Question 4

Part 1

As per the safe harbour rules to be introduced under the GAAR provisions, if the debt-equity ratio of Indian subsidiary is more than 3:1 than this entity will be termed as thinly capitalized entity and the amount of interest accruing on the loan amount exceeding the safe harbour debt-equity ratio will be disallowed for corporate tax purposes and will be termed as distribution of dividend from the Indian Subsidiary to its parent company. All provisions relating to payment of dividend to non-resident will come into play and tax at the rates of 20% (Sec.115) will need to be deposited under the withholding machinery provision of Sec.195.

Part 2

If an Indian subsidiary plans to buy back its shares from its UK parent organization, this transaction may get subjected to 20% WHT under Section 115QA of India Income Tax Act (15% under the India-UK tax treaty) on the spread of the price at which Indian subsidiary plans to buy back these shares and the price at which these shares were originally allotted to UK parent.

This tax should be deposited with Indian Revenue within 14 days from the date of payment of consideration on buy back of shares.

Part 3

This being an intra-group reorganization whereby shares of an Indian Subsidiary are transferred to another non-resident affiliate entity at NIL consideration, this transaction will not be subjected to any taxes in India both, from the perspective of UK parent or foreign subsidiary until the further exit route is used by this group.

Part 4

If UK parent transfers shares of an Indian subsidiary to an unrelated company outside India, this transaction will be subjected to India taxes for the reason that the underlying asset which has been disposed of by UK parent is the shares of an India incorporated entity which is sourced in India and thus, transfer of India source asset will be subject to India taxes.

Any gain realized by UK parent on this share transfer transaction will be subject to capital gain tax in India. Further, since the acquisition of these shares is made by a foreign entity incorporated outside India, this foreign entity is under an obligation to make Sec.195 withholding tax on the capital gain realized by UK parent company from this transfer transaction.

Further to above, if these India entity shares are held by UK parent through Mauritius route and Mauritius entity disposes off this investment to an unrelated buyer in foreign jurisdiction, this transfer of shares by a Mauritius entity to foreign entity can be treated as tax-free in India under the India-Mauritius tax treaty which states that any capital gain earned by Mauritius resident from transfer or sale of capital asset (securities and shares) of Indian resident, such capital gain transaction will be taxable only in Mauritius.

However, to avail benefit under the India-Mauritius tax treaty, Mauritius entity must submit its valid tax residence certificate with Indian Revenue demonstrating that it is the beneficial owner of this capital gain and is not a look through entity.

Part 5

CCDs, which are to be compulsorily converted into equity stock of Indian entity at a future date, will be treated at par with the equity stock and will have same tax treatment as is accorded to equity stock.

Transfer of CCDs by UK parent to any other shareholder will have no tax consequences for the Indian subsidiary unless this transfer results in change of management.

Question 5

Part 1

The activities of first division of TH UK which is concerned with export promotions of TH India products in the EU market and collects orders from EU customers and sends these to TH India for approval and delivery will be treated as normal business income under the India-UK tax treaty and should be subjected to taxes in India only if TH UK operates in India through a permanent establishment (PE) (Article 7 of the India-UK tax treaty).

This export commission earned by TH UK relates to the sales and marketing efforts of TH UK entity wherein TH UK employees scout for business in EU market for TH India product and brings order on table for TH India approval. Since all these activities relating to market pitching, business scouting and client discussions are done outside India by TH UK employees working under control and supervision of TH UK, these services can be termed as income accruing or arising in India under Section 9 of India Income Tax Act and should not be subject to withholding tax.

However, it is worthwhile to add that the rate at which commission is paid to TH UK for these activities should be benchmarked by TH UK to determine if the charges paid as export commission are at arms'-length.

Part 2

The ITC services provided by TH UK through a third party service providers may get subject to Sec.195 provisions wherein even a non-resident service provider dealing at arms' length with another non-resident service provider makes payment to the latter non-resident for services delivered in India or in relation to business operations of an Indian entity.

