International Taxation: Past, Present and Future

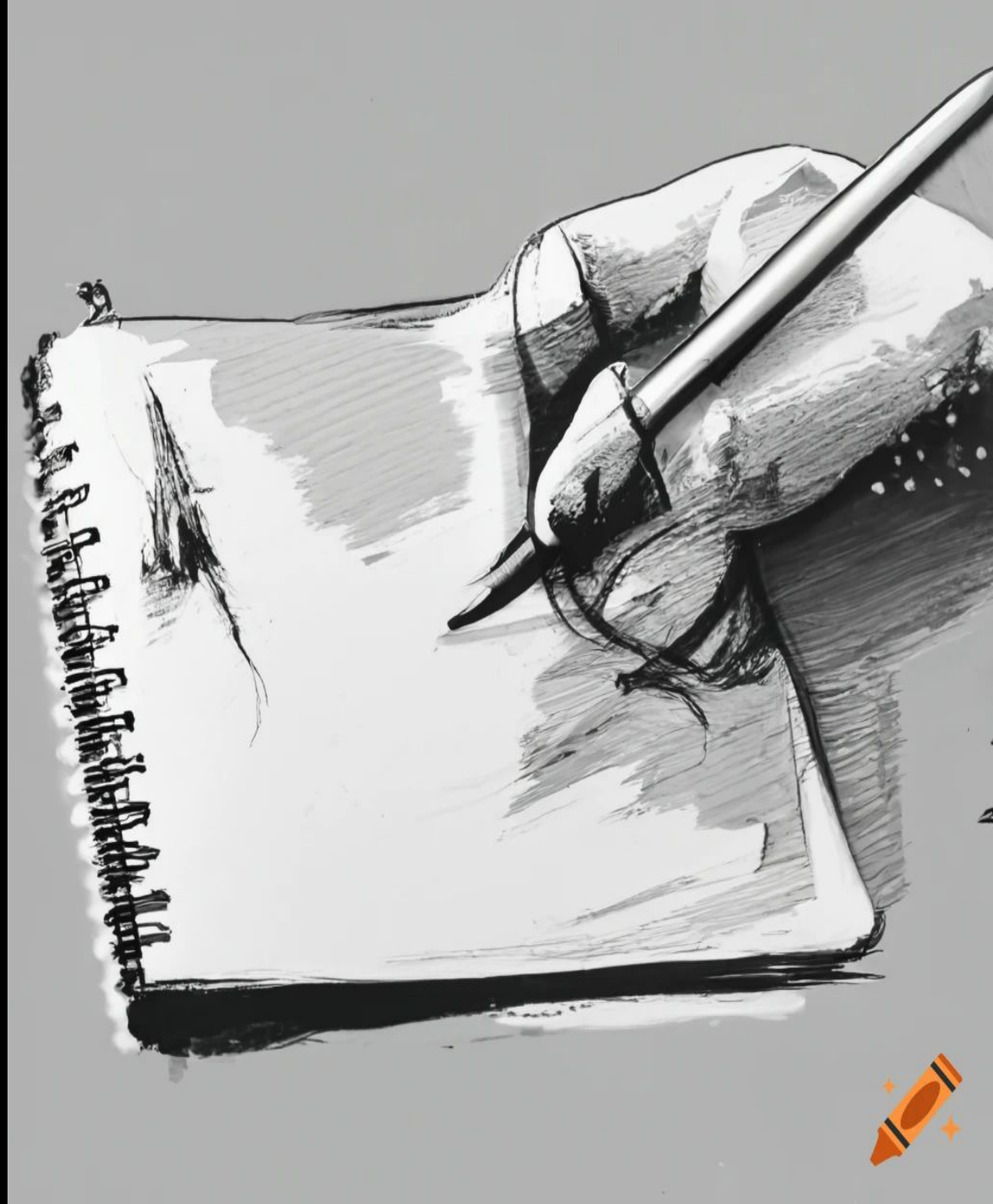
Vikram Vijayaraghavan, Advocate
M/s Subbaraya Aiyar, Padmanabhan & Ramamani Advocates

1st July 2023, Revenue Bar Association (Chennai)

Agenda

A waltz through International Taxation!

- Focus on **concepts**, **DTAA's** and its nuances
- Past
  - Basis and evolution of international taxation viz a viz DTAA and the Act
- Present
  - Current problems. Points to ponder.
- Future
  - Rapid and surprising changes happening in international taxation



Past

- What is international taxation?
- Source & Residence concepts
- India’s S.5-S.9
- Double taxation
- DTAA’s
- India and DTAA’s
- Treaty Models
- Interpretation of Treaties
- Articles of DTAA (Article 1-26)
- Corresponding Sections of IT Act
- Typical FTS/Royalty Disallowance
- Bird’s eye view of International Taxation

What is international taxation?

- International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries
- Movement of people, goods, activities –Economic flows
- Every jurisdiction wants a share of the taxation pie!
- Allocation of taxing rights between jurisdictions (delineated as *source & residence*), with elimination of double taxation, is at the heart of international taxation

- **Source vs Residence**

Residence: State where person earning such income resides

Source: State where income has its origin

- **Source vs Residence jurisdiction**

Residence: Income may be taxed under law of country because of nexus between country and person earning income, irrespective of the place where the income is earned

Source: Income may be taxed under tax law of a country because of nexus between country and activities that generate the income, with no reference to the residence of the taxpayer

Indian Income Tax Act – Source & Residence rules

S.5 - Charging Section - Scope of Total Income

Resident	Global income taxable
Resident but Not Ordinary Resident (RNOR)	• Income accrued or arising or arising or deemed to accrue or arise in India. • Income received or deemed to be received in India. • Accrued or arising outside India from business controlled in or profession setup in India
Non-Resident (NR)	• Income accrued or arising or arising or deemed to accrue or arise in India. • Income received or deemed to be received in India.

S.6 – Residential Status

Basic conditions

>= 182 days in PY

(or)

>= 60* days or more in PY and >= 365 days in 4 PPY

Additional Conditions

Resident in 2/10 PY

And

Presence for >= 730 days during 7 PPY

- Replace 60 with 182 days
  - Indian citizen leaving for emp. Or crew member of Indian ships
  - Indian citizen or PIO visiting India
- Replace 60 with 120 days for Indian Citizen / PIO visiting Indian Income having total income (other than foreign sources) > Rs.15L
- Fulfil basic & additional conditions -> Resident, only basic conditions -> RNOR. Not fulfilling conditions -> NR

S.6(1A) - Deemed residency

Citizen of India

Total Income (other than income from foreign sources) > Rs.15L

If he/she is not liable to tax in any country by reasons of domicile, residence or any other criteria of similar nature

S.2(29A) - “Liable to Tax” - there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country

Mohsinally Alimohammed Rafik [1995] 213 ITR 317 (AAR)?

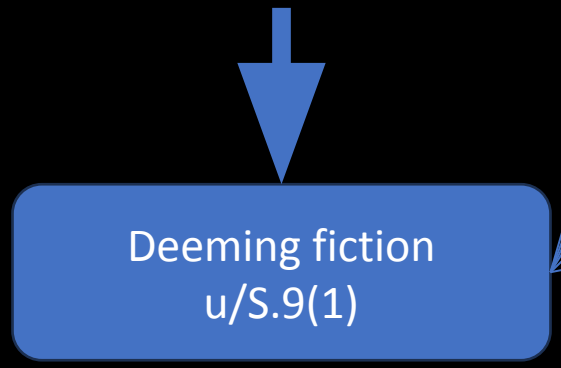
Deeming fiction– S.9

Charging Section – S.5:

S.5(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is **deemed to accrue or arise to him** in India during such year.



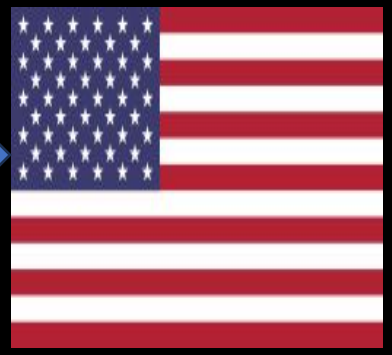
9(1)(i) Income accruing or arising directly or indirectly, through or from India	Article 7 r.w. Article 5 Business Profits r.w. PE
9(1)(ii) Salaries earned in India	9(1)(ii) Salaries earned in India
9(1)(iv) Dividend	Article 10 Dividends
9(1)(v) Interest	Article 11 Interest
9(1)(vi) Royalty	Article 12/13 Royalties
9(1)(vii) Fees for Technical Services (FTS)	Article 12/13 Fees for Technical Services (FTS)

Double taxation

USA Company (Payee/Licensor)

Residence country tax

on royalty income

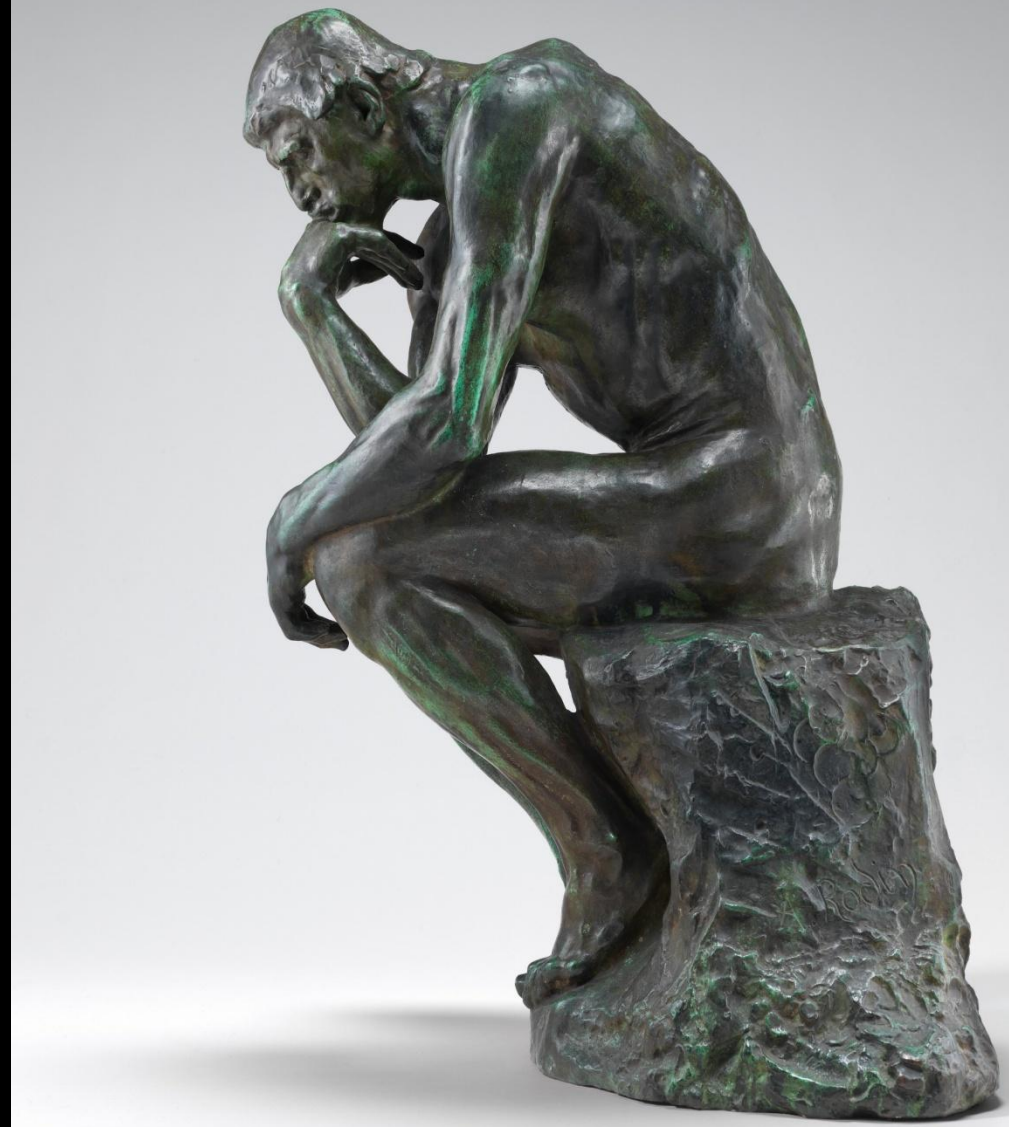


Royalty payment net TDS 10%

Indian Company (Payer/Licensee)

Source country tax

TDS deposited



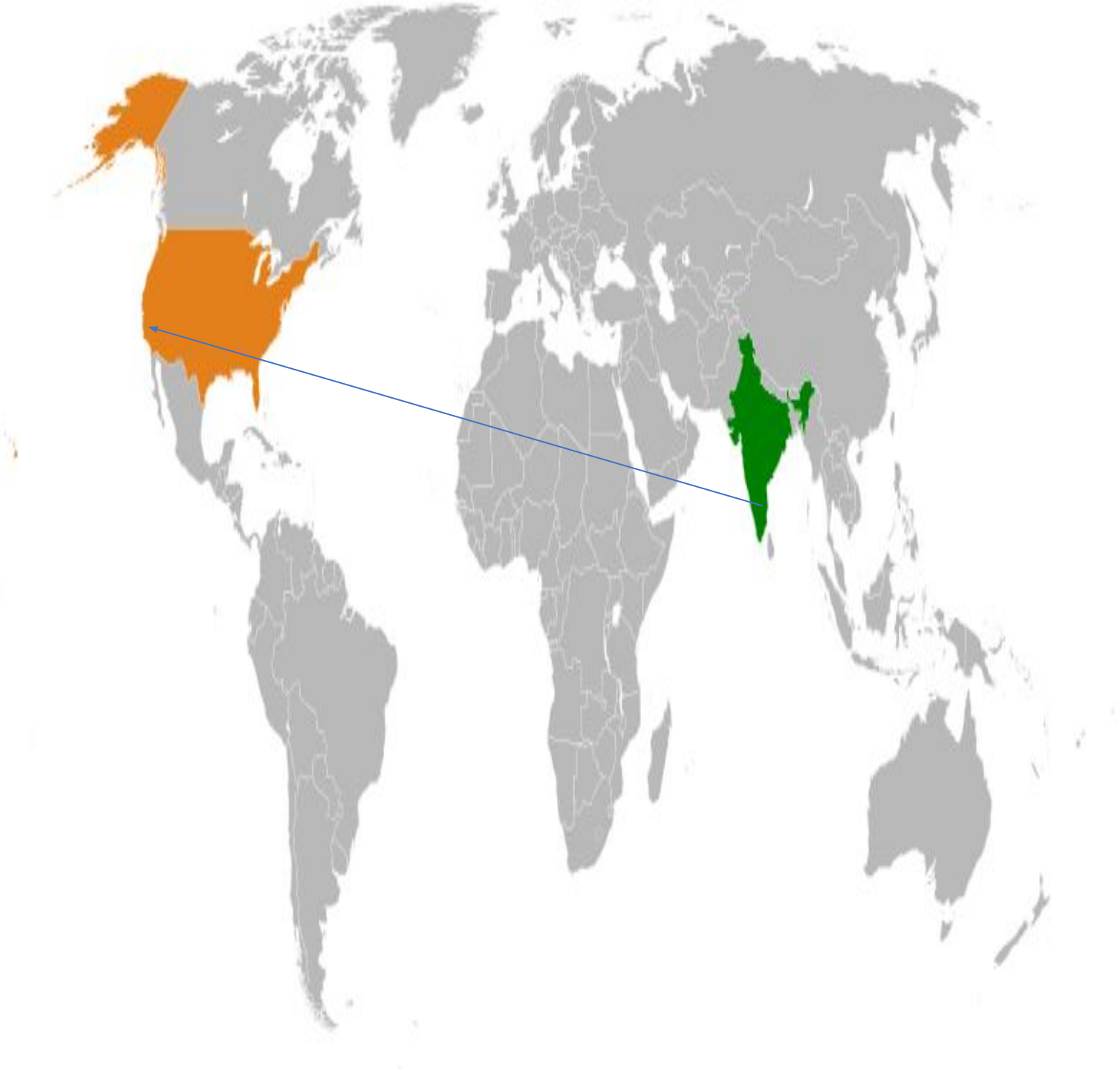
Double taxation

US citizen+resident owns Indian immovable property

Rental income taxable in India

Global income taxable in USA

Bottomline: Think of any cross-border transaction and you are likely to find examples of double taxation!



