<u>Question 1 (1)</u>

Research function peformed by Alchamey India.

In the instant case , Alchemy India employees are scientist and engineers which fulfils the conditions mentioned in the explanation 2 of section 9(1)(vii). Further, as per the section 9(1)(vii)(c), any non-resident using the technical services for the purpose of earning any income from any source in India would be liable to tax in India. However, Alchemy UK is not using the services solely for the purpose of India but selling the phones worldwide so services cannot be utilised for the purpose of arriving income from India. The facts of the case are similar to Qualcomm case wherein it was held that supply of goods though technology is embedded in it can be considered as supply of technology. So essentially Alchamy UK is deriving income from India in the form of sale of goods and this situation is also not covered by the explanation to the section 9(2). In such a case it would be income arising from sale of telephone phones, which as held in Ishikawajima Harima's case also that it would not be considered as income arising from India.

Further Alchamey UK, by virtue of **make available clause** in the India treaty is not liable to get taxed in India.

In view of above there is no liability of Alchemy UK to withhold taxes of Alchemy India. However it is advisable that Alchemy UK makes an application under 195(2).

Answer to Question 1(2)

Indian tax implication of access charges paid by Alechmy India.

Transfer pricing: The cost charged by UK should be at arms length price. Though there is no markup charged on the costs but benchmarking for the cost should be done and it should be ensured that the basis of arriving the costs has been well documented.

Withholding taxes: The access charges are neither royalty nor fees for technical services are defined in section 9(1)(vi) and 9(1)(vii). This was also confirmed in the case of right florist, Infrasoft , nokia etc.

Even if it is considered as fees for technical services , such access of information does not result in technology as being **make available** to Indian entity so there is no need to withhold taxes.

Finally, if the charges are at cost then there is no income element so TDS should not be deducted.

It is better to obtain TRC from UK before taking treaty benefit between India and UK.

Answer to Question 1(3)

As per income tax act, the income is charged to tax in India if it accrues in India as per section 5 of the act or if it is deemed to accrue or arise in India as per section 9. The same view was also upheld in the case of Ishikawajima harima's case.

Fees for technological services are deemed to accrue or arise in India if as per section 9(1)(c) the payment is made by non-resident for the purpose of making or earning any income from any source is India. This scope was enlarged by introducing explanation to section 9(2) which provides that the place of providing the services are immaterial.

However the services provided by Lassnet cannot be considered as being used in India. Alchemy UK is deriving income from the sale of telephone worldwide and not only in India. Alchemy does not have any business connection section 9(1)(i) or PE as per Article 5 from the treaty.

Therefore Lassnet is providing services to UK and not to India so lassnet should not be liable for taxes in India.

Answer to Question 1(4).

There are 2 issues which needs to be examined with respect to payments to SRK by Alechmey HK
1. WHT liability for the commission.
2. Creation of PE by appointment of SRK.

1.**WHT liability** In case of EON technologies , Delhi HC has clarified that such kind of activities are not in nature of technical services therefore non-resident making payment would not be liable to deduct taxes in such cases.

2. **Agency PE** in terms of Article 5 between India and UK would not be created for the following reasons:
a. SRK is not able to conclude the contract.
b. SRK is working on principal to principal basis.
c. Though he is deriving major revenue from HK but he is not exclusive agent of HK.
d. There are prohibition clause but which are general and which does not take away the independence status of SRK.

So no tax implications.

Answer to Question 1(5).

Alchemy India would be able to carry forward its losses if the following conditions are fulfilled:
1. By virtue of such restructuring the shareholding of ultimate parent should not change, which is happening in this case.
2. The business should be a continuing one.
3. There are no restrictions on issuance of shares at nil consideration but GAAR provisions (if it comes) should be taken into account. In any case, Hong Kong does not provide an efficient tax exit route by making the capital gains exempt in case of indirect transfers.

Question 2 (2)

Infusion of capital without premium

Earlier in the case of Shell and Vodafone India services it was held that issuance of shares at less than Fair market value would be considered as income by the transfer pricing office. In these cases even interest was demanded as on the deemed loan provided by subsidiary company to parent company.

However Bombay high court has given a decision in favour of assessee which is as follows:
1. Issuance of share capital is an international transasction withihin meaning of section 92B.
2. Issuance of share capital at discount does not give rise to income or loss.