Although these ITC services purchased by TH UK for TH India are required only for sale of TH India product in EU Market, since these services are technical in nature and can be delivered remotely from outside India, these services will be deemed to be an income accruing or arising in India under Sec. 9(1)(vii) of India Income Tax Act and will be subject to Sec.195 withholding tax.

This WHT will be imposed on entire sum payable to TH UK including the mark-up charged by TH UK on third-party service fee.

Further to add, the mark-up charged by TH UK should be benchmarked under Chapter X of India Income Tax Act to determine if the charged paid by TH India to its associate entity TH UK are at arms' length.

Part 3

Foreign dividend received by an Indian entity will be subject to Indian taxes at the rate of 15% (Sec. 115BBD).

With the introduction of the Protocol to the India-UK tax treaty, which has come into force with effect from December 2013, the tax credit benefit of underlying taxes paid by UK subsidiary on its profits out of which dividend is paid has been done away with and is no longer available.

Part 4

Since this share transfer is an intra-group restructuring executed at NIL consideration, this transaction will not be subject to India taxes unless the group plans to exit out of this investment. However, if it can be demonstrated that this transaction is a tainted transaction wherein the intent of the parties is to principally avoid taxes or to draw tax benefit, this transaction shall be disregarded for tax purposes and to compute the tax liability of the taxpayers.

Part 5

At the outset, it appears that the intra-group restructuring was done with a principle motive of obtaining tax benefit from this arrangement and there is no commercial substance to this transaction. Although this transaction can be covered by Indian GAAR, since there are specific anti-avoidance rules included in the India-Singapore Tax treaty, this SAAR will have its play in this arrangement.

The India-Singapore tax treaty contains an LOB clause which requires fulfilment of two principle conditions before treating capital gain on sale of share transaction as an exempt transaction.

These conditions are:

i) The Singapore entity should not be a shell entity; and
ii) Annual operating expense of Singapore entity should exceed $250,000.

In the instance case, although TH SG has an active management with it own local board, it doesn't satisfy the other condition of annual operating expense of $250,000. Here, since TH SG annual expenditure is merely of $40,000, it will get trapped under SAAR and the capital gain accruing to Indian entity on sale of its UK subsidiary will be subject to India Taxes.

Question 6

Part 1

Under the stated facts wherein GC enters into a contract with GPD for installation and construction of jetties and associated port equipment, the key activities performed by GC and IC (Indian subcontractor) are as under:

i) Sale of machinery by GC to GPD;

ii) Sub-contracting a part of work (installation and assembly) to an independent third party contractor who has relevant experience in these subcontracted services; and

iii) Deputation of two of its employees to India (Goa) for two months (approx. 60 days) in the 2015-16 financial year to ensure completion of this project.

The first activity of sale of machinery which is an offshore supply wherein the title of this property is transferred outside India and property is also transferred outside India (Ishikawajima Harima case), this activity under Section 9 of India Income Tax Act, 1961 will not be deemed to accrue or arise in India and will not be subject to any taxation in India.

The 2nd activity wherein Installation and Assembly services are outsourced to a third party contractor (IC) who acts on its own through its own workforce and without day-to-day supervision or direction of GC, will be treated at arms-length and will not create IC an agency PE of GC. Further, since GC doesn't have any PE or other business connection in India (total stay under this project will be of less than 90 days), payment made by GC to its sub-contractor IC will not be subject to India withholding tax provisions.

Third activity of deputation of two of its employees to India to supervise GPD project work and to ensure its completion will not result in creation of GC's PE in India.

Furthermore, while making payment to GC by GPD, this transaction may come under the purview of India withholding tax provisions as the work done by non-resident entity either through its own personnel or through sub-contractor is done in India. Further to add, since the activity of Installation and Assembly of Machinery is incidental to sale of Machinery, price charged by GC for supply of machinery (even if separate prices are quoted for installation and assembly) should be treated as a single trade transaction and business income under Article 7 of the India-UK tax treaty. This business income can be brought under India tax net if GC (UK entity) is operating in India through a Permanent Establishment which, though, is not a case here.

