THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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PAPER 2.05 – INDIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

Suggested Solutions

Question 1

Part 1

Under Indian tax law, profits of a non-resident are taxable if they accrue in India under section 5 ITA or are deemed to accrue under section 9. Since Azura UK is a UK resident, the UK- India Tax Treaty would apply. Under Article 7 of the Treaty, Azura's profits would be subject to Indian tax only if it were to carry on business in India though a permanent establishment in India. Consider the question of PE under fixed place PE and service PE. Consider if the exceptions to PE status apply. Consider the impact of the *Morgan Stanley* case as well as the *E-Funds Corporation* case, and the comments in these cases on subsidiaries as permanent establishments.

Part 2

The capital subscription has been challenged by the revenue (see *Shell* and *Verizon*) under the transfer-pricing regime. The student must first set out the scope for transfer pricing in India, describe the relevant statutory provisions and then address the present controversy. Capital subscription should not have adverse tax consequences in the light of the Bombay High Court judgment in the *Vodafone* case and the subsequent revenue decision not to appeal. In 2012, section 56, ITA has been amended to make taxable any amount received by the issuing company in a subscription that exceeds the fair market value of the issued shares. However this amendment only applies if the subscriber is an Indian resident.

Part 3

For UK employees, consider exemption under the India-UK tax treaty. No such exemption would apply for HK employees. Consider the favourable treatment for tax equalisation agreements in India. The ‘hypo tax’ should not be added to the income of the UK and HK employee for Indian tax purposes.

Part 4

The student must provide an explanation of the scope of salary taxation in India before going to on to analyse taxation of ESOPs in India, and consider whether and to what extent tax is imposed at each stage (granting, vesting, exercise, sale) Careful attention must be paid to both the salary income and capital gains implications of an exercise and sale of vested shares by the employees.

Part 5

The issue is whether this is a transfer of a copyright or a copyrighted article. A recent Delhi High Court decision (*Infrasoft*) has classified this kind of income as business income and not royalty. However decisions by other high courts (e.g. Karnataka High Court in *Samsung*) have gone the other way. An additional complication is that Silicasoft is being modified and customised in India and it is unclear how this can happen without some copyright being transferred to Azura India. A more careful look at the documentation is necessary. If the transaction is taxable, Azura India would have a withholding obligation under section 195. Azura might want to consider an application under section 195(2) or an application for an advance ruling.

Question 2

Part 1

India-Mauritius DTAA would ensure that the sale of shares by Armaan Mauritius would not suffer taxation in India provided that the directors of Armaan Mauritius can demonstrate that they have acted independently and that their powers were not usurped by Mr. Kashyap. Mr. Kashyap would be subject to Indian tax because of the retrospective amendment to section 9 but a recent Delhi High Court judgement (*Copal Research*) has interpreted the 'substantially' requirement in section 9(1) Explanation 5 to mean that the Indian assets have to comprise at least 50% of the worldwide assets (of Armaan Jersey), which is not the case here. Your client is Armaan, not RV. You can ask Mr. Kashyap to take the position that there is no Indian tax withholding required and ask for grossing up if RV decides to be cautious and withholds Indian tax.

Part 2

The dividends ought not to have any Indian tax consequences although it is possible at least in theory that the section 9 retrospective amendments (Explanation 5, section 9(1)(i)) would tax the dividends. Post *Copal Research*, consider if Armaan can take the position that upstream dividends do not have an Indian source.

Part 3

On similar facts the revenue argued as such in the *Copal Research* case but the Delhi High court rejected this argument by adopting the 'look at' approach in the Vodafone case. Also it can be shown that there were commercial reasons both for the Armaan corporate structure and the manner in which the Armaan sales were structured.

Part 4

The student is expected to present a careful analysis of the applicable GAAR provisions including the trigger factors. GAAR should not have an impact on the sale as the sale was not motivated solely by a tax avoidance motive.

Question 3

Part 1

Discuss the law on 'Association of Persons' and note the detailed discussion on the topic in several cases including, for example, the recent Delhi High Court decision of *Linde AG, Linde Engineering Division v Deputy Director of Income Tax*.

Part 2

There are several factors that point away from AOP. CL and SP are paid separately for their work, and they do not depend on each other to complete their respective work. On the other hand, they are jointly liable to VR, they have a common project director, common performance guarantee and a common insurance policy. Consider how the *Linde AG* case looked at these issues, and advise on the likelihood of the consortium being considered as an AOP.

Part 3

The AOP would most likely be taxed under section 5 as a resident in India (consider the application of section 6 to the facts) and CL would lose the benefit of the UK-India DTAA.