Above decision has been accepted by govt as it has decided not to appeal in the Supreme Court, which makes the position very clear.

Section 56 which provides that issuance of share at discount would be income in the hands of recipient but this is not applicable in case of foreign companies. Is not applicable on foreign companies.

Answer-to-Question- 2(3)

The situation of symphony is grossly covered by the case of **Clifford Chance, a UK company,** wherein it was held that such kind of services are covered by **article 15** of the India UK treaty. Partnership firms are covered by the Treaty. Therefore if the period of stay is less than 90 days then the income would not be chargeable to tax. It was further held that by harmonius reading of **Article 7(1) and 7(3**) of the DTAA,the force of attraction rule would not be applicable in India UK treaty.

Therefore if the period of stay is more than 90 days than the income to the extent attributable would be taxed in India.

In view of above, since partners and associates put together have spent 70 days in India so this will not be taxable in India.

Answer-to-Question- 2(4)

Till the time there are significant changes in the treaty, the UK can consider routing the investment through Mauritius and Singapore. Capital gains are exempt in both the above treaties. In Mauritius investment will be exempt if carried out before 01.04.2017. However, following provisions of the act should be considered:

1. Deemed assets: As per explanation 5 and 6 of section 9(1)(i), assets shall be deemed to be situated in India if it derives its substantial value from Indian assets. Substantial value means more than 50% of the value is derived from Indian assets.

2. Section 56(viia) : Provides for taxability in the hands of recipient if these are transferred at less than FMV. However we assume that PV UK will transfer shares to above jurisdictions at Fair market value.

Position in GAAR

As per the recommendation by some committee existing investments will be grandfathered. It has also been recommended that the circular 789/2000 should be held valid for existing investments. As per GAAR, if there LoB clause in the treaty then the investments should not be questioned by the officer. So if investment is parked in Singapore which has LOB clause, then it provides a shield from GAAR. LoB for Singapore provides that is company should not be a conduit or shell company to take benefit of exemption. For being called as non-conduit company there should be real business operations and the company should have spent 200K USD in the past 2 years OR the company should be a listed company.

However with the Mauritius treated being renegotiated the treaty, the Singapore treaty which is co-terminus to Mauritius treaty may Lget impacted.

Till the time of changes in treaty and GAAR provision would respect the treaty so PV UK can consider making investment in india through Singapore/ Mauritius. However in GAAR, UK should be able to show the commercial susbtance of the transaction.

Indian Judicial attitude

It is more towards adopting **look at** approach rather than adopting looking through approach

1. Vodafone international: Supreme court didn't adopt look through approach and made it clear that the assesse has right to do the tax planning through the tax loop holes available in the law. It has also clarified that the officers should restrict themselves to the existing scope of law. If the intention of law is to avoid such cases then they have options in the form of making rules for indirect transfers, thin capitalisation, CFC, GAAR etc

2. Sanofi: AP high court didn't consider the amendment in section 9(1)(i) as overriding to section 90(2) and ruled in favour of assesse.

3. Copal research: Delhi high court considered sequential sales as valid as long as TRC for Maurities was in place.

4. AT&T : Decision was given in favour if income tax as the purpose of creating the entity in maturities was solely to exit at some point of time.

5. Aazadi bachao aandolan: Harmonius reading of Section 4, 5 and 90 provides that treaty benefit should be available.

6. ABC international: Punjab high court has refused to invoke look through approach.

Thus, courts are included to pass on a message that by not accepting the treat benefit there is breakdown of the faith between the Govt. of India and other country. If the law maker has other intention it should be clearly built in the law by making anti avoidance rules.

Question 4(1)

There has been number of case laws in Indian scenarios where courts have adopted the approach of the "substance over the form" /"look through" whereas there are certain instance whereas where courts have delivered the judgement based on the existing laws. Few of the cases are listed below:

1. IshikaHajima Harima Heavy industries: The decision delivered by SC was that as per Indian income tax act the income cannot be taxed in India unless the source of the income is in India. This decision was reversed by inserting an explanation to section 9(2) retrospectively in 2010.