DTAA’s

- International agreements entered into by two or more sovereign nations to avoid double taxation, facilitate exchange of goods and services and the movement of capital and persons, aid recovery of tax
- **Fundamentally, Treaties strike a compromise between source and residence taxation.**
    - Some rights to tax are given to the source, and the residence country is required to relieve double taxation either by giving a credit for such source taxes paid, or by exempting the relevant income from its taxes.
- Integral part of DTAA:
    - Protocol
    - Memorandum of Understanding
- Types of DTAA's:
    - **Bilateral,** Multilateral
    - Comprehensive, Limited

India and DTAA’s: Monist view

- S.90(2) - taxpayer has option to be taxed under Articles of DTAA or domestic law, **whichever are more beneficial** to the taxpayer.
  - DTAA has Articles for eliminating double taxation (credit or exemption)

- S.91 – Relief from double taxation in countries without DTAA’s entered into with India
  - Allowed credit for foreign taxes paid against Indian taxes as per prescribed rules

Act vs. DTAA: A constant battle

- Act provisions and DTAA articles are always to be considered
- In many cases, the relevant DTAA may have beneficial provisions which can be invoked
- But…
  - New amendments and levies challenge the power and usefulness of DTAA's
  - Over time, there is a unilateral exercise to get around the limitations of the DTAA as we shall see later in the lecture

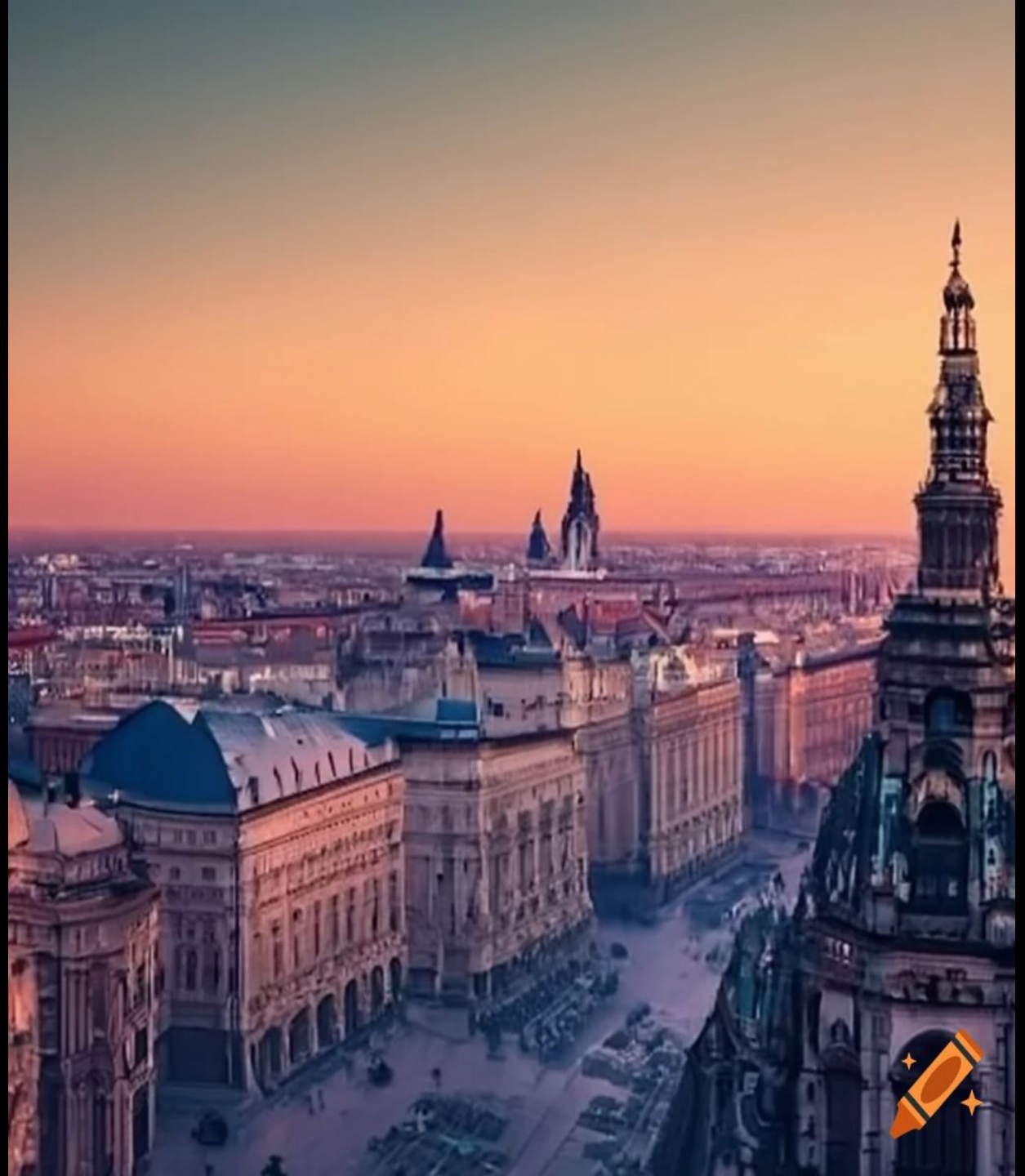
Income Tax vs. DTAA Overview

Type of income of NR	Income Tax Act	DTAA
Business Income	S.9(1)(i) - Business connection / PE	Article 7 r.w. Article 5
Royalties	S.9(1)(vi) and S.115A	Article 13
FTS	S.9(1)(vii) and S.115A	Article 13
Capital Gains	S.9(1)(i) and S.45	Article 14
Profession	S.9(1)(i) - Fixed base	Article 15 (Independent Personal Services)
Salary	S.9(1)(ii) and S.115A	Article 16 (Dependent Personal Services)
Dividend Income	S.9(1)(v) and S.115A	Article 11
Interest	S.9(1)(iv) and S.115A	Article 12

Tax Treaty Models

- OECD Model**:** Residence Based
- UN Model : Source Based
- US Model : For US treaties
- Andean Model

- **Interpretation of Tax Treaties**
  - Protocol / Exchange of Notes
  - Model Commentaries, US Technical Explanation
- **Sources of Interpretation**
  - Public International Law: **Vienna Convention on Law of Treaties (VCLT)**
    - **Articles 26, 27:** Binding on each party, Internal law not to be invoked to perform treaty
    - India is not a signatory to VCLT!
  - Other sources: Judicial decisions, Advance rulings, Mutual Agreement Procedures, MLIs, Tax authorities' practices in both states



Bird's eye view of International Taxation disputes in India

S.4: Total income of previous year of every year shall be charged at prescribed rates

S.5(2): charging section – income of **NR** (per **S.6**)

- *accrues* or arise or
- ***deemed to accrue or arise*** (S.9) or
- *received in India* or
- ***deemed to be received*** *in India*

S.9: deeming provisions

(OR)

Relevant DTAA

- Typically, Article 7 r.w. Article 5 (Business profits r.w. Permanent Establishment), or
- Need to apply relevant Article depending on type of income (ex: Article 12 Royalties/FTS)

S.195: Machinery provision: tax on "sums chargeable" as per "rates in force"

Bird's eye view of International Taxation

S.195 - Machinery provision:

"S.195. (1) Any person responsible for paying to a non-resident…. or ***any other sum chargeable under the provisions of this Act*** *not being income chargeable under the head "Salaries" shall, at the time of credit of such income to the account of the payee or at the time of payment thereof ….deduct income-tax thereon at the* ***rates in force****"*

- S.195(2) certificate – mandatory. *Samsung* fiasco
- **G.E.India Tech. Centre vs. CIT (327 ITR 456)** set things to rest. CBDT Circular 3 o f 2015

S.2(37A) Rates of income-tax specified in the Finance Act **or the rates specified in the DTAA**, whichever is applicable by virtue of Section 90 or Section 90A

- S.115A/B/C etc. vs relevant DTAA rates

Bird's eye view of International Taxation

Disallowance provisions

S.40(a)(i) – disallowance for non-deduction of tax.

S.201(1) – assessee in default

S.160 (Representative assessee), **S.163 Agent** (having business connection)

Relief:

- FA 2012 - S.201(1) proviso - Not assessee in default if payee has offered income (Form 26A)
- FA 2019 – S.40(a)(i) – linked to S.201(1), no disallowance on payee return furnished offering income

Points to ponder: *When in doubt, deduct?*

- S.195A: Another option is to "gross-up"
- S.195(2), S.197: Nil deduction certificates
- S.248 : Pay tax and appeal

Articles of DTAA

- Scope
- Definitions
- Substantive Provisions
- Elimination of Double Taxation
- Miscellaneous

Scope

Article 1	Personal Scope
Article 2	Taxes Covered
Article 29	Entry into force
Article 30	Termination

Definitions

Article 3	General Definitios
Article 4	Residence
Article 5	Permanent Establishment

Articles of DTAA

Substantive Articles deal with different types of income

Substantive Articles	
Article 6	Immovable Properties
Article 7	Business Profits
Article 8	Shipping
Article 10	Dividends
Article 11	Interest
Article 12	Royalties & Fees for Technical Ser
Article 13	Capital Gains
Article 14	Independent Personal Services
Article 15	Dependent Personal Services
Article 16	Directors

Substantive Articles.....	
Article 17	Artistes and sportspersons
Article 18	Pensions
Article 19	Government Servants
Article 20	Students
Article 21	Other Income
Article 22	Capital

DTAA Articles: Run through

Article 1 - Persons covered:

DTAA applies to 'persons who are resident of one or both Contracting States'

Article 2 - Taxes covered:

Covers income tax, surchage. Not indirect taxes

Article 3 - Definitions:

"**person**" includes an individual, a company, a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;

"**company**" means any body corporate or any entity which is treated as a company or body corporate for tax purposes;

Article 3 - not the same in every DTAA!

USA:

- "person" includes an individual, an estate, a trust, a partnership, a company, any other body of persons, or other taxable entity ;
- the term "company" means any body corporate or any entity which is treated as a company or body corporate for tax purposes ;

Singapore:

- the term "person" includes an individual, a company, a body of persons and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States ;

DTAA Articles: Run through

Article 4 - Residence

- “Resident of one of the States” means any person who, under the laws of that State, is *liable to tax* therein by reason of his domicile

- “subject to tax” vs “liable to tax”
  - India – Sweden, India US tax treaty

DTAA Articles: Run through

What if resident of both countries? **Apply <u>tie-breaker rule</u>**

For Individuals

- Permanent home / “center of vital interest”
- Habitual abode
- Nationality
- Mutual agreement by competent authorities

For others

- Place of Effective Management (POEM)

Article 7 : Business profits

Business profits of an enterprise is taxable in state of residence, unless carried out in other State using a PE (Article 5)

Profits maybe taxed in other State but only so much that is attributable to:

(a) that PE;

(b) sales in that other State of goods, merchandise of same or similar kind as those sold through that PE;

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE

Force of Attraction

FoA clause not present in OECD MC!

~30 out of 85 India DTAA's have FoA clauses

Most use UN Model "Limited FoA"
Example : USA, Canada, Belgium

Others use *"directly or indirectly attributable to PE"*
Example: UK, Singapore, Japan

Full FoA (as opposed to Limited FoA) is not used practically ; it posits all profits derived in SourceState taxable as profits of the PE whether or not through PE

Article 7: PE & Carve-out

Article 7(2) **Attribution Rule**: Profits of PE which it might be expected to make if it were a distinct and separate enterprise. OECD calls for FAR analysis

Article 7(3): PE deductions: UN Model provides for business deductions to arrive at PE profits, excludes royalty, interest paid etc. to head office. OECD doesn't provide for these deductions.

Article 7(4)/7(6): Both Models: *"Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."*

DTAA Articles: Article 5 - PE - Example from OECD MC

Article	What it covers	Type of PE
Article 5(1)	Basic Rule	Fixed base PE
Article 5(2)	Illustrative list	Fixed base PE
Article 5(3)	PE in relation to projects	Construction & Service PE
Article 5(4)	List of exclusions	Exclusions from Fixed base PE
Article 5(5)/5(6)	Dependent & Independent Agent	Agency PE
Article 5(7)	Associated Enterprise	Subsidiary PE

CIT v. Vishakapatnam Port Trust (44 ITR 146 AP)

"The words Permanent Establishment postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a ***virtual projection of the foreign enterprise of one country onto the soil of another country****.*

- Circular No. 14 of 2001 ([2001] 252 ITR (St.) 65, 107) clarified that term PE not been defined in Act but its meaning understood from DTAA.
- However, vide Finance Act, 2002, the definition of PE was inserted in the Act under **S.92F(iiia)** which states that the PE includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
- Morgan Stanley [2007] 292 ITR 416 (SC) observed that the PE is an inclusive definition covers service PE, agency PE, construction PE, etc.

Fixed base PE

Income generating activities?

PE

Preparatory & Auxiliary activities?

No PE

Agency PE

Dependent Agent?

PE

Independent Agent?

No PE

Installation/ Construction PE

Building site, construction, installation project > 6/12* months?

PE

Service PE

Services by employees or others if last beyond period aggregating to 90* days in a year

PE

* Criteria varies across DTAA's

Article 5(1) - Fixed Base PE

In OECD, UN and US Models:

"For the purpose of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on"

- ✔ Existence of 'place of business'
- ✔ Place of business is at disposal
- ✔ Place of business must be 'fixed'
- ✔ Business is carried on wholly or partly through fixed place of business

"Place of business"?

- Reasonable degree of permanence and continuity
- Geographical and Commercial Coherence

"Place of business at disposal"?

- Certain space should be available at the disposal
- Ownership test – immaterial
- Some domain / control / right to use is required
- Test of place of business at disposal (para 4.2 – 4.6 of OECD MC)

Article 5(2) - Fixed base PE Inclusive List - MC

- A place of management
- A branch
- An office
- A factory
- A workshop
- A mine, an oil or gas well, a quary or any other place of extraction of natural resources

Article 5(3) - Construction/Installation PE

“A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months”	"a) A building site, a construction,assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than six months;"	"a) A building site, a construction,assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than six months;"
	“(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.”	