However, if it is established that GC has created a permanent establishment in India (combined stay on GPD and MP project likely to exceed 90 days threshold under Article 5 of the India-UK Treaty), then, GC's income from supply of machinery to GPD may be taxed under India Income tax Act as business Income.

Part 2

Yes, since GC is planning to send its personnel to India (Mumbai) for supervision of installation work on MP Project, its cumulative presence in India including the one for GPD project, is likely to exceed 90 days threshold as specified under Article 5 of the India-UK tax treaty and this GC may end up creating a permanent establishment in India. With the creation of PE in India, following tax consequences are likely to follow:

i) All business carried out by GC through subcontractors or its own personnel deputed in India will be subject to taxation in India in the same manner as any other resident taxpayer is taxed.

ii) Salary of all its employees working on India assignment in India (for howsoever short duration) will get subject to India taxes and relief under Article 16 (dependent personnel services) will not be available to such employees.

iii) GC will be required to comply with Section 192 withholding tax provisions for deduction and deposit of withholding tax on its India deputed employees' salaries.

iv) Consultation fee paid / payable to Mr Silverman for the provision of technical expertise about the petroleum industry will be deemed to accrue or arise in India (Under clause (vii) of subsection 1 of Section 9) and will be subject to Section 195 withholding tax.

v) All other provisions of India Income Tax Act will apply to GC UK as they apply to any other resident taxpayer.

<u>Part 3</u>

As discussed in point (iv) of Part 2, if GC is considered to have created a PE in India, payment of consultation fee to Mr Silverman will be deemed to linked with PE operations and will be subject to 10% withholding tax under Sec.195 withholding tax provisions (Income deemed to accrue or arise in India under Sec. 9(1)(vii)).

However, if GC is not treated to have created a PE in India, then the payments made to Mr Silverman who is a Jersey tax resident and is operating completely from his home location in Jersey to be a payment made by a non-resident entity for work performed outside India and thus, will not be subject to any India withholding tax provisions.

However, further to add, with the amendment of Sec.195 whereby even non-resident entity payers' have been brought into tax net, Indian Revenue may contemplate that this transaction is linked with Indian operations of GC and should be subjected to Sec.195 withholding tax. We recommend that GC should make an application under Sec.195(2) to get clarity on this issue.

<u>Part 4</u>

Contract termination fee payable by GC UK to Mr Silverman, a Jersey tax resident, is a normal business transaction and should be treated in a manner, depending on status of GC operations in India, i.e.:

i) If GC is operating in India through a Permanent Establishment (PE) as discussed in above Parts, payment made to Mr Silverman on contract termination may be claimed to be related to PE operations and can be subjected to Sec.195 withholding tax at a rate as applicable.

ii) However, if GC is not-operating through a PE in India, similar to the consultancy services, even the contract termination charges will not be subject to India Income Tax.

Part 5

Regarding access to OilWrite's software programme wherein subscriber of this software (GC) will only get a right to download copy of this software from OilWrite UK-based online servers and to operate it on their systems without any additional right to make any copy of this software or to distribute, display or to access source code of this software, we believe that this access to OilWrite should not be treated as income accruing or arising in India under clause (vi) or (vii) of subsection 1 of Section 9 and thus, should not be subjected to the withholding tax machinery of Section 195 of Income Tax Act. A similar stand is taken by Indian Revenue in the case of Right Florists wherein Indian company had acquired a non-exclusive, non-transferable right to use a software downloaded from servers located outside India.

Given above decision by Indian Revenue, we believe that no income of OilWrite will be subject to India taxes merely because of having its user-base in India unless it operates in India through a permanent establishment. This payment from GC to OilWrite will also not be subject to any withholding tax in India.