Part 4

CL must try to avoid a business connection in India, thus avoiding an Indian tax on the sale of the machinery. CL can negotiate with VR to ensure that the transfer of title occurs in the UK rather than in India. CL will not be subjected to tax if its profits from the sale of machinery are considered as business income arising overseas. In this case, the title does not pass until after the acceptance tests in India. Consider if this legal position can be modified during negotiations. For example, CL could be made contractually accountable for the quality of the machinery even after the title is transferred to VR. Similarly CL can contractually take responsibility for any loss during transit even if the title to the goods pass in the UK. The revenue might try to link the sale of equipment to a possible PE in India (because of the work done by the project director). If CL negotiates a transfer of title within the UK, then it can take the position that the sale was completed before the PE came into existence (assuming there is a PE) and therefore the profits from the sale cannot be attributed to the PE.

CL's profits from technical designs would be subject to Indian tax as fee from technical services (after the retrospective amendment) unless CL can show these are inexplicably linked to sale of machinery. It is advisable that the schedule does not mention a separate price list for engineering design and technical specifications.

Part 5

CL can take the position that there is no withholding requirement because the interest will have not have an Indian source; the funds will be used by CL in connection with its business of manufacturing and selling plant and machinery in the UK. Therefore, there is no deemed accrual in India under Section 9(1) (v) ITA.

Question 4

The question is in essay form. Therefore the answers can be descriptive, focussing on the following:

Part 1

Discuss the lack of thin capitalisation rules in India but consider the potential impact of GAAR and transfer pricing legislation.

Part 2

Explain how the buy-back would be covered by section 115QA which imposes a tax of 20% on the consideration paid for the buy-back of shares as reduced by the amount which was received for the issue of such shares. Since the dividend distribution tax is 15%, companies would probably prefer the dividend route rather than the buy-back route, absent any other tax considerations. The UK company will not be subject to taxation for the buy back as it is exempted under section 10.

Part 3

From UK parent's perspective: consider if the transfer of shares is outside the Indian tax regime as there is no consideration. Discuss *Orient Green* where such a transfer was considered as a colourable device and discuss if this decision can be distinguished if proper procedures are followed. Consider favourable decisions such as *Goodyear Tire and Rubber.* From Foreign Sub's perspective: Although Section 56 ITA has been amended to tax such receipts as 'income from other sources', Foreign Sub can take the position that it is not amenable to tax as such a receipt has not accrued in India. Foreign Sub's source of income is its UK parent, which is not an Indian source.

Part 4

If UK company transfers shares of Indian subsidiary, it will be taxed under Indian law as per India-UK DTAA. Discuss the Indian tax issues concerning tax rate, indexation and MAT. If Mauritius holding company transfers shares, no Indian tax payable as per India Mauritius DTAA but discuss how the holding company must have a residency certificate and must be a legitimate entity.

Part 5

Discuss the possibility that consideration received for any subsequent transfer of the CCDs to fellow shareholders might be characterised as interest income rather than capital gains and the different tax consequences thereupon. Address the discussion on this point in the *Zaheer Mauritius* case. The *Zaheer Mauritius* decision supports the proposition that the transfer of CCDs would result in capital gains treatment, but a more careful analysis of the CCD documentation is required.

Question 5

Part 1

Discuss cases such as the Delhi High Court decision in *EON Technology* in support of the position that an export commission is in the nature of business income and absent a business connection or a permanent establishment, there should not be any Indian tax consequences.. However, refer to the AAR decisions in *SKF Boilers* and *Rajiv Malhotra* which have held that commission income is taxable Indian source income. There is some uncertainty about the classification of commission income. *Rajiv Malhotra* classified the commission income as 'income from other sources' under the tax treaty applicable in that case, and this would mean the permanent establishment exception would not be applicable to this income. Consider whether a more cautious approach would be for TH India to apply for a section 195(2) determination. TH India must make sure the commission is arm's length income to avoid transfer pricing issues.

Part 2

Likely to be considered as FTS under section 9 (See AAR ruling in XYZ and *Havells India Ltd.*) but consider whether these services would be classified as technical services under India-UK DTAA as the services do not appear to make available any technical knowledge to TH India. There is a risk that the revenue might argue that such services make available technical knowledge to TH India because such services might be used by TH India in negotiations with third parties. Consider whether one should take the cautious route of applying for a ruling under section 195(2).

Part 3

Discuss the taxation of dividends received by an Indian resident from a foreign company under the India UK tax treaty. UK will not tax the dividends paid but the dividends would be taxable in India. There is no underlying tax credit in India; therefore there will be no credit for taxes paid in the UK on income earned by JH UK.