Article 5(4): PE Exclusions

Auxiliary/Preparatory Activities

- Use of facilities for storage or display of goods
- Maintenance of stock of goods for storage or display
- Maintenance of stock for processing of goods
- Purchasing goods or merchandise or for collecting information for the enterprise
- Carrying on, for the enterprise, any other **activity of a preparatory or auxiliary character**

Article 5(5) - Agency PE - DAPE - OECD & UN Model

5. …where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, ***habitually concludes contracts****, or habitually plays the principal role leading to the conclusion of contracts that are* ***routinely concluded without material modification*** *by the enterprise, and these contracts are*

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment…

Person said to have authority to conclude contracts if, he/she:

- Sufficient authority to bind foreign enterprise, decide final terms.
- Can act independently, without control from the principal
- Is authorized to negotiate all elements, details of a contract
- Approval of contract by foreign enterprise is mere formality

Klaus Vogel : "if authority to negotiate and conclude contract is so restricted to allow agent to settle for only such price and terms and conditions as were fixed in advance by principal"

Arvind Skar: *even if* contract concluded by agent, if as along as authority limited to fixed prices and conditions determined by principal – no Agency PE

Article 5(6)– Agency PE – Independent Agent

Paragraph 5….shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an ***independent agent and acts for the enterprise in the ordinary course of that business****. Where,* ***however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related****, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*

UN Model also has this para:

…an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person…..

Article 5(7) - Subsidiary PE

"The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other"

- Identical under OECD, UN and US MC

- **Existence of a subsidiary by itself does not constitute PE**
  - Legal independence of the subsidiary respected
  - Test of fixed base PE / service PE / agency PE need to be satisfied
  - ***Daimler Chrysler AG (39 SOT 418) case***

S.9(1)(i) - Article 7 r.w Article 5's counterpart

S.9. *(1) The following incomes shall be deemed to accrue or arise in India :*

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—For the purposes of this clause—

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

- Remember, this gave us:
  - ***Vodafone*** case with Explanations 4-7 in S.9(1)(i)
  - TDS on **Foreign Commission Agent** payments

- Circular No. 14 of 2001 ([2001] 252 ITR (St.) 65, 107) clarified that term PE not been defined in Act but its meaning understood from DTAA.
- However, vide Finance Act, 2002, the definition of PE was inserted in the Act under **S.92F(iiia)** which states that the PE includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.
- Morgan Stanley [2007] 292 ITR 416 (SC) observed that the PE is an inclusive definition covers service PE, agency PE, construction PE, etc.

Article 10, 11 and 12: Dividend, Interest, Royalties / Fees for Technical Services

- Taxable on gross basis (if not attributed to PE)
- Source rules restricted than under domestic law
- Recipient must be Beneficial owner
- A lot of litigation under **Royalty and FTS!**

Fees for Technical Services – Article 12/13

4. …"fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services …:

……

(c) **make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.**

5. The definition of FTS **does not include:**

- Services that are ancillary and subsidiary / inextricably linked to sale of property
- **For teaching in or by educational institutions ;**
- For services for private use of individual payer;
- To employee of payer or to any individual/partnership for professional services as per Article 15 (Independent personal services)

Fees for Technical Services under the Act – S.9(1)(vii)

Explanation 2.—For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consi-deration) for the ***rendering of any managerial, technical or consultancy services*** *(including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries";*

FTS under the Act – Section 9(1)(vii)

- ***Ishikawajima-Harima Heavy Industries Ltd. Vs. DIT [2007] 288 ITR 408 (S.C.)***
  - **Twin test of rendering & utilization in India :** *"In view of the aforesaid reasons, no ambiguity has been left by the Apex Court in holding that if the technical or consultancy services, though utilized in India, are rendered outside India, the fees for the same will not be liable to tax in India within the provisions of section 9(1)(vii) of the Act."*
- Finance Act 2007 failed amendment
  - Jindal Thermal Power vs. DCIT (**225 CTR 220)**
  - Clifford Chance **318 ITR 237 (Bom.)**
- Finance Act 2010 – Second time lucky!

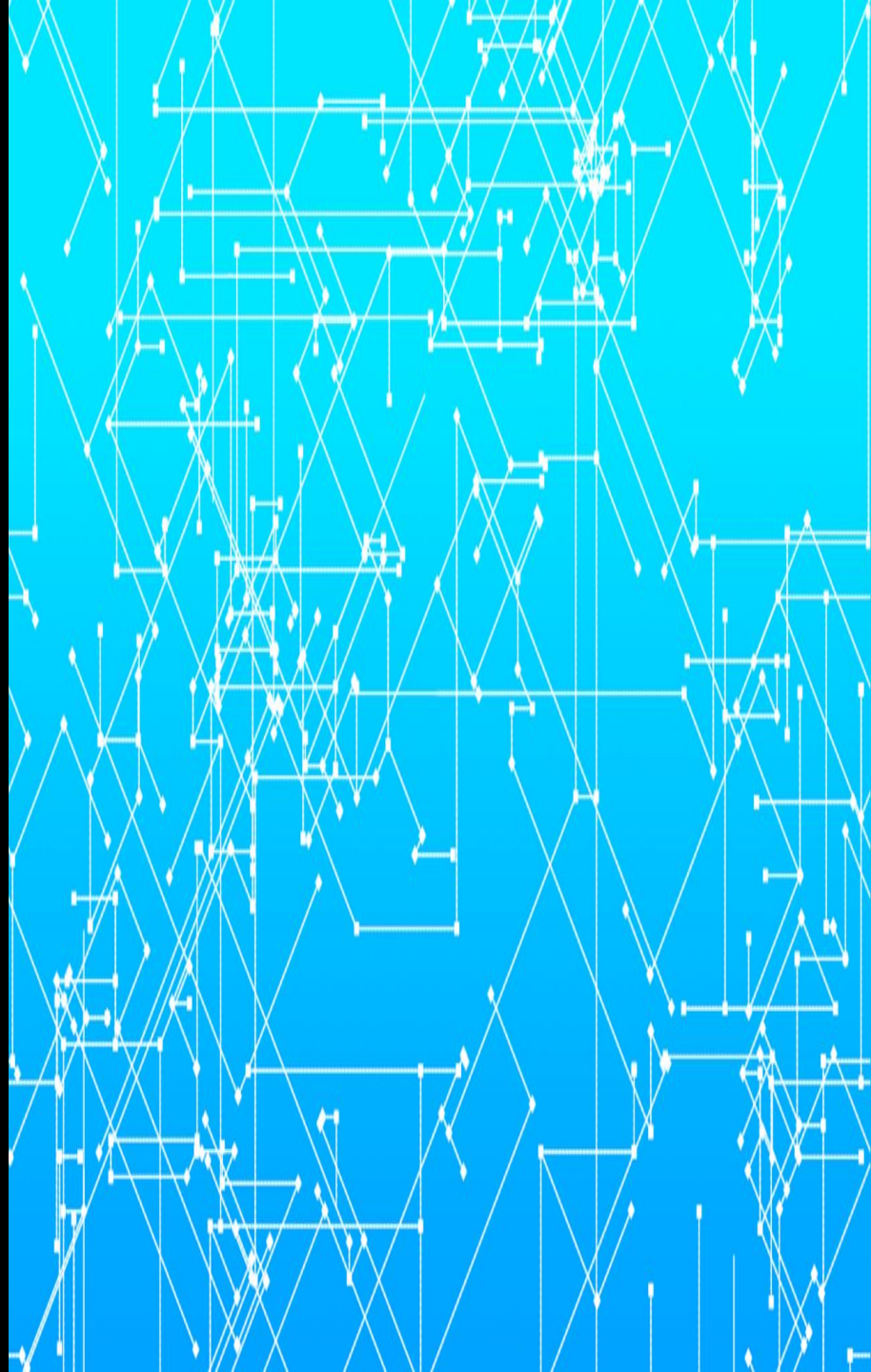
Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

FTS – Make Available clause in DTAA

- **Good example of restricted Source Rule !**
  - Excellent examples of make available in India-USA Technical Memorandum
- After Finance Act 2010 amendment, refuge seems to be mainly in the "make available" clause in the DTAA's
  - Standard service being the other argument – *Skycell vs DCIT 251 ITR 53*
- Service recipient to thenceforth be able to perform service
  - Logic: Teach a person to fish instead of giving them a fish
- Well enshrined in Indian jurisprudence:
  - Hon'ble Delhi High Court in the case of DIT Vs Guy Carpenter & Co Ltd ([(2012) 346 ITR 504 (Del)] and
  - Hon'ble Karnataka High Court in the case of CIT Vs De Beers India Pvt. Ltd [(2012) 346 ITR 467 (Kar)]



Royalty under DTAA – Article 12/13

Article 13(3). For the purposes of this Article, the term "royalties" means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

Royalty under the Act – S.9(1)(vi)

Explanation 2.—For the purposes of this clause, **"royalty" means consideration** (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(*i*) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*ii*) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*iii*) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(*iv*) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(*iva*) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(*v*) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(*vi*) the rendering of any services in connection with the activities referred to in sub-clauses (*i*) to (*iv*), (*iva*) and (*v*)

Royalty under the Act – S.9(1)(vi) Finance Act 2012 wref 1-4-1976

Explanation 3.—For the purposes of this clause, **"computer software"** means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(*a*) the possession or control of such right, property or information is with the payer;

(*b*) such right, property or information is used directly by the payer;

(*c*) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;

TDS on Royalty payments– a chequered history

- Satellite Transponders
- Software
- Leased line/Bandwidth charges (Verizon)
- Shipping of coal (Poompuhar)
- Online Advertisement (Google Case)

Royalty – Explanation 2– Interpretation by Judiciary

- **Satellite transponder lease: Asia Satellite Telecommn. Co Ltd. vs DIT (332 ITR 340 Del.)**
  - No income is deemed to accrue in India from use of satellite outside India to beam TV signals into India even if bulk of revenue arises due to viewers in India **(not "use of equipment", not use of "process")**
- **Software license:** Not transfer of "copyright" but transfer of "copyrighted article"
  - Motorola 95 ITD 269 (SB)
  - TII Team Telecom 140 TTJ (Mum) 649
  - Ericsson AB 204 TM 192
  - (Dissenting voices in *Microsoft Delhi Tribunal, Kar. HC in Samsung 203*)
- **Bottomline:** A very wide interpretation of the language used in Explanation 2 by Dept. typically read down by the Courts

Followed by Finance Act 2012 amendments to overturn various decisions, Explanations 3-6 in S.9(1)(vi)

Royalty – FA 2012 amendments - Act cannot override DTAA!

- **DIT vs. New Skies Satellite BV (Delhi HC)** 9(1)(vi) vs. Article 12 of DTAA: The retrospective amendment to s. 9(1)(vi) so as to supersede the law laid down in **Asia Satellite 332 ITR 340 (Del)** and assess transmission fees as "royalty" has no impact on assessees covered by DTAA because a corresponding amendment has not been made to the definition of "royalty" therein. Amendments to domestic law do not affect the DTAA
- **WNS North America Inc. vs. ADIT (152 TTJ 145) Mumbai Trib** and **DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC, B4U International Holdings Limited [18 ITR(Trib.) 62] (Mum.)**
  - Amendment in Act does not have the effect of automatically altering the analogous provisions of the Double Taxation Avoidance Agreements

Royalty – FA 2012 amendments – Madras HC took a different view

Verizon Communications Singapore Pte Ltd. Vs. ITO (361 ITR 475 Madras HC)

- Provision of bandwidth / telecom services is Royalty for the **'use, or the right to use equipment'** under S.9(1)(vi) and under Article 12(3)(b) of the India-Singapore DTAA
- It is also **"use of process"** u/S.9(1)(vi) and Article 12(3) of the DTAA
- It is FTS u/S.12(4) of the DTAA!!
- Earlier Decisions disregarded due to Finance Act 2012 amendments
- Amendments in 2012 were clarificatory
- **Distinguishes Asia Satellite** saying it related to clauses (I), (vi) and (vii)
- Amendment in Explanation 5 gives very expansive meaning to word Royalty
- DTAA "pari materia" to Act; to be assessed as Royalty under even the DTAA

Royalty – Software

Checkered history for taxation of Royalty as software! Initially the tide was tilted towards the assessee:

- Distinction between 'copyrighted articles' and 'copyright' is relevant. Payment for 'copyrighted article' not Royalty. [**DIT v. Ericsson A.B. [2012] 204 Taxman 192 (Del HC)**] *et al*

Cat among pigeons: **Samsung Elec. Co Ltd (345 ITR 494) (Kar.)** - payment for software is royalty!

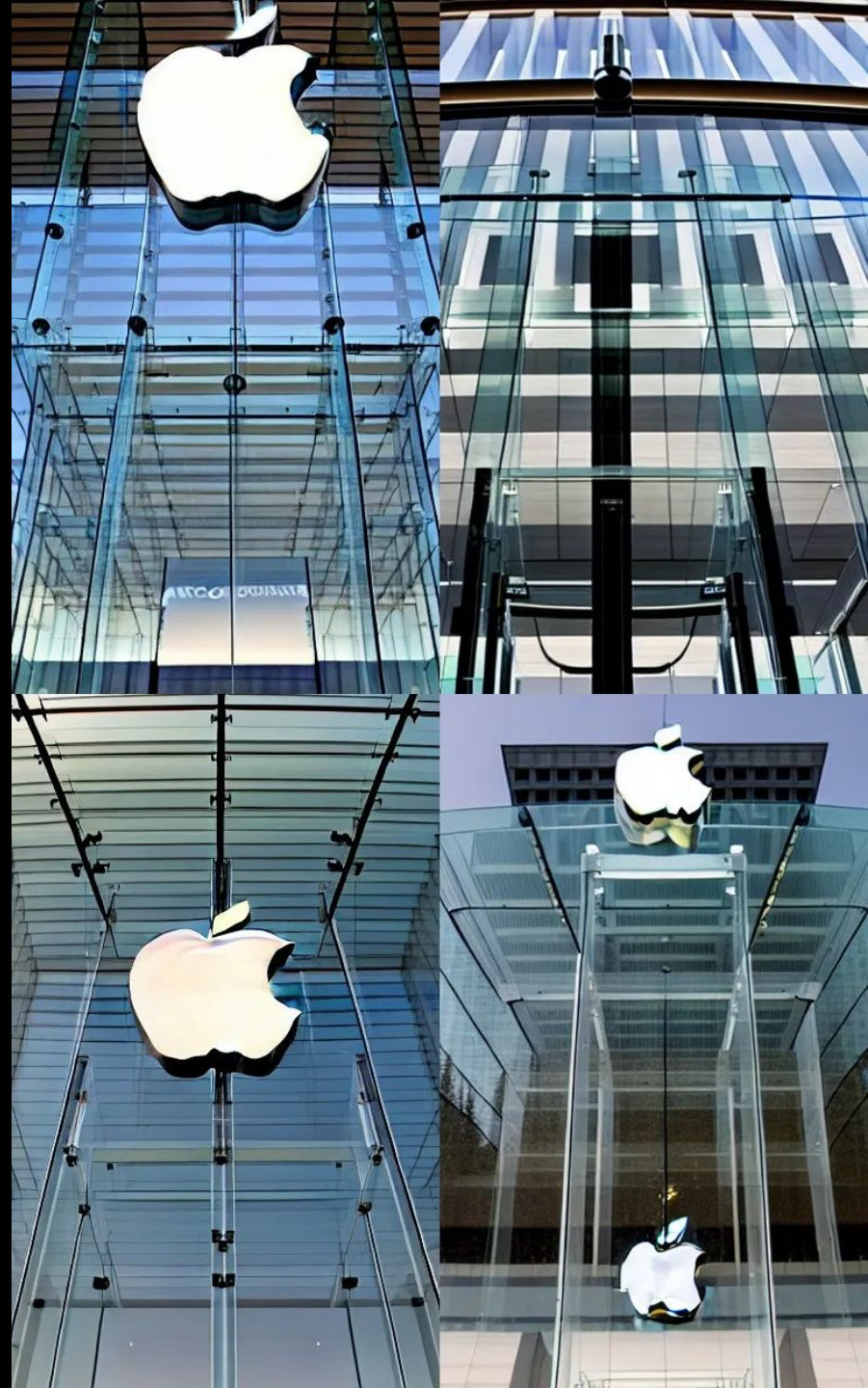
Post-amendment also no change and Software not taxable as Royalty under DTAA

- DIT v. Nokia Networks OY [2012] (253 CTR 417)
- Novel Inc. v. DDIT(Intl. Tax) [2014] (49 SOT 45)

Engineering Analysis Centre of Excellence Pvt Ld vs. CIT (CA Ns 8733-8734 of 2018 dated 2.3.2021) has put an end to debate….or has it? ☺️

- CIT vs. Vinzas Solutions Pvt. Ltd. (TCA 861/2016 dated 04.1.2017 Madras HC)

Payments for Online database access/online subscriptions / journals follow a similar story, mirroring judgments on software royalty.



