation of not filing of Return of Income is available only in respect of Dividend Income (referred to in Sec 115-O) and Interest Income on which tax has been deducted [Sec. 115A(5)]. Royalties and fees for technical services received by non-resident (not being company) or a foreign company from an Indian concern or the Government in pursuance of agreement entered after 31-3-2003, if the non-resident has a Permanent Establishment in India or renders professional services from a fixed place shall be taxed on net income [Section 44DA]. Any income by way of royalty or fees for technical services arising to any foreign company (as may be notified by the Central Government from time to time) under an agreement entered into with that Government for providing services in connection with security of India is exempt [Section 10(6C)].

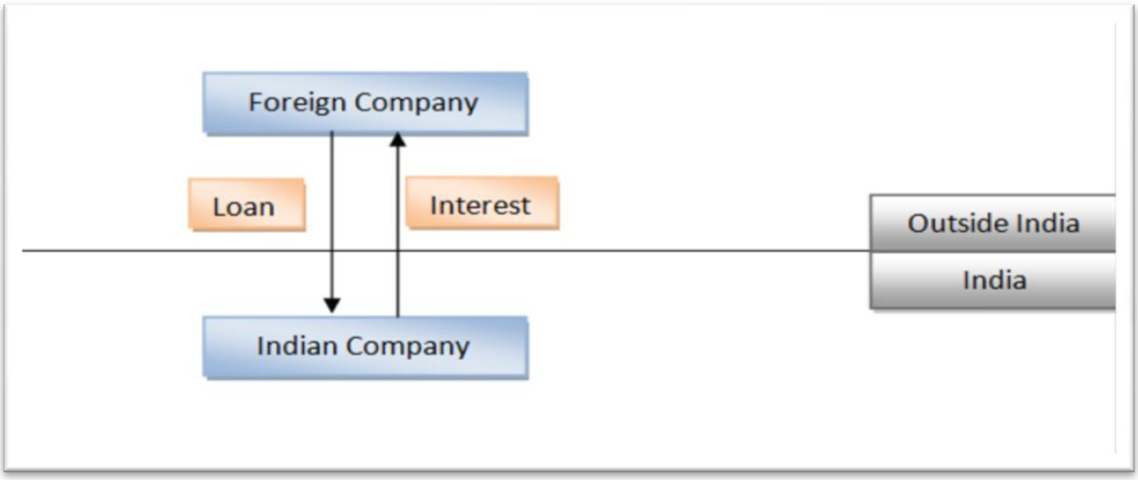
E. Financing Project by Way of Debt

Introduction

- Historically, the Indian banking sector has been the major driving force supporting the country's growth by channelizing domestic savings towards capacity creations and the size of the banking sector in terms of assets and earnings has grown in line with the entire economy. However, over the past decade, Indian financial system has undergone many changes; a higher volume of debt financing, opening up of more venues to borrow funds. Bank credit is gradually losing steam in meeting the funding requirements of the Indian corporate sector with the rising risk averseness of banks and expansion of capital markets. Corporates are no longer hesitant in approaching the market to raise funds either through equity or debt. It has been a beneficial relationship with a wider choice for financial planning for corporates on one side and more choice for diversification for investors including banks themselves on the other. Increasing ease in the primary issuance process for various instruments has benefitted both sides and so has increased awareness and risk appetite among investors. This type of structural shift is likely to have significant implications on the transmission of policy measures as well as financial stability in an increasingly open financial system.

Diagram explaining financing project by way of debt:

- The Diagram below depicts a project by way of debt where a foreign company invest in domestic company.



Current/Likely tax issues

- **Withholding Tax under Incometax**

  Payment by way of interest made by a domestic corporation to a non-resident or a foreign corporation in respect of monies borrowed in foreign currency under a loan agreement or by the issue of a long-term bond (including long-term infrastructure bond) before 1 July 2017, as approved by the GoI, subject to compliance withcertain conditions, attracts withholding tax of only 5% (plus applicable surcharge and cess).

  Furthermore, interest paid to an FPI on or after 1 June 2013 and before 1 July 2017 in respect of investments made in a security being an INR-denominated bond of an Indian company (provided the rate of interest shall not exceed the rate notified in this regard by the Central Government) or a government security, shall attract withholding tax at a concessional rate of 5% (plus applicable surcharge and cess). CBDT clarified vide press release that interest paid to a non-resident in respect of investment made in an INR-denominated bond of a specified Indian company will also attract concessional withholding tax rate of 5%.

- **Withholding Tax under Treaty**

  There have been recent amendments to the India to Mauritius treaty where 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.

F. Sensitivity Analysis

The Table below summarises the sensitivity analysis on the identified economic activityhaving regard to the relevant provisions of Income tax law

Parameters	Provision of GAAR	Impact of BEPS	Provision of Treaty	Impact of POEM	Transparency and Exchange of Information
Cross Border M&A	High	High	Moderate	High	High
Foreign Portfolio Investors	High	Moderate	High	Low	Low
Outbound Investments	Moderate	High	High	High	High
Payment to Foreign collaborator by way of Dividend, Royalty and Fees for technical service	Low	Moderate	High	High	Moderate
Financing by way of Debt	High	High	High	Low	High
Provision on Indirect Transfer	High	High	Low	High	High

CONCLUDING REMARKS

The government has announced number of initiatives that will change the future of the investment, tax and regulatory landscape in India. The opening up of the commodities market to institutional investors and permitting of FPI investments in unlisted debt securities as well as securitized debt instruments are being actively considered.

We can expect from the government further steps in this direction of providing the adequate direction and certainty in tax policy/regulation &it’s implementation. Budget 2017 would offer one opportunity to 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..