2. Vodafone international: High court adopted a look through approach while delivering decision on Vodafone international which was examined on the basis of the existing law by the Supreme Court and it was held that indirect transfers of shares cannot be taxed in India particularly when it is between two non-residents and the agreement being executed outside India. Following facts were also considered by SC while delivering the decision.
a. Timing of exit.
b. Involvement of holding company in the operations.
c. period of continuation of the operations.
d. duration of the structure prior to the exit.

3. Copal research: Decision given by Delhi high court in which sequential sales was considered as valid and even the upward payment of divided was considered as out of the ambit of Indian taxes. The court was of view that if the Mauritius treaty does not have LoB clause, then benefit of the treaty must be provided.

4. Abacus International: Benefit of the India- Singapore treaty was not given in terms of the Limitation of benefit clause between 2 countries. The assesse failed to produce the evidence of the remittance of the money to the Singapore account as per article 24 of the India - Singapore treaty. So the court adopted look through approach to the extent of the anti-avoidance provisions given in the DTAA.

5. AT&T (Aditya birla Nuvo): The US company has a subsidiary company in Mauritius which in turned holded shares in Indian company. The JV between India and other partner was signed by US only. Mauritius was only a route for transfer of funds to India. Based on other evidences also it was clear that the motive was to sale the shares of Indian company at some point of time to avoid the capital gains. Court adopted look through approach even though the treaty provided the benefit.

6. Sanofi : In the absence of non obtante claue of 9(1)(i), section 90(2) was considered valid and order was passed in favour of assesse.

IN view of the above, we can say that Indian judiciary is prepared to be aggressive and go beyond English judicial position when the situation warrants.

Answer-to-Question-4(2)

GAAR would be operative from 01.04.2017 and would be applied to deny the tax avoidance/ tax evasion benefits to the tax payers in certain conditions. It consists of section 95 to section 102 of the income tax act.

GAAR reflects the substance over form principle. The transaction can be considered void for tax purposes if there is no business reason underlying the transaction or if the transaction is given a legal form which does not correspond to its actual character.

An arrangement which results directly or indirectly in a tax benefit is presumed to be an avoidance arrangement, unless the person obtaining the benefit proves that obtaining the tax benefit was not his main purpose the agreement.

Onus will be on tax authorities before issuance of show cause notice for GAAR. So the following three criteria which must be fulfilled in order to describe an arrangement impressible avoidance arrangement.

1. It lacs a **commerical substance** of bonafide purpose
2. Result in misuse or abuse of the provision of the act or results in obligations and **rights not normally created** between persons dealing at arm's length.
3. such transaction or arrangement **results in a tax benefit**.

Answer-to-Question-4(3)

GAAR and tax treaties

The benefits of a tax treaty are not available if its provisions are abused. Those benefits could be denied only under the domestic law because tax is levied under the domestic law. Therefore an abuse of treaty is an abuse of domestic laws. Anti-abuse provisions like GAAR creates no conflict between the domestic laws and the treaty provisions. The GAAR is applied to deny tax benefit to non-resident taxpayers who would otherise be entitled to them through proper use of treaty.

Finance act 2912 inserted the following provision in section 90 of the income tax act 1961 Section 90(2A)

"Notwithstanding anything constrained in subsection (2) the provisions of Chapter XA shall apply to the assesse , if such provisions are not beneficial to him."

Other points:

1. GAAR would not be invoked wherever there are SAAR provisions in treaty like LOB clauses in Singapore.
2. Corresponding adjustment would be allowed to same tax payer and not to the other taxpayer.
This approach would work as a deterrent for tax evasion / avoidance approach.
4. GAAR should not be applicable on the foreign restructurings. Circular 789/2000 to be valid till it is withhold.

Question 5(1)

Loan by UK for its business operation in UK : This does not fit into condition mentioned in 9(1)(v)(c)(read with section 195) which states interest payment to be taxable in India should be used for purpose of business carried in India or for the purpose making income from Indian source. So no taxes are required to be withhold on this portion.

Loan by UK for its Indian operations carried through Mumbai office: Since this utilisation of loan is for the purpose of business carried out in India so it fits into the withholding requirement of section 9(1)(v)(c).