Royalty – Shipping

Madras HC in **Poompuhar Shipping Corp Ltd. Vs. ITO (360 ITR 257)** held that

Equipment rental is Royalty even if payer does not have control.

Retrospective amendment in Explanation 5 is purely clarificatory.

Irrespective of Explanation 5, use or right to use simpilcitor is sufficient for it to fall under Royalty

Ship is an "equipment" based on S.43(3) of Act

Ship plying between coastal lines on Indian shores cannot fall under "international traffic" as per DTAA

Foreign ship has PE in India when its ships are in India and berths reserved for it

Proceedings upheld under S.201 and S.163

Royalty – Shipping – Bareboat charter

- **CIT vs. Van Oord ACZ Equipment BV [TS-695-HC-2014(Madras)]**
  - Distinguishes Poompuhar judgment
- Van Oord ACZ Equipment BV (the taxpayer) , incorporated in Netherlands, had let out dredging equipment to an Indian company, Van Oord ACZ India Private Limited. The equipment was let out on a **bareboat charter** basis, i.e., without the Master or the Crew.
- HC held that the **taxpayer was not liable to tax in India in respect of income earned from hiring of dredger on bareboat charter**
  - Based on amended DTAA of India-Netherlands which does not cover payments for use of industrial, commercial or scientific equipment
  - Poompuhar distinguished as time-charter; this case is bareboat charter
  - No PE as entire control of equipment not with taxpayer
- Useful for amended DTAA's like Belgium, France, Israel, Kazhakstan, Greece, Netherlands, Spain, Greece and Sweden)

Royalty – Google Adwords

- Assessee (Google India) is a wholly owned subsidiary of Google International LLC, U.S.
- Appointed as a non-exclusive authorized distributor of Adword programs to the advertisers in India by Google Ireland Ltd (GIL). Google is specialized in internet search engines and related advertising services.
- **Google Adword Program Distribution** agreement (the agreement) with assessee and GIL for resale of online advertising space to Indain advertisers
- The assessee held that it was a reseller of the ad space and nothing more; it was akin to placing an ad in a newspaper/billboard etc.
- Distribution payments from Google India to Google Ireland for 100's of crores every year. Were these payments Royalty and hence tax withholding required u/S 195 r.w DTAA?
- Initially ITAT said yes, then went to HC and came back and ITAT said no, its not Royalty

Typical FTS/Royalty disallowance

Step 1: **Classification of payments made from India to foreign entity:**

- Typically, classified by Dept. as *not* being business profits (S.9(1)(i) or Article 7 r.w. Article 5), rather
- Being Royalty or Fees for technical services (S.9(1)(vi)/S.9(1)(vii) or Article 12/13)
- And a lot of PE cases now (service PE, DAPE, supervisory PE etc.). But PE tax on net basis (i.e. income of PE – its expenses) , Royalty/FTS tax on gross
- Note that S.9 is a *deeming* provision : Accruing or arising in India irrespective of place of service!

Step 2: Hold that, due to S.9 above, sums paid to NR were chargeable to tax and **withholding as per S.195**

Step 3: As tax was not withheld u/S. 195, **disallowance of expenditure u/S. 40(a)(i) on said payments to NR**

Article 13 - Capital Gains

Immovable property	Country in which it is situated
Shares of company, interest in firm, etc which principally consists of immovable property	Country in which property is principally situated (substantial test > 50% etc)
Shares other than case above	Company's residence country
Any other property forming business property of PE	Country in which PE is situate
Any other property	Residence country of alienator
Rule of interpretation	MLI to be interpreted in accordance with ordinary principles of treaty interpretation

Article 14: Independent Personal Services

- Deals with taxation of income in respect of professional services or activities of independent character
  - Independent activities of lawyers, physicians, engineers, architects, dentists, accountants
  - Independent scientific, literary, artistic, educational or teaching activities
- Taxable in source State IF:
  - If regular fixed base available in that State or
  - Stay exceeds threshold period in Treaty
- Amount taxable is what is attributable to fixed base or activities in source State
- OECD deleted this Article in 2000!

(Point of interest: FTS vs Fees professional services – S.40(a)(ia) FA 2014 amendment)

Article 21: Other Income

- Income not dealt with any articles of the treaty
  - Residuary article
  - Element of income to be present
  - Fixed base/PE – attributability
- *"Subject to the provisions of paragraph 2, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing Articles of this Convention shall be taxable only in that Contracting State."*

Article 23A/B : Elimination of double taxation

Credit method: *Looks at tax*

- Ordinary
- Full-Credit method

Exemption method: *Looks at income*

- Full and
- Exemption by progression

Tax Sparing

Underlying credits

DTAA: Tax Credit Method

A. Global Income	Rs.500,000/- (Rs.200k INDIA +Rs.300k USA)
B. Tax on Global Income (Indian slab rates)	Rs.12,500
C. Average rate of tax (B/A)	12,500/500,000 = 2.5%
D. Foreign income * average rate of tax	300,000*2.5% = 7,500
E. Tax paid in foreign country	20,000
F. Tax Credit = Lesser of D and E	Rs.7,500/- ftc available
G. Tax to be paid in India	Rs.12,500 - Rs.7,500 = Rs.5,000

Article 24: Non-discrimination

Prevention of discrimination under tax laws of the host country on account of the following four criteria:

- Nationality of the taxpayer [Art 24(1)] – tax deductions?
- PE in the host country [Art 24(3)]
- Deduction - Payment of interest, royalties, other consideration, etc. to a recipient abroad [Art 24(4)]
- Holding of shares in a resident enterprise by non-residents [Art 24(5)]
- Other provisions:
- Stateless Persons [Art 24(2)]
- Inclusion of other taxes [Art 24(6)]

CIT vs. Herbalife International (69 taxmann.com 205)

Section 40 (a) (i) of the Act, as it was during the AY in question i.e. 2001-02, did not provide for deduction in the TDS where the payment was made in India. The requirement of deduction of TDS on payments made in India to residents was inserted, for the first time by way of Section 40 (a) (ia) of the Act wef 1st April 2005

Anti-avoidance Articles

Article 25: Mutual Agreement Procedure

- Administrative measure under the DTAA which is designed to eliminate or avoid double taxation.
- Upon complaint made by taxpayer, this authorizes the CA of the contracting states to resolve, by mutual agreement, difficulties regarding Articles of DTAA. (CBDT MAP/Guidance 2020, 7.8.2020)

Article 26: Exchange of Information

- Competent Authorities shall exchange info. Beware! Automatic exchangeArticle 9: Associated Enterprise

Article 9: Associated Enterprise

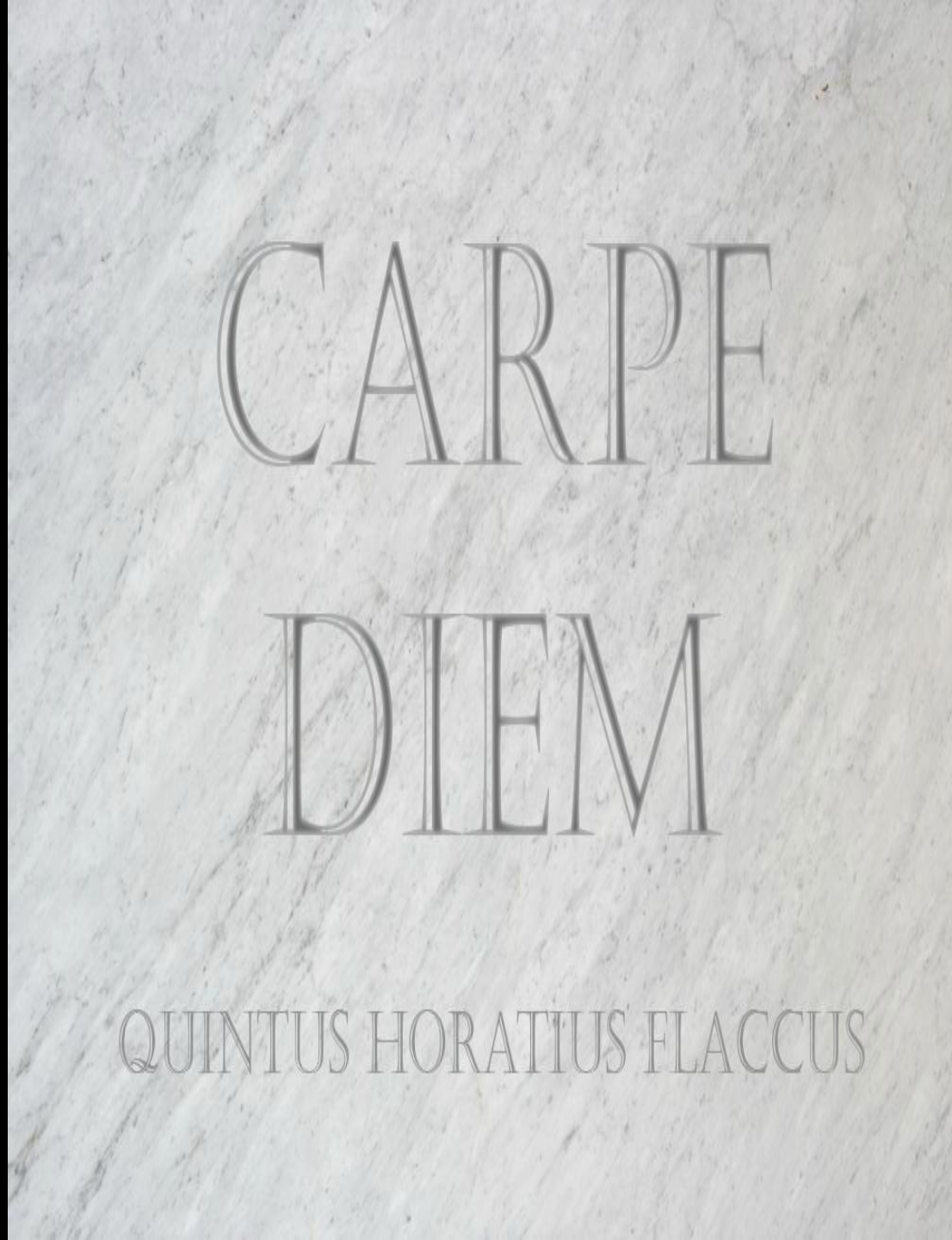
- Capital, management or control of both enterprises and transactions not at ALP.
- Profits which, but for those conditions would have accrued to one of the enterprises, but have not so accrued, may be included in the profits of that enterprise and taxed accordingly

Primary, Corresponding & Secondary adjustments

Primary	Corresponding	Secondary
First adjustment made in a tax jurisdiction for underlying transaction not at arm's-length	Made by other tax jurisdiction to eliminate or mitigate double taxation.	Made by same jurisdiction which did primary
Triggers corresponding and secondary adjustment	Recommended by OECD TP Guidelines	Address issue of remittance of difference between transaction price and ALP. India - S.94E

Present

1. **DTAA:** Specific Article not present in DTAA?
2. **PE:** Risk vs Title – "storage PE"
3. **PE:** Aggregation of projects
4. **PE:** Preparatory/Auxiliary exclusions
5. **PE:** Fixed Place – Formula One
6. **PE:** Covid PE
7. **Royalty:** Website registration
8. **Secondment:** Deputation of employees
9. **MFN clause:** The new battleground!
10. **Dividends:** DTAA vs. 115-O rate
11. **Limitation of Benefits**
12. **Royalty:** Impossibility of performance++
13. **Salary:** Work abroad, paid in India



What if a specific Article is not present in a DTAA?

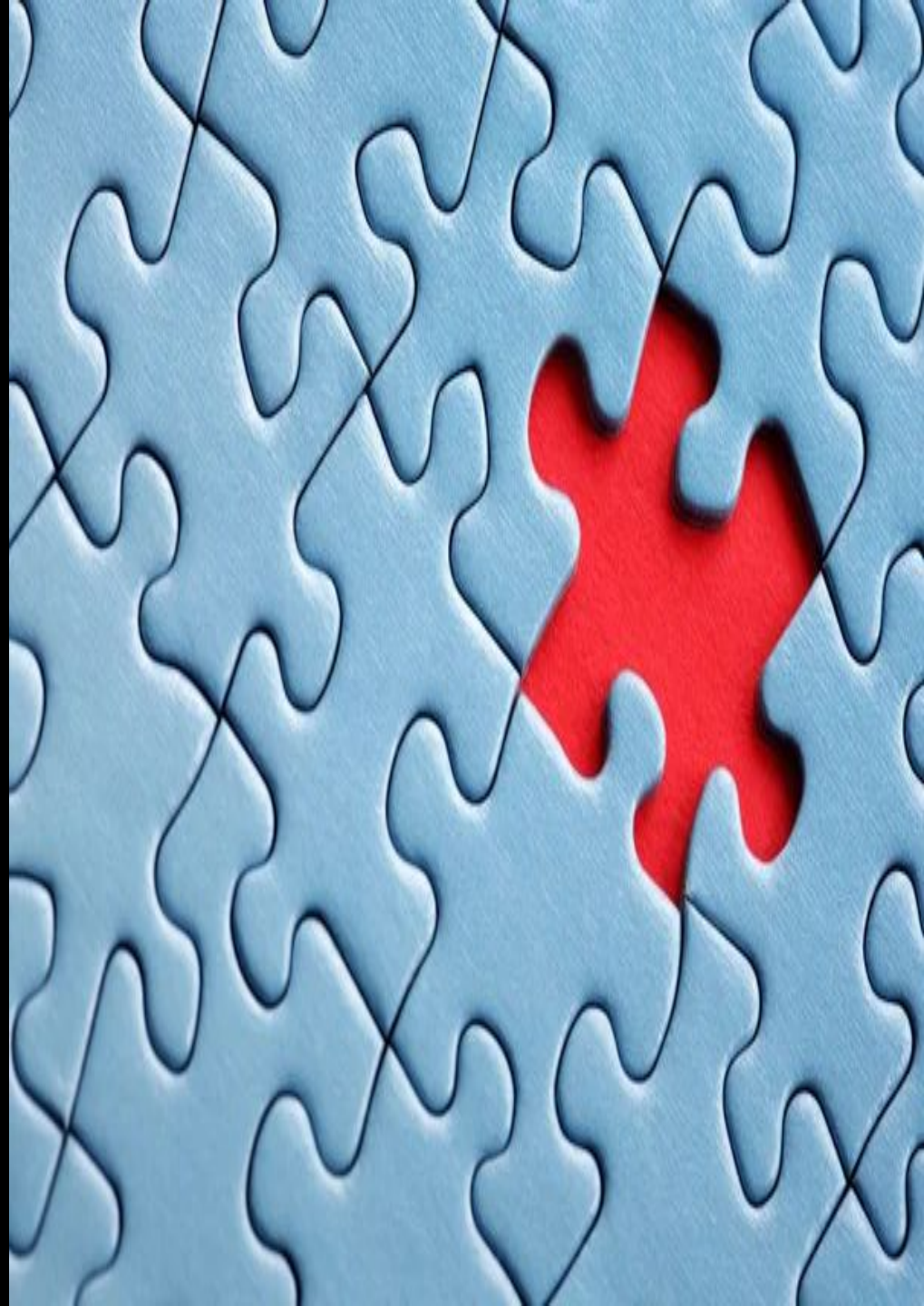
FTS Article is not present in India-Thailand, India-UAE, India-Mauritius. What if Indian taxpayer pays UAE entity for FTS?