Part 4

Section 56 has been amended to tax such receipts in the hands of TH Singapore as 'income from other sources'. The taxable receipt would be the fair market value of TH UK shares transferred to TH Singapore (exceeding Rs. 50,000). For TH India, the transfer of shares should be outside the Indian capital gains regime as there is no consideration. But see *Orient Green* where such a transfer was considered as a colourable device, but this decision can be distinguished if proper corporate mechanics are followed. Consider favourable decisions such as *Goodyear Tire and Rubber.*

Part 5

The India-Singapore DTAA (with its Limitations of Benefits article in the treaty that requires TH Singapore to have incurred an expenditure of more than $200,000 annually) is not applicable to the facts. Here, a Singaore resident company is going to sell a UK capital asset. But the sales transaction is also vulnerable to challenge by the Indian revenue on tax avoidance grounds because of the proximity between the transfer of TH UK shares to TH Singapore and TH Singapore's sale of TH UK's shares.

Question 6

Part 1

The answer must set out the scope for non-resident taxation under the ITA. The supply of equipment should not result in Indian tax because title passed overseas and GC did not have a presence in India at the time of the transfer of title. An additional issue is whether the sub-contracting work would result in a PE for GC. The student can refer to the *Pintsch Bamag* case on this issue. It is unlikely that sub-contracting work, in the manner it has been described in the facts (no substantive role played by GC) would result in a PE for GC.

Part 2

GC's work is taxable under section 44BB as it is related to the exploration of mineral oils. The question is whether there is a PE. Although GC's personnel have spent only two months in India, there is a a likelihood of a PE under Article 5(2)(K) of the India-UK DTAA as the services relate to the minerals oil sector. Therefore it is likely that GC would be taxed on this income under section 44BB. The student can refer to the AAR ruling in *Global Industries Asia Pacific Pte*. Ltd for a discussion of these issues.

Part 3

The services provided by Mr. Silverman are technical services within the definition in Section 9 as they are "managerial, technical or consultancy services". The last Explanation to Section 9 makes it clear that it does not matter whether the consultant provided his services in India. The key connecting factor where the payer of the fees is non-resident, is that the fees are paid to for services used in an Indian business or have an Indian source. The fees have an Indian source as the services are being used on GC's work in India. GC has an obligation to withhold. The withholding obligation under section 195 extends to a non-resident that has no business presence in India. In any case, GC is likely to have a business presence in India (see answer to question 2 above).

Part 4

The termination fee is probably best classified as a payment for the giving up of a capital asset. Therefore this would be a case of capital gain. However it is unlikely to be considered as Indian source capital gain under section 9; GC can be confident in taking the position that the termination payments would not be taxed under Indian rules as such rights under the consultancy agreement are not a capital asset situated in India (the agreement, the parties to which are both non-resident, is concluded outside India and the payments under the agreement are made outside India). Therefore GC can take the position that there is no withholding obligation under section 195 as there is no tax liability (per *GE* case)

Part 5

If the subscription income is business income, OilWrite will not have a taxable presence in India in the absence of a permanent establishment. However, there is a risk that the subscription income would be considered as royalty income. While some decisions (*Factset, Dun and Bradstreet Espana*) have held that subscription income should not be classified as royalty income, others (*Wipro*) have held that subscription fees are royalty income.

From GC's point of view, if the subscription income is considered as royalty income, a careful consideration of section 9(vi)(c) is necessary. Consider if, in principle, there is an obligation to withhold as the subscription would be used in an Indian business or have an Indian source. GC might use the subscription for its projects world-wide, in which case the application of section 9 (vi)(c) is not clear. The fact that OilWrite does not have a residence or place of business in India is not relevant after the recent amendments to section 9. Consider whether an application with the AAR might be required here.

Question 7

The questions are in essay form, therefore the answers can be descriptive focussing on the following:

Part 1

Discuss the tax payer friendly capital gains/dividends/interest provisions under the Mauritius and Singapore double tax treaties, and mention comparative advantages and disadvantages, if any.

Part 2

Discuss the CBDT circular, *Azadi Bachao Andolan* and *Vodafone* cases. Discuss more recent cases such as *Aditya Birla Nuvo*. Also discuss the implications of section 90(5).

Part 3

Analyse in detail the discussion on this point in the *Vodafone* case.

Part 4

This question provides an opportunity to the student to analyse the GAAR rules in detail and query whether they enable the revenue to adopt a look through approach.

Part 5

Discuss the *Sanofi* case but also point out the continuing uncertainty in this area.