Loan by UK for on lending to Nifty India: Nifty India should withhold taxes while making interest payment to Nifty UK. The rate would be lower of domestic laws and treaty. Rate in domestic law is lower as per section 115A -10% so this much of taxes should be withhold by Indian entity. Nifty UK should not make any deduction on the portion to the extent related to nifty India at the time of making payment to bank as it is not relating to Indian business.

Payment of interest on debentures (CCD) : Lower of domestic taxes and treaty interest paid on the CCD's should be deducted which is currently 10%.

Answer-to-Question - 5(2)

CCD's should be taxable in the hands of Indian partner as capital gains on the date of the date of transfer/ conversion to equity.
Section 56(2)(vii)(a) would be applicable if the transfer price is less than the fair market value and thus the difference would be taxable as other receipts in the hands of the recipient.

Answer to Question - 5(3)

The services provided by HSN UK and CSN Singapore may be considered as fees for technical services by the Indian tax authorities. There has been number of cases where such kind of transmission has been considered as technical services (FTS) by the Indian tax authorities. Though in most of the cases, Indian courts have ruled in favour of tax payer (Asian satellite networks pvt ltd)

Further the explanation inserted in the section 9(2) provides that FTS/ Royalty and interest would be taxable in India irrespective of the fact that the non-resident has a residence or place of business in India or whether the non-resident has rendered services in India. This explanation having effect from retrospectively encourages the tax officers to tax aggressive positions.

So if is considered as FTS by tax authorities, then clearly such services are used in India (though not performed in India). In such a scenario tax withholding implications would apply.

In case CSN is chosen as the service provider, then application under 195(2)/ Advance rulings should be made by Nifty UK to obtain clarity on the services being considered as FTS or not. If not considered as FTS then in the absence of any business connection/ source in India as per the article 5, same should not be taxable in India.

However in case of **Singapore** the services are not resulting into "**make available"**. That is to say the user of the services cannot independently apply these services so it does not result into make available. In such a scenario the benefit of make available between India and Singapore would be available.

To take benefit of the treaty and avoid future litigations it is better to choose the Singapore service provider.

<u>Question 7(1)</u>

Position as per domestic taxation : As per domestic taxation regulations, as per the section (9) (1)(vi) read along with explanation 4 to 6, the payment for software licence must be categorised as royalty. In case of Infrasoft limited, nokia networks and ericcson, court has clearly made a distinction between copyright and use of copyrighted article. Therefore in the instant case the payment for use of copyrighted article cannot be considered as royalty. However in view of explanations inserted in section 9(1)(vi) and Section 9(2), this position is not free from litigation.

Position as per the DTAA: The payments cannot be considered as royalty unless the user of the software is able to make commercial gain out of the use of the software which otherwise is prerogative to the owner. Since source code has not been shared with the user it cannot be considered as revenue being generated by Indian customer directly from the use of the software. However since the software is customised for Indian Entity it can be considered as technical services. In UK-India because of "make available clause" in article 12 the services cannot be considered as being taxable in India unless the user is independly able to use the services without the help of service provider.

Whether business income? There is no permanent establishment of Aggregator in India as per article 5 so there is no business income from sale of software.

Conclusion based on above 3 conditions.
As per section 90(2) , the assesse can choose to be taxed based on position beneficial to him out of domestic taxation and DTAA. Therefore sales of aggregator's software in 2015-16 would not be subject to Indian taxation.

Answer-to-Question-7(2)

Subsidy, though arising in India, but is granted on account of capital investment in India.

Therefore such subsidy costs should be reduced from the cost of acquisition of assets. The taxability would arise on account of the capital gains arising out of the sale of the business/ assets at a stage and not at the time of grant of capital subsidy.

Answer-to-Question-7(3)

As per the Indian income tax act the income can be taxed in India if it arises or accrues in India as per the section 5 of the act or if it is deemed to be accrue or arise in India as per the section 9. The income will not accrue to India if the entity does not have permanent establishment as per the article 5 of the DTAA. Income can be deemed to accrue or arise in India if it is resulted out of the business connection in India as per section 9(1)(i)

Since none of the above conditions exist in case of quark, so quark will be subject to taxation as **income from other sources.**

Assuming that aggregator has the tax residency certificate of Mauritius the India Mauritius treaty can be applied. Then, per the India Mauritius treaty the income from other sources can be taxed in Mauritius only and not by India so there would not be any withholding obligation for Aggregator.