Remember Article 7(6) – *"Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."*

Payment must be treated as Business Profits of payee/NR under Article 7, assuming it is in their normal course of business or profession. (If not, Article on "Other income" can be applied)

What if a specific Article is not present in a DTAA?

- Madras High Court in the case of **Bangkok Glass Industry Co. Ltd. v.ACIT** (34 taxmann.com 77) affirmed this principle
- Mumbai Tribunal in the case of **McKinsey & Co. (Thailand) Co. Ltd. v. DDIT (**36 taxmann.com 375 (Mum.)),
- **Channel Guide India Ltd v. ACIT (139 ITD 49)**
- **ACIT v. Viceroy Hotels Ltd.(11 taxmann.com 216 Hyd)**
- **Spice Telecom vs. ITO (113 TTJ 502 Bang.)**



Contract Risk – Storage PE

- India-Germany Contract for supply of paint shop
- Part of a larger Request for Quote (RFQ) with separate Purchase Orders.
  - Off-shore (Germany) equipment purchase. High sea sales
  - On-shore (India) supervisory services PE
  - *Ishikawajima-Harima* says Off-shore supplies not taxable
  - Protocol to India-Germany specifically says supply of equipment cannot be added to Indian PE, unless for tax evasion! Onus on Revenue.
- **Risk vs title:** What if there is retention money involved. Does risk pass only on completion and hence "storage PE" is created in India as equipment is in clients place for > 6 months? ITAT Chennai held YES in ***Durr Systems GMBH vs CIT (310/2017 dated 27.3.2019)***
- Relied on *Ansaldo (310 ITR 237) decision* – an albatross for PE cases in Madras? *LG Cables (ITA 703/2009, 24.12.10)* Delhi HC distinguishes Ansaldo and holds risk in commercial sense cannot defeat title transfer.

PE Aggregation

Multiple contracts India with different clients by same NR company. Separate installation projects. Should they be aggregated ?

Answer is **NO**, the threshold should be construed per project. unless otherwise Article 5 states so specifically such as India-Australia

ADIT vs. Valentine Maritime (Mauritius) (130 TTJ 417)

Article 5(2)(i) of India-Mauritius :"*a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine months"*

Article 5 (2)(k) of India-Australia : "*.... a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities)"*

Two exceptions:

- Assessee has artificially split the contract so as to avoid the duration test. Onus is on revenue to prove so
- When activities are so *inextricably interconnected or interdependent* that these are required to be viewed as a coherent whole

Preparatory/ Auxiliary Exclusions

- **Does an Indian liaison office constitute a PE?** Depends on the work of said office.
- Mere downloading info, issuing cheques not PE.
    - **UOI vs UAE Exchange Centre (CA 9775 of 2011 dated 24-7-20)**
- Project Office setup to act as a "communication channel" between Samsung and ONGC does not constitute a PE
    - **DIT vs. Samsung Heavy Industries (CA 12183 of 2016 dated 22-7-20 SC)**
- Crux: What is a core vs preparatory/auxiliary activity?
    - Can we split up activities into separate entities? Anti-"Fragmentation" rule

Royalty – Website Registration

- **Godaddy.com LLC vs. ACIT (ITA No.1878/Del/2017, AY 2013-14 dated 3.4.2018)**
- Domain name is an intangible asset which is similar to trademark. Consequently, income from services rendered in connection with such domain name registration is assessable as "royalty" u/s 9(1)(vi) of the Income-tax Act
- Relied on Hon'ble Apex Court in the case of **Satyam Infoway Ltd. Vs. Siffynet Solutions Pvt.Ltd. – [2004] Supp (2) SCR 465 (SC)** stating that in that case SC held that the **domain name is a valuable commercial right and it has all the characteristics of a trademark** and accordingly, it was held that the domain names are subject to legal norms applicable to trademark.

MFN clause – Steria, Nestle et al

"if you give Abhi a toffee, you must give me a toffee too" ☺️

Assume:

State A-State B have treaty which restricts A's right to tax dividends at 15%.

State A- State B treaty also has an MFN clause it

Now:

State A subsequently enters into treaty with State C. In that treaty, right to tax dividends by A is restricted to 5%.

Applying MFN clause:

State A right to tax dividends to State B is also restricted to 5%.

Whatever favourable benefits were given to State C has to be extended to State B also, due to MFN

Indian tax treaties having MFN Clauses:

OECD Member States – Belgium, France, Netherlands, Spain, Sweden and Switzerland, etc

Non-OECD States – Saudi Arabia, Philippines etc

But things get complicated….

- MFN can restrict **BOTH scope and rate.**
- MFN clause is present in Protocol. Should Protocol be separately notified?
- *ITC Mumbai ITAT* and *Steria India, Delhi HC* says NO need for separate notification. Protocol integral part of Treaty
  - Many other rulings…**Shell ruling** (ITA No. 1283/Ahd/2010 dated 10/11/2015)

Sweden	*In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services) if under* **any Convention. Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services to a rate lower or a scope more restricted than the rate or scope** *provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention.*
France	*And whereas paragraph 7 of the Protocol dated 29th September, 1992, to the aforesaid Convention provides that if after the 1st day of September, 1989,* **under any Convention Agreement or Protocol concluded between India and a third State which is a member of the Organisation for Economic Co-operation and Development, India should limit its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention** *on the said items of income, then, as from the date on which the Convention between India and France or the relevant India Convention, Agreement or Protocol enters into force, whichever enters into force later, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention ;*
Switzerland	*4. If after the signature of the Protocol of 16th February, 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then,* **Switzerland and India shall enter into negotiations without undue delay** *in order to provide the same treatment to Switzerland as that provided to the third State."*
Philippines (Non OECD)	*4. With reference to Articles 8 and 9 if at any time after the date of signature of the Convention the Philippines agrees to a lower or nil rate of tax with a third State the Government of the Republic of the Philippines shall without undue delay inform the Government of India through diplomatic channels and the two Governments* **will undertake to review these Articles** *with a view to providing such lower or nil rate to profits of the same kind derived under similar circumstances by enterprises of both Contracting States.*

India-Netherlands Protocol MFN clause

If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.

Concentrix: Key Dates

21-Jan-1989	Indian-Netherlands tax treaty
17-Feb-2005	India-Slovenia tax treaty
21-Jul-2010	Slovenia becomes OECD Member
28-Feb-2012	Netherlands vide decree stated tax rate fo dividends pursuant to MFN should be 5% not 15% retroactively from 21-Jul-2010 since Slovenia became OECD member

Concentrix: Delhi HC decision

Whether third state has to be a member of OECD both at the time of conclusion of the DTAA with India as well as at the time of applicability of MFN clause	The use of the word in MFN clause “is” in the sentence “which is a member of the OECD” requires countries to be OECD members when source taxation is triggered in India and not at the time when the subject treaty was executed.
Whether notification has to be issued separately for enforcing MFN clause	Plain reading of the protocol would show that the protocol forms an integral part of the Convention. Therefore, no separate notification is required, insofar as the applicability of provisions of the protocol is concerned.

CBDT Circular 3/2022

- Decree published by Netherlands, France etc on activation of MFN clause *do not represent shared understanding of treaty partners …..not in object with the object and purpose enshrined in the DTAA* ☺️
- Third State must be a member of OECD both at time of conclusion of treaty and application of MFN
- Requirement of notification under S.90 of the Act. Reference to Azadi Bachao Andolan!

GRI Renewables (ITA 202/Pun/2021)

- Plain language of S.90(1) overlooked. No separate notification required for limbs of treaty
- Circular binding on AO not Tribunal, transgresses S.90(1)
- In any case, new obligation or new disability implies prospective effect only.

Secondment

- **Deputed employees (secondees) from Foreign Co. to Indian Subsidiary Co.**
- Work for Indian Co. for few years. Lien with Foreign Co. to return after that time.
- Salary paid directly overseas by Foreign Co to deputed employees' foreign bank accounts and claimed as reimbursement from Indian Sub Co
- Such **salaries offered to tax in India** by the secondees after withholding tax obligations for employee taxes.
- **Whether reimbursement of salary cost of secondees by India to Foreign co was income of Foreign.Co liable to TDS u/s 195?**

Centrica Delhi HC (SLP dismissed by SC)

FTS applicable with secondees “making available” their technical expertise!

Service PE – applicable!

Payment is not reimbursement, rather payment for services

Payment is not diversion of income by overriding title

In Northern Operating Systems SC recently said Indian Co Liable To **Service Tax** On Secondment From Overseas Group as *Recipient Of Manpower Supply*

Morgan Stanley Mumbai ITAT

Service PE created

Not FTS.

Once Service PE created, FTS will not apply. Centrica did not consider the exclusion clause

Service PE revenue offset by deductions of salary costs.

Flipkart, Boeing, AT&T

Control and supervision with Indian Sub. Co.

Not FTS

Considered Centrica, NOS

Dividend Distribution Tax – Treaty vs. 115-O

"Whether the protection granted by the tax treaties under section 90 of the Income Tax Act 1961, in respect of taxation of dividend in the source jurisdiction, can be extended, even in the absence of a specific treaty provision to that effect, to the dividend distribution tax under section 115-O in the hands of a domestic company?"

- Assessee paid dividend in AY 2016-17 to French NR shareholder.
- S.115-O domestic company is required to pay additional income tax on any amount declared, distributed or paid by way of dividend.
- Assessee took the plea that rate at which tax u/s.115-O has to be paid cannot be more than the rate at which dividend can be taxed in the hands of the NR shareholder under India-France DTAA.
- Giesecke & Devrient ITAT Delhi said yes, Total Oil Special Bench said NO

Dividend Distribution Tax: S.115-O vs Treaty

DDT tax on company not shareholder (refers to Godrej & Boyce HC, SC, SIDB Mumbai HC)

Unlike provisions of TCS/TDS that specifically provide such payments are on behalf of payee, DDT provisions do not mention the same.

Since DDT is not tax on shareholder but on income of domestic co, there is no double taxation of same income. Domestic co does not enter the domain of tax treaty at all.

No specific extension of tax treaty rate to DDT under India-France, unlike India-Hungary.

> *"When the company paying the dividends is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend"*

DDT payable on S.115-O rate not Treaty.

A plain reading of the provisions of Sec.115O shows that it creates a charge to additional income tax on any amount declared, distributed or paid by domestic company by way of dividend for any assessment year. The tax so charged is "in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year". The additional income tax is referred to as "tax on distributed profits" commonly referred to as "Dividend Distribution Tax". It is a tax on "distributed profits" and not a tax on "dividend distributed“

Limitation of Benefit clauses

- Benefits of the DTAA only to **legitimate residents** of Contracting countries. Designed to test **substance over form**
  - Denies DTAA benefits if the person seeking to obtain DTAA benefits is not a "qualified person" (resident)
- Various tests put in place – depends on Treaty
  - Shell/conduit company
  - Active business or trade test
  - Ownership – base erosion test
- India-USA, India-Singapore, India-Mauritius, India-Kuwait

India-USA Article 24

"1. A person…resident of a Contracting State…shall be entitled…to relief from taxation in that other Contracting State only if:

(a) more than 50 per cent of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of one of the Contracting States or other individuals subject to tax in either Contracting State on their worldwide incomes, or citizens of the United States ; and

(b) the income of such person is not used…..to meet liabilities (including liabilities for interest or royalties) to persons who are not resident of one of the Contracting States"

Salary

- Deeming fiction on salary – S9(1)(ii)

income which falls under the head "Salaries", if it is earned in India.

Explanation.—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(a) service rendered in India; and....

shall be regarded as income earned in India ;

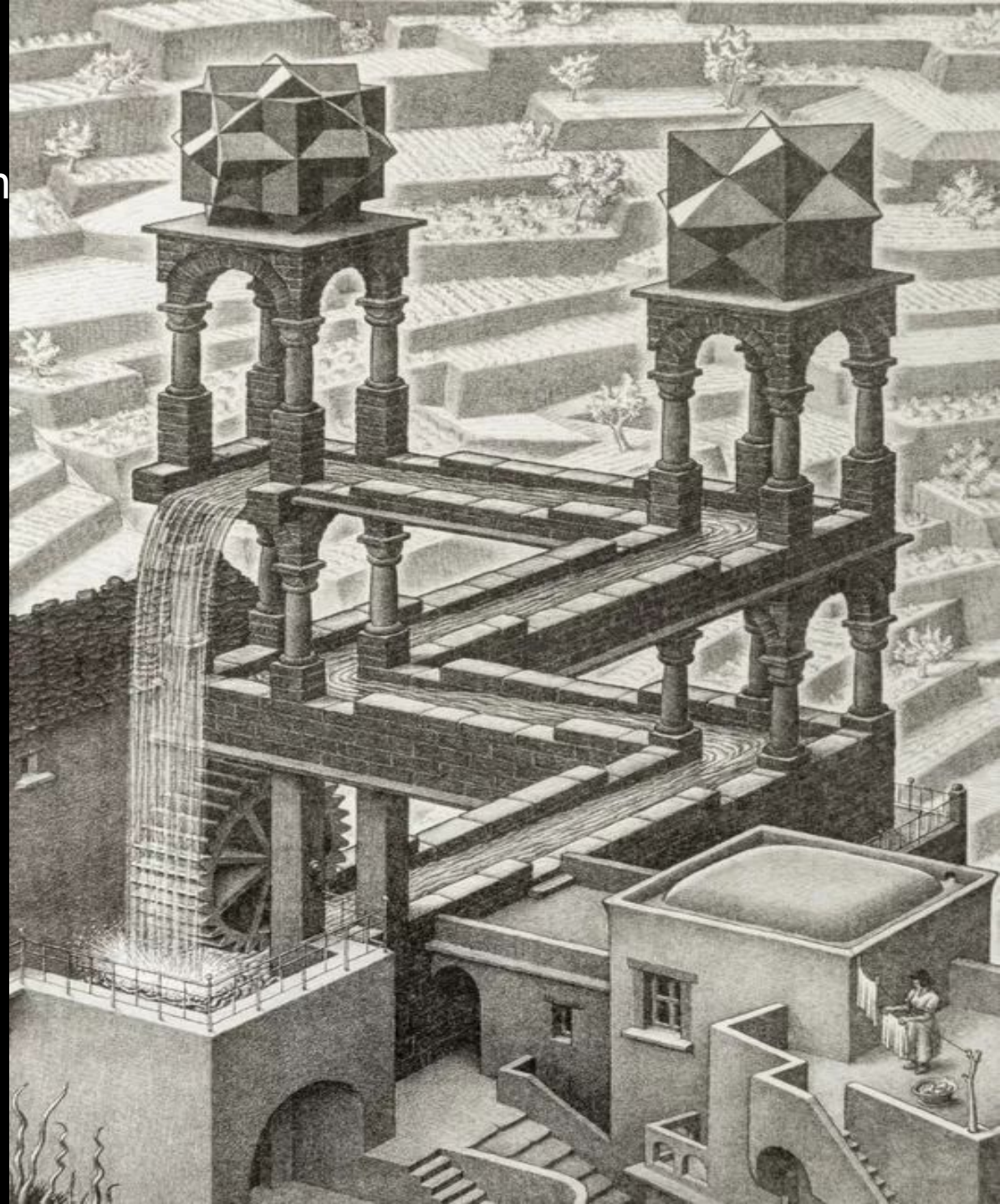
- What about salary of non-resident seafarer services rendered for non-resident shipping line outside India but money received in Indian NRE account - *DIT vs Prahlada Vijendra Rao (198 taxmann 551), CBDT Circular 13/2017*
- Indian employee was in India for 63 days only in fiscal. Rest worked in UK for the company and earned salary there. Not taxable - *Kanagaraj Shanmugam vs ITO (2936/Chny/2018)*
- *Capt. A.L. Fernandez vs ITO [81ITD203 (Mum)(TM)]* where assessee was on board an Indian vessel. It was employed by the Indian Government and as salary was received in India - Same was held to be taxable in India.
- WFH – Point to ponder – Permanent Establishment created by fixed place of employee WFH in India? Covid PE relaxations – Circular 11 of 2020, 3 of 2021