Question 7

Part 1

Tax treaties signed by India with Mauritius and Singapore contain favourable tax clauses which allow foreign investors to bring their investments in India in a tax efficient manner ensuring zero or minimal tax implications. A few of these benefits which accrue to foreign investors include:

i) Benefit of underlying tax credit accruing on dividend income. That is, in addition to the taxes paid at source on dividend income, a credit for underlying taxes paid by distributing company on its profits out of which dividend is declared is also made available in either of the treaties signed by India with Mauritius and Singapore.

ii) Capital Gain realized on sale of shares or other securities is not subjected to any taxation if investment in these shares or securities is made through entities operating in Mauritius or Singapore. However, in the India-Singapore tax treaty with the introduction of LOB clause, this CG exemption needs to be evaluated critically.

Part 2

Although the tax residency certificate issued by Mauritius Government should be relied upon on the face of it, if Indian Revenue is of the opinion, that the entity claiming relief under the India-Mauritius tax treaty is not a beneficial owner of income and is merely acting as a look through entity, Indian Revenue may challenge validity of the tax residency certificate issued by Mauritius Government and may ask for further documents or certifications to satisfy itself that the claim made by Mauritius entity under the India-Mauritius tax treaty is not a sham transaction. Besides above, India Revenue may also require Mauritius authority to certify that the entity seeking tax residence certificate is assessed under Mauritius Taxes on its income.

Part 3

Under the Vodafone judgement, SC held that if an assessee is trying to exploit tax benefit while behaving within the four corners of law, the transaction should not be disregarded by Indian Revenue merely because the law contained some loophole which assessee has exploited through tax planning. All Indian Revenue can do is it can bring about the legal provisions to plug that loophole to curb on future tax planning.

Supreme Court further discussed that it was never the intent of law to bring within its text net the capital gain arising on transactions undertaken between two non-resident entities. And therefore, Indian Revenue should not go beyond the ambit of law to see if such transactions resulted in any tax benefit on assets or property situated in India. Indian Revenue should restrict its scope only at the law currently in state of force.

Part 4

General Anti-Avoidance Rules (GAAR) proposed to be introduced in India with effect from 1 April 2017 will apply on all transactions or arrangements which are devised primarily with a motive to avoid taxes or to draw tax benefit from such arrangements. Here, if Indian Revenue is of the opinion that the transactions entered into by dealing parties or transaction proposed to be entered into by dealing parties is driven by the intent of tax avoidance, Indian Revenue may look through the framework of such transaction (or arrangement) to understand true intent of parties and to determine the actual tax liability of that transaction.

However, these 'look through' rights provided to Indian Revenue under the GAAR provisions can be exercised arbitrarily and should be supported by convincing reasons providing a detailed note of nature and basis of such tax avoidance apprehensions.

Part 5

In the Finance Minister 2015 Budget Speech, he clarified that Indian Government will no longer make any retrospective tax amendments in Law. However, he has remained silent about the status of retrospective amendments made in recent past.

Further to add to above, Indian Government which is known to be tax aggressive in relation to collection of taxes is taking some steps to build in its trust in foreign investors that the intent of the Government is to become more investor friendly and not as an aggressive tax collecting economy. The most recent steps taken by Indian Government in this direction includes:

i) CBDT has notified that the Vodafone ruling of Bombay High Court on share issue transaction should be followed in all other taxpayer cases pending at different levels of litigation;

ii) India has come up with draft rules on multiple year data and range concept;

iii) India has agreed to setup a committee to review all cases of indirect asset transfer which may get affected by Vodafone changes introduced in law retrospectively through Finance Act 2012; and

iv) India has revived its discussion with US Revenue for resolving 100 dispute resolution cases and also to enter into bilateral APAs.

About the impact of retrospective tax amendments on treaty relief entitlement, India has not made much progress on this front but has revived its discussion with various tax jurisdictions to bring in necessary changes in double tax avoidance agreements or to settle these cases through MAP proceedings.