Impossibility of performance

- Finance Act, 2010
  - Law of the land till FA 2010 was *Ishikawajima*, can taxpayer perform an impossible task of predicting FA'10?
  - Metro & Metro vs. ACIT (ITA No.393/Agra/2012)
  - Channel Guide vs. ACIT (139 ITD 49)

- Finance Act, 2012
  - Number of royalty amendments. Same logic applies, how can payer predict amendments?
  - One more interesting point in **NGC Networks**

*"(iv) Further, we also notice that under Section 40(a)(i) of the Act….meaning of royalty…**is that as provided in Explanation 2 to Section 9(1)(vi) of the Act and not Explanation 6 to Section 9(1)(vi) of the Act.** Thus, the disallowance….can only be if the payment is 'Royalty' in terms of Explanation 2 …. Undisputedly, the payment made for channel placement as a fee, is not royalty in terms of Explanation 2 to S.9(1)(vi) of the Act.."*



Future

- Significant Economic Presence (SEP)
- Equalization Levy
- GAAR
- OECD BEPS Actions
- MLI
- OECD Two Pillar

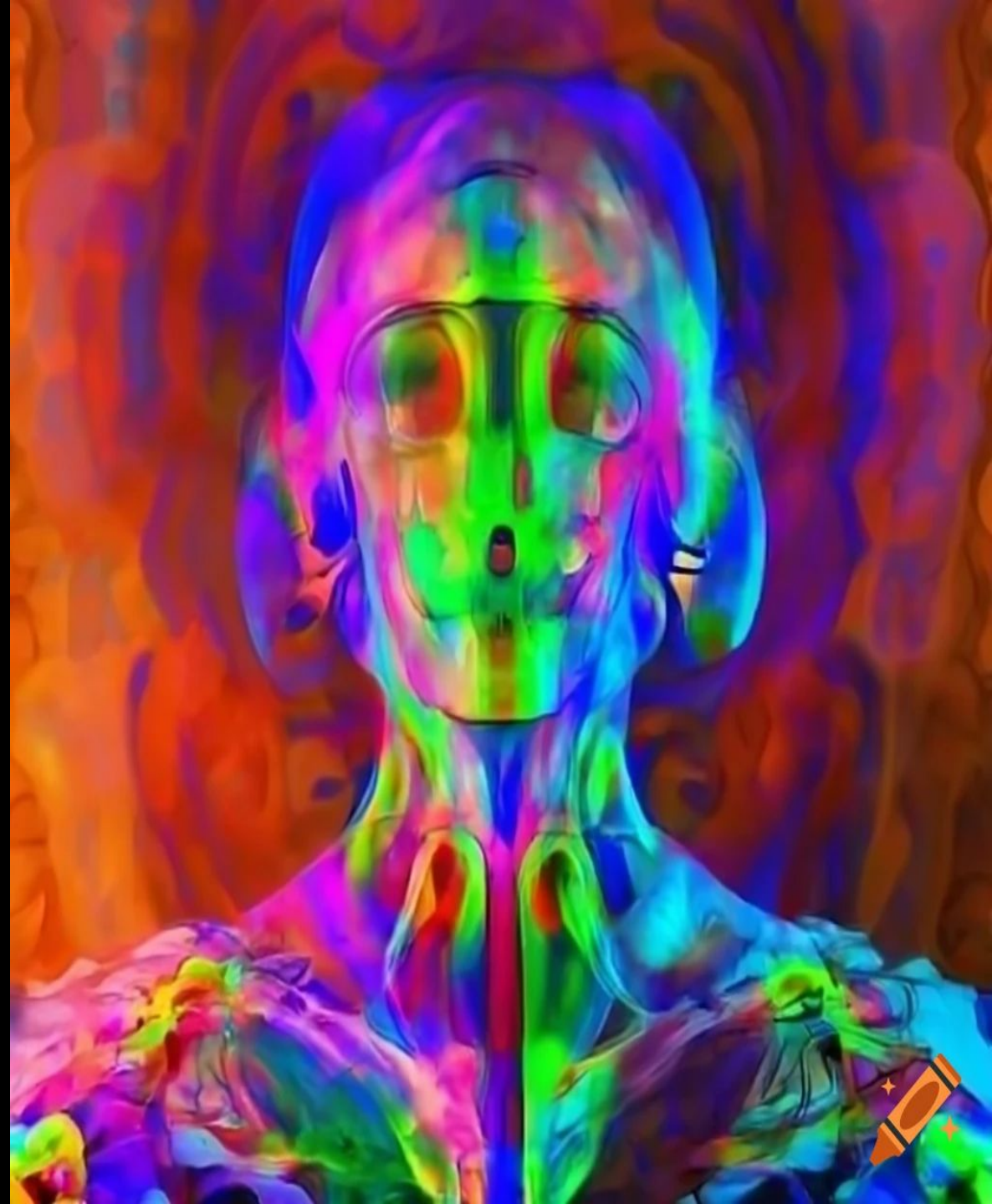
Future: Sound of one-handed clapping:

Changes being done unilaterally to the Act to override DTAA:

- Introducing new kinds of tax or unilateral amendments to Act: such as **Significant Economic Presence, Equalization Levy**
- Either by directly adding Sections to Act with non-obstante clause such as **S.206AA** (or)
- Unilateral actions delegated to the CBDT such as **S.94A**

Virtual PE – Significant Economic Presence

- Finance Act, 2018 enlarged the scope of the term "Business Connection" to include new nexus to tax benefit profits of NR's having Significant Economic Presence (SEP) in India **[wef 1-4-2022]**
- SEP concept was raised by the OECD as part of their report on Base Erosion and Profit Shifting (BEPS) Action Plan 1.
- There were three options discussed in the BEPS Report on Action 1:
  - **Articulation of a new nexus in the form of significant economic presence;**
  - A withholding tax on certain types of digital transactions; and
  - **Imposition of an equalization levy.** (Later in this lecture!)



Virtual PE – SEP - S.9(1)(i) Explanation 2A, 3A

"significant economic presence"—

(a) transaction in respect of any goods, services or property carried out by NR with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions (OR)

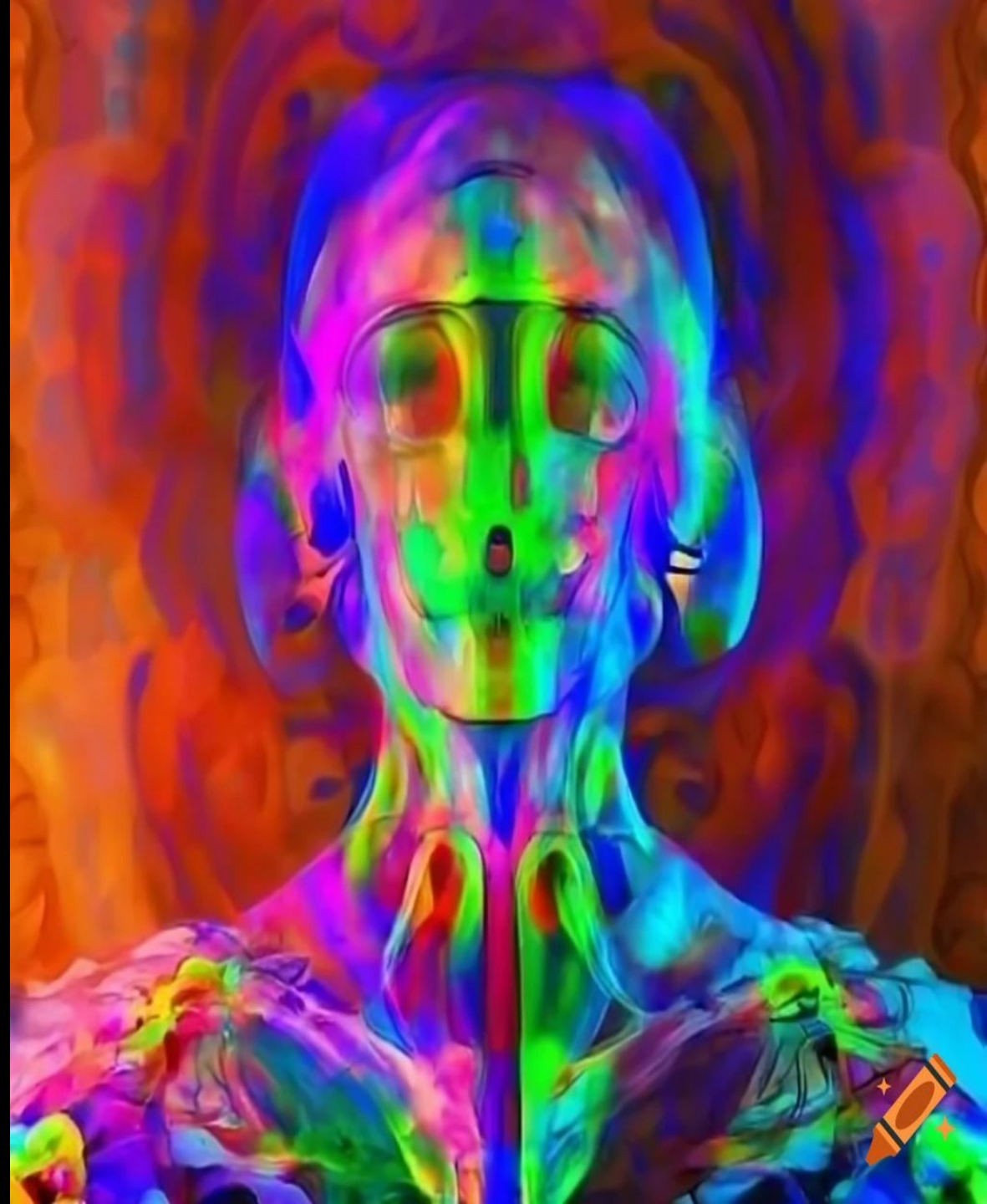
INR 2 crores

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India

300,000 users

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Whether or not:
(i) agreement for such activities is entered in India; or
(ii) NR has a residence or place of business in India; or
(iii) NR non-resident renders services in India:



Virtual PE – SEP - S.9(1)(i) Explanation 2A, 3A

- Can it override Article 5 r.w Article 7 of DTAA?
- IP address in the IT Act?

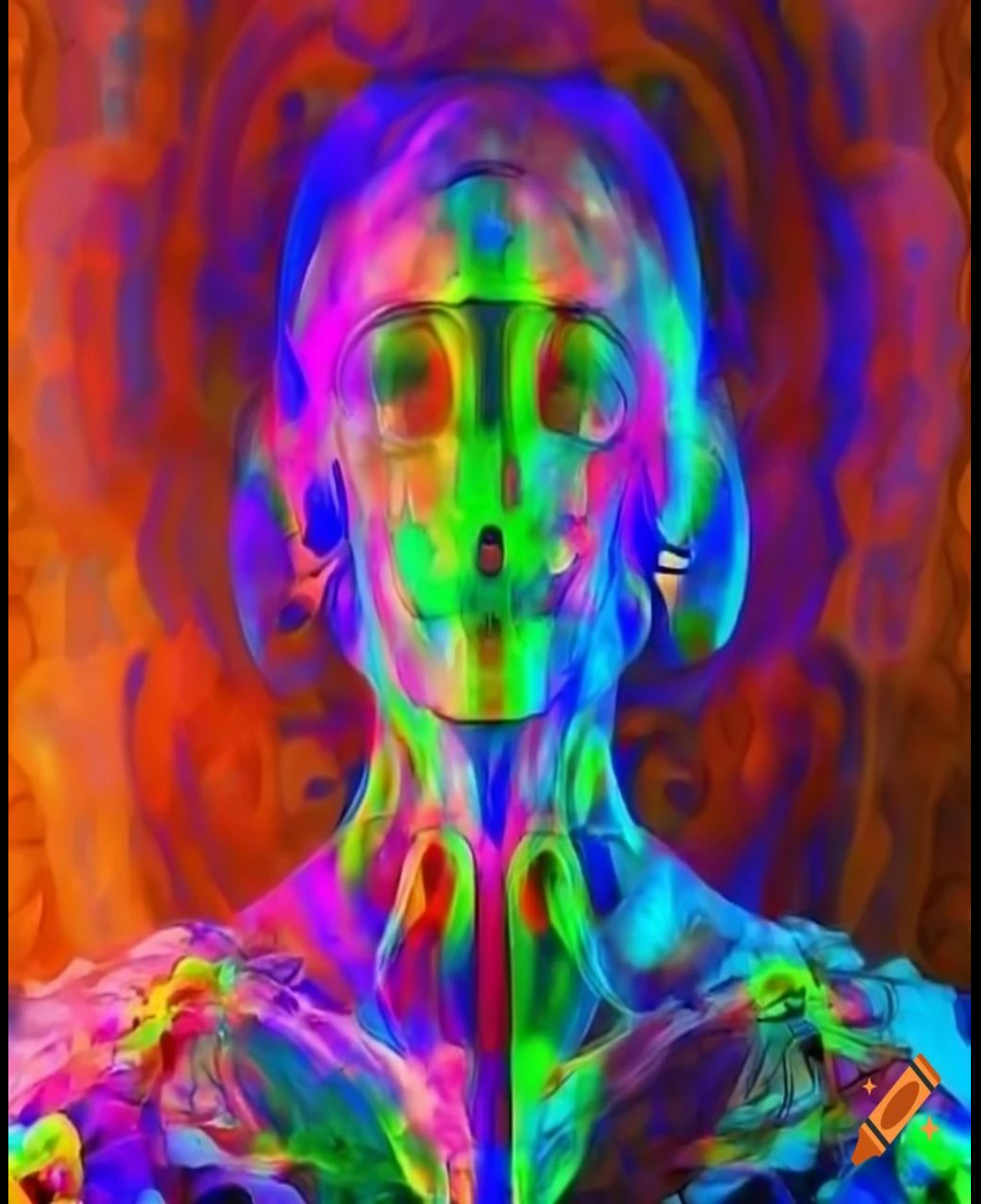
Explanation 3A - ...income attributable to the operations carried out in India...shall include income from

*(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through **internet protocol address** located in India;*

*(ii) sale of data collected from a person who resides in India or from a person who uses **internet protocol address** located in India; and*

*(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses **internet protocol address** located in India:*

Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A.



Equalization Levy

- E-commerce companies are the new generation of business leaders and online advertisement revenue is the key growth engine of this sector
- Many precedents prior to EL that online advertisement payments were not taxable in India – after all no PE!
  - Pinstorm, Right Florists, eBay International

Equalization Levy

- **EL1.0:** FA 2016 introduced EL on payments for online advertisements ("specified service")
  - Received by NR not having Indian PE
  - S.10(50) to exempt under IT Act, S.40(a)(ib) for disallowing payment without EL.
  - S.166(1)-(3) calls for deduction by payer on specified services at 6% on gross amounts
- **EL 2.0:** FA 2020 – EL is widely expanded!
  - On consideration receivable from **specified payers** by NR **e-commerce operator** engaged in **e-commerce supply or services** made or provided or facilitated by it
  - E-commerce operator, e-commerce supply and services, specified players all widely defined
  - 2% of consideration of e-commerce operator
- Many precedents prior to EL that online ad payments not taxable in India –no PE! Ex: Pinstorm, Right Florists, eBay

E-commerce operator –NR who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both

E-commerce supply or services – S.164(cb) –

- Online sale of goods owned by e-commerce operator
- Online provision of services by e-commerce operator
- Both *facilitated* by e-commerce operator

Specified payers – S.165A(1)

- A person resident in India; or
- An NR in 'specified circumstances'
- A person who buys goods, services using Indian IP

Specified circumstances – S. 165A(3)

- Sale of advertisement targeting a customer, who is resident in India or accesses the advertisement through an IP address located in India
- Sale of data collected from customer, who is resident in India or from a person using Indian IP

EL 2.0 - Finance Act, 2021 – Adding salt to wound?

S.163(3) Proviso - the consideration received for specified services shall not include the consideration which is taxable as royalty/FTS under Act/DTAA

Explanation to S.164(cb) that "online sale of goods" & online provision of services" shall include:
(a) acceptance of offer for sale; or
(b) placing of purchase order; or
(c) acceptance of purchase order; or
(d) payment of consideration; or
(e) supply of goods, provision of services, partly or wholly

S.165A(3)(b) providing that consideration received from e-commerce supply or services shall include:

- Consideration for sale of goods **irrespective of whether the e-commerce operator owns the goods**
- Consideration for provision of services **irrespective of whether service** facilitated by e-commerce operator

GAAR

S.98. Consequences of impermissible avoidance arrangement.—

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences…. including denial of tax benefit or **a benefit under a tax treaty**, shall be determined, in such manner as is deemed appropriate…. including by way of but not limited to the following, namely:—

- Disregard, combine, recharacterize, treat the place of residence of any party as situs, deem, reallocate etc.

(11) "tax benefit" means—
(c) a **reduction** or avoidance or deferral **of tax** or other amount that would be payable under this Act, as a result of a tax treaty; or
(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

---

S.90 (2A) Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.

S.206AAA, S.94A

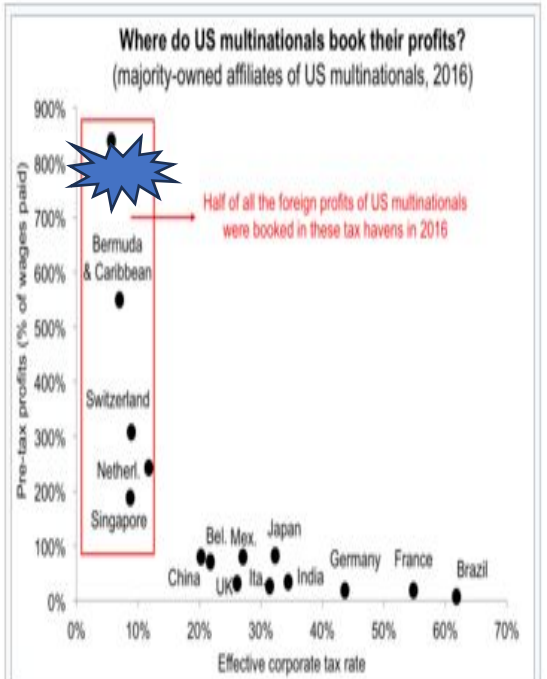
- S.206AA where TDS @ 20% when no PAN irrespective of DTAA?!
  - Rule 37BC watered this down
  - Watered down by Rule 37BC of IT Rules w.e.f 1.6.2016 ; shall not apply to interest, royalty , FTS and payments on transfer of capital asset
  - *Dy. DIT (International Taxation) v. Serum Institute Of India Ltd. 68 SOT 254 (Pune-Trib.)*
- S.94A is another example: Cyprus notified as notified jurisdictional area by CBDT on 1st Nov 2013, rescinded retrospectively from 14th Dec. 2016
  - Madras HC upheld S.94A as constitutional in T.Rajkumar vs UOI (Appeal Number : Writ Petition Nos.- 17241 to 17243 & 17407 to 17412 of 2015 dated 12/4/2016)

OECD BEP Actions

- Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinationals that exploit gaps and mismatches in tax rules to avoid paying tax.
- Developing countries' higher reliance on income tax means they suffer from BEPS more. BEPS practices cost countries USD 100-240 billion in lost revenue annually.
- Working together within OECD/G20 Framework on BEPS, 135+ countries and jurisdictions are collaborating on the implementation of 15 measures to tackle tax avoidance, improve **coherence** of international tax rules and ensure more **transparent** tax environment.
    - Lot of complaints of people using Treaties for tax avoidance and require some action.

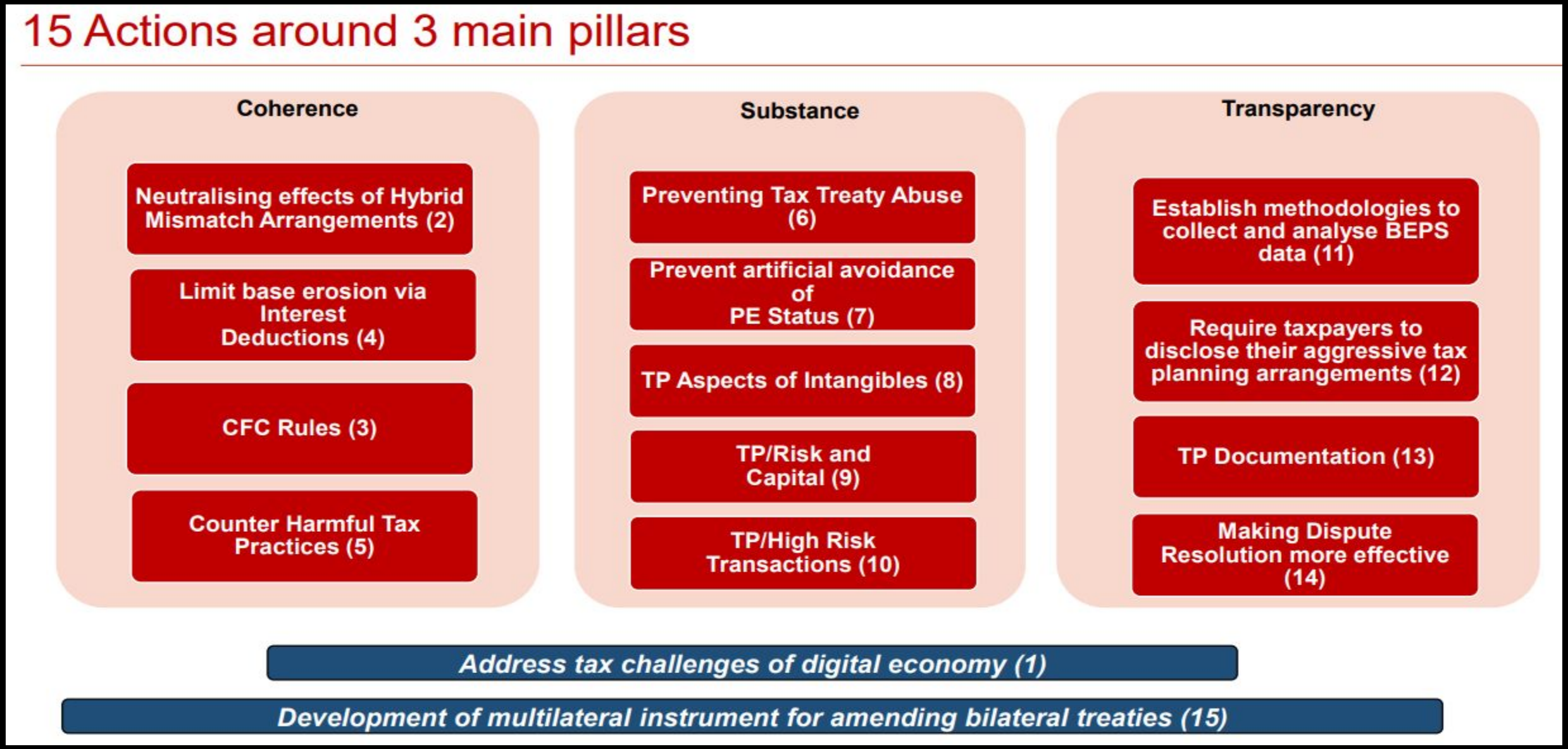
Zucman–Tørsløv–Wier. *Missing Profits of Nations*. Table 1: Shifted Profits (2015)[30]

Profits Shifted (2015 $ bn)[30]	Jurisdiction	Headline Corporate Tax Rate (all firms) (%)	Effective Corporate Tax Rate (foreign firms) (%)[30]
106		12.5	4
97	Caribbean† (ex. Bermuda)	<3	2
70	Singapore	17	8
58	Switzerland	21	16
57	Netherlands	25	10
47	Luxembourg	29	3
42	Puerto Rico	37.5	3
39	Hong Kong	18	18
24	Bermuda	0	0
13	Belgium	25	19
12	Malta	35	5



U.S. multinationals book over half of their non–U.S. profits in tax havens by using BEPS tools (2016 BEA).[2][32]

OECD BEP Actions*



*Source: see last page credits

BEPS: India's rapid response

Action Plan 1	Equalization Levy, Significant Economic Presence (SEP)
Action Plan 4	S.94B - Interest claimed by entity to AE restricted to 30% of EBITDA (or) interest payable to AE whichever is lesser
Action Plan 5	S.115BBF - Royalty income from patent developed and registered in India @ 10%. No deduction allowed against it.
Action Plan 8-10	India committed to implementing the BEPS reports on TP recos. Receipt of low-value intra-group services added in Safe Harbour rules
Action 13	Rule 10DB - CbCr in IT Act

*Action Plan 6 -GAAR?

OECD – BEPS Action Plan 15 – Multi Lateral Instrument (MLI)

- Multilateral Convention to Implement Tax Treaty Related Matters to Prevent BEPS entered into force 1st July 2018
  - Designed to strengthen existing tax treaties concluded among its parties without the need for burdensome and time-consuming bilateral renegotiations.
  - **Master template, sits alongside Tax Treaties**
  - ~100 countries are signatories to MLI. Not USA

"The Convention operates to modify tax treaties between two or more Parties to the Convention. The MLI will not function in the same way as an amending protocol to a single existing tax treaty, which would directly amend or modify the texts of the tax treaty; instead, it will be applied alongside existing tax treaties, modifying their applications to order to implement the BEPS measures"

Part	Title	Articles	BEPS Action Plans
I	Scope and interpretation of terms	1 & 2	-
II	Hybrid mismatches • Transparent entities • Dual resident entities • Methods for elimination of double taxation	3 to 5	Action Plans 2 and 6
III	Treaty abuse • Purpose of tax treaties (minimum standard) • Prevention of treaty abuse (minimum standard) • Dividend transfer transactions • Capital gains on interests in land rich entities • Third country PEs • Taxation of own residents	6 to 11	Action Plan 6
IV	Avoidance of PE status • Commissionaires and similar arrangements • Specific activity exemptions • Splitting-up of contracts • Definition of a person closely related to an enterprise	12 to 15	Action Plan 7
V	Improving dispute resolution (minimum standard)	16 & 17	Action Plan 14
VI	Arbitration	18 to 26	
VII	Final provisions	27 to 36	-

MLI: A primer

What is it?	A single instrument that modifies multiple tax treaties in one stroke (OECD/G20)
Applicability	Not automatic. Have to be signatory to MLI. And both Contracting jurisdictions need to notify their tax treaties as Covered Tax Agreements (CTA)
CTA?	A Tax Treaty that is in force between two or more Parties with respect to which each such Party has notified to the Depository as a listed agreement under the MLI
Impact on DTAA	Will not replace the existing treaty, but operate alongside it– supplement, compliment and modify application of DTAA!
Is DTAA frozen, is MLI frozen?	No and No.
Rule of interpretation	MLI to be interpreted in accordance with ordinary principles of treaty interpretation

MLI: Flexible Framework

Minimum Standards	All countries to meet Minimum Standards (BEPS AP 6 - Treaty Abuse, AP 14 - Dispute Res.)
“Reservations”	Flexibility to opt out of a provision if not MS
Optional Provisions	Choose among alternate provisions intended to address the same issue
Notification clauses	Notify choice of optional provision and existing provisions of CTA to be modified/replaced
Compatibility clauses	MLI provisions applies “in place of”, “applies to”, “modifies”, “in the absence of”

Hierarchy to check whether a DTA is affected by MLI:

i) Is the DTA notified by both the countries under article 2(1)(a)(ii) i.e., CTA of MLI? If yes, then MLI applies to the DTA prima facie. If any of the countries has not notified the DTA, MLI will not apply.

ii) **Reservation:** Has any country made a reservation for any provision of MLI? If yes, then that MLI provision does not apply. DTA is not affected. This is the position, even if the other county has not made a reservation. Thus, if no country makes reservation for the MLI provision, the MLI provision will apply.

iii) **Optional provision:** Have the countries selected the optional / alternative provision of MLI?

- i) If yes, have they selected the same option? If yes, the MLI will modify the DTA.
- ii) If any one country does not select an option, or both countries select different options, that MLI provision (the options) does not apply.

Indian CTAs

MLI to enter into effect from 1 April 2020

List of jurisdictions that have notified tax treaty with India as CTA and have deposited their ratification instruments with OECD Secretariat by 30 June 2019

Austria	Australia	**Belgium**
Finland	**France**	Georgia
Ireland	Israel	**Japan**
Lithuania	**Luxembourg**	Malta
Netherlands	New Zealand	Poland
Russia	Serbia	**Singapore**
Slovak Republic	Slovenia	Sweden
United Kingdom	**UAE**	

Article 3 of the MLI – Transparent entities

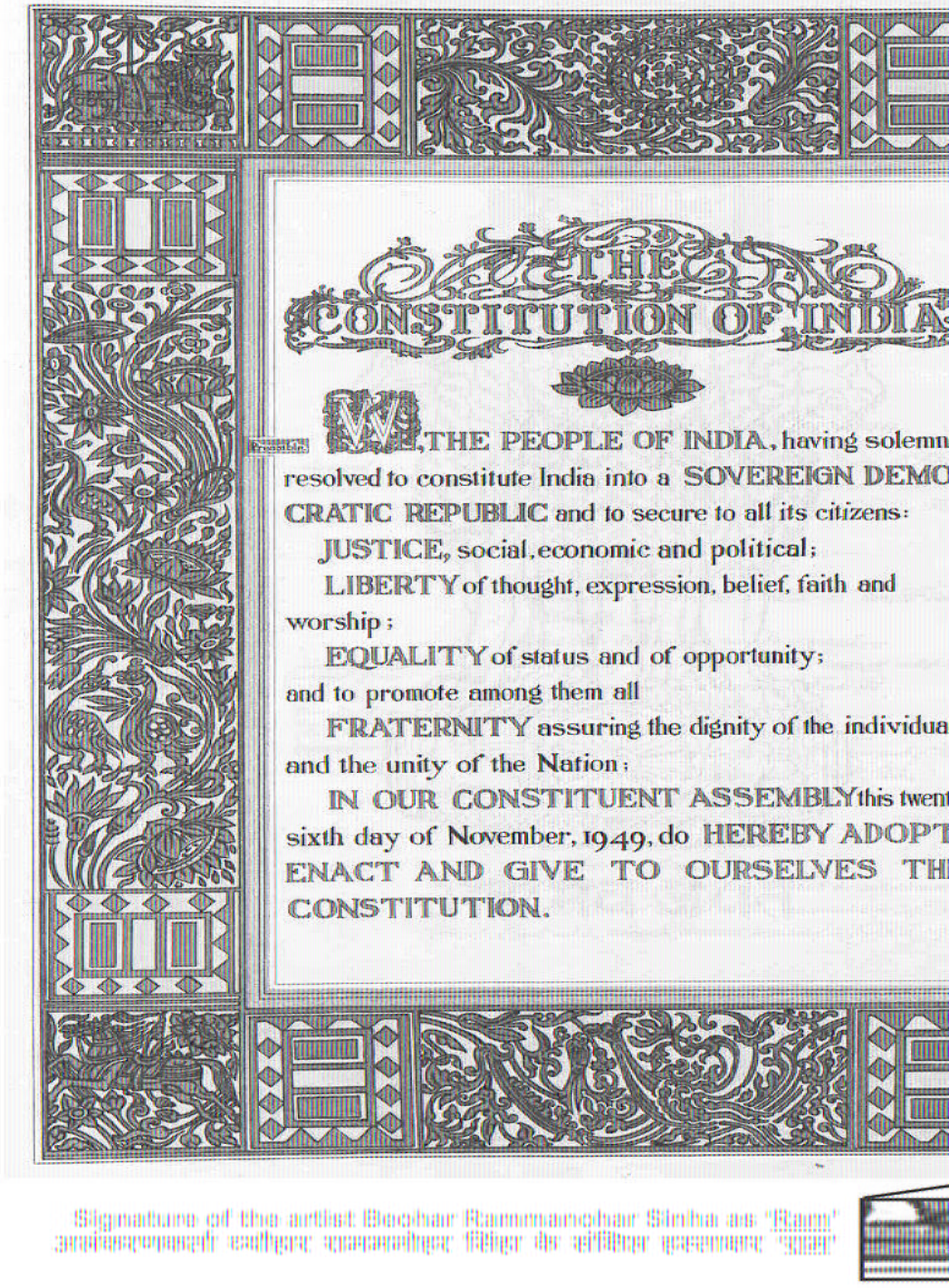
India has made a reservation!

Article 4 of the MLI – Dual Resident Entity

- No change for Individuals. Tie breaker applies
- Dual Resident Entity (DRE) is a person resident in more than one Contracting State
- POEM is the DTAA tie-breaker to determine residential status
    - Not a common definition across countries! India's Circular brings in CFC into POEM for example
- MLI proposes to solve dual residential status conflicts of persons other than individuals through MAP procedure!
    - Will take into account POEM as well as incorporation, constitution etc
- **India opted for this**. So, applies to all its CTA's unless reservation made by treaty partner

Article 6 – Preamble – Minimum Standard

- Article 6 primarily seeks to insert a statement in the preamble of the tax treaties to the effect that the purpose of the treaty is not to create opportunities for double non-taxation or reduced taxation through tax avoidance or evasion including treaty shopping.
- USA is not a signatory to the MLI.
  - "Most of our tax treaties are already there keeping in mind these objectives" ☺️



Article 7 – Prevention of Treaty Abuse – Minimum Standard

- Provides safeguard against "treaty abuse"
- **Statement of intent in clear terms** to avoid creation of opportunities for non-taxation or reduced taxation through tax evasion including treaty shopping arrangements
- Introduction of **Principal Purpose Test** (compare it with GAAR). **This is a Minimum standard!**
- Optional Provisions:
  - **India has chosen to apply SLOB. <u>So, India position = PPT+SLOB</u>**
  - The SLOB will apply if all countries to the DTA have chosen to apply the SLOB. If one country applies SLOB and the other does not, then SLOB will not apply. Only PPT will apply.
  - E.g. U.K. has not opted SLOB. Hence SLOB will not apply to India-UK DTA.

Article 7 – SLOB

- Simplified Limitation of Benefits is a SAAR.
- Qualified person:
  - Individual, State, Certain entities permitted by Competent Authorities,
  - Entities that meet ownership requirements, turnover requirements
  - Certain collective investment vehicles, charities and pension funds
- If not a ‘Qualified Person’ then Treaty benefit would be available on satisfaction of certain condition
- Interestingly, SLOB can be allowed to be applied asymmetrically (Greece)
- PPT (GAAR) +SLOB (SAAR) + GAAR IT Act!

Article 7 – Principal Purpose Test

"Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, ***that obtaining that benefit was one of the principal purposes of any arrangement or transaction*** *that resulted directly or indirectly in that benefit,* ***unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement."***

- "One of the principal purposes" – Tougher than GAAR?!
- Onus on Department.

Article 8 – Dividend transfer transaction

- Introduces additional criteria of "365 days minimum holding period" for the shareholder to avail concessional tax rates under CTA!
- Lot of countries like Netherlands, Singapore, Denmark, Cyprus have reserved Article 8. Beneficial Owner test is enough?
- India opted for this provision.

Article 9 - Capital Gains from alienation of shares or interests deriving value principally from immovable property

- Introduces additional criteria of "365 days minimum holding period" in case of gains arising from alienation of shares or other participation rights if such shares or rights derive more than a specified percentage of their value from immovable property situated in the source jurisdiction
- Optional provision of inserting a minimum value derivation criterion of 50 percent of their value directly or indirectly from immovable propert
- Under Indian tax treaties, this value test exists at the time of transfer, not for the 365 days prior. It will change based on MLI application.
- Optional provision – so provision will apply to CTA if other partner has chosen same option.

Article 12 – Artificial Avoidance of PE through Commissionaire Arrangements and similar strategies

- Commissionaire Arrangement: An agreement through which a person sells products in a given State in its own name but on behalf of a foreign enterprise that is owner of products.
- *"or Habitually plays the Principal role"*
  - Covers cases where conclusion directly results from actions performed in State S on behalf of principal in R even though under relevant law contract not concluded by that person in State S
  - Is the conclusion of the contract directly a result of substantial activities taking place in S though for contract law conclusion is outside S?
  - Actions of person who convinces third party to enter into contract with principal enterprise.
- "Contracts that are routinely concluded without material modification by the enterprise"
- **India opted for this provision**

Article 13 – Activity based PE exclusions through specific activity exemptions

- Exemption from PE is available only if the activities carried on are of preparatory and auxiliary nature. Additionally anti-fragmentation rule
- **Article 13(4) – Anti-fragmentation rule!**
  - Ex: Splitting of contract to cross threshold test of 6 months
- India opted for this provision. So other CTA has to choose to apply this for this rule to apply.

Article 14 – Splitting up of contracts

- Addresses avoidance of PE by splitting the contracts between related enterprises to circumvent the threshold of PE creation
- India silent on this and hence it applies!

Article 16 – MAP – Minimum Standard

- India led the opposition to arbitration if CA negotiation doesn't work. 100+ countries supported this.
  - Article 18-26 Mandatory binding arbitration India has not opted for.
- OECD folded to water down the minimum standard as implement a bilateral notification or consultation process which India agreed to.
  - Remember MAP Guidance/2020 Circular!

Other MLI changes

- Scope of Agency PE expanded in that agent will not be independent if agent works for other persons but such persons are considered "closely related to the first enterprise" (Article 15)
- Corresponding adjustment to be automatic (Article 17)

(i) with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after 01st January, 2020; and

(ii) with respect to all other taxes levied by Singapore, for taxes levied with respect to taxable periods beginning on or after 01st April, 2020.

The Government of the Republic of India and the Government of the Republic of Singapore, desiring to conclude an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

The following preamble text described in paragraph 1 of Article 6 of the MLI is included in the preamble of the Agreement:

ARTICLE 6 OF THE MLI *Purpose of a Covered Tax Agreement*

Intending to eliminate double taxation with respect to the taxes covered by this Agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Agreement for the indirect benefit of residents of third jurisdictions),

Have agreed as follows:

ARTICLE 1

PERSONAL SCOPE

This Agreement shall apply to persons who are residents of one or both of the Contracting States.

ARTICLE 2

TAXES COVERED

1. The taxes to which this Agreement shall apply are:

(*a*) in India :
income-tax including any surcharge thereon (hereinafter referred to as "Indian tax") ;

(*b*) in Singapore :
the income tax (hereinafter referred to as "Singapore tax").

2. The Agreement shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of the present Agreement in addition to, or in place of, the taxes referred to in paragraph 1. The competent authorities of the Contracting States shall notify each other of any substantial changes which are made in their respective taxation laws.

ARTICLE 3

GENERAL DEFINITIONS

1. In this Agreement, unless the context otherwise requires:

(*a*) the term "India" means the territory of India and includes the territorial sea and air space above it, as well as any other maritime zone in which India has sovereign rights, other rights and jurisdictions, according to the Indian law and in accordance with international law;

(*b*) the term "Singapore" means the Republic of Singapore ;

(*c*) the terms "a Contracting State" and "the other Contracting State" mean India or Singapore as the context requires ;

(*d*) the term "company" means any body corporate or any entity which is treated as a company or body corporate under the taxation laws in force in the respective Contracting States ;

(*e*) the term "competent authority" means in the case of India, the Central Government in the Ministry of Finance (Department of Revenue) or their authorised representative; and in the case of Singapore, the Minister for Finance or his authorised representative ;

(*f*) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(*g*) the term "fiscal year" means :

(*i*) in the case of India, "previous year" as defined under section 3 of the Income-tax Act, 1961 ;

(*ii*) in the case of Singapore, calendar year ;

ARTICLE 28A

MISCELLANEOUS

his Agreement shall not prevent a Contracting State from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.

ARTICLE 29

DIPLOMATIC AND CONSULAR OFFICIALS

lothing in this Agreement shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

The following paragraph 1 of Article 7 of the MLI applies to the provisions of this Agreement:

ARTICLE 7 OF THE MLI - PREVENTION OF TREATY ABUSE (*Principal purposes test provision*)

Notwithstanding any provisions of the Agreement, a benefit under the Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Agreement.

ARTICLE 30

ENTRY INTO FORCE

. Each of the Contracting States shall notify the other the completion of the procedures requires by its law for the bringing into force of this Agreement. This Agreement shall enter into force on the date of the later of these notifications and shall thereupon have effect:

MLIs: Principal Purpose Test

Singapore Co. (Payee/Licensor)

Residence country tax

on royalty income

Pre MLI: Check and use restrictive definition of Royalty in DTAA!

Post MLI: In addition to Pre-MLI –

- Preamble to considered
- PPT test: availing tax benefit should not be Principal purpose of transaction

Royalty payment net TDS 10%

Indian Company (Payer/Licensee)

Source country tax

TDS deposited

Before MLI - Good Old Days?

- Tax Residency Certificate - S.90(4), Form 10F S.90(5)
- Is payee resident country covered by Tax Trea with India?
- No PE Declaration
- No POEM?
- Whether recipient is beneficial owner?
- Whether LOB clause satisfied?
- Whether “make available” clause satisfied?
- Whether MFN clause applicable?

Post MLI era

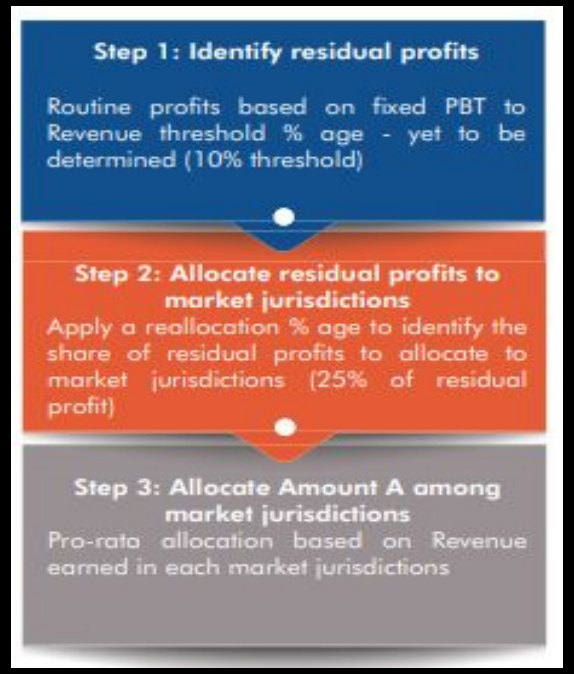
- What is the **Principal Purpose** for undertaking the transaction from a particular Treaty country?
- What are the activities of payee's representatives in India?
- Is payee hit by expanded definition of PE
- Are payments being made to multiple group entities under split contracts?

Parry's Corner - Madras 1890

OECD Two Pillar Approach

- While BEPS was going on, countries took unilateral measures to address the gaps in the global tax architecture.
  - UK's Digital Services Tax, India introduced Equalization Levy etc.
  - USA retaliated with trade measures.
- So, OECD was forced to come up with its radical Two-Pillar approach and has now been formalized with 137 (out of 141) world’s largest economies agreeing to be a part of the Inclusive Framework and implement this approach.

PILLAR ONE Large MNES (currently, turnover > Euro 20billion) and profitability > 10% would allocate 25% of excess profits ("residual profits) to countries where they sell their products irrespective of the physical presence.



PILLAR TWO
Global Anti-Base Erosion (GlOBE) Rules provides that all countries will impose a minimum tax of 15% on corporates.

While countries may still choose to not impose a 15% tax, P2 provides where profits are earned in places where tax rate < 15%, home/source country can tax those profits by way of application of following rules:

Income Inclusion Rule ('IIR')	Parent company pays **top-up tax**[2] on its proportionate share of income of its group entity located in low-tax jurisdiction
Switch-Over Rule ('SOR')	Compliments the IIR by providing an enabling mechanism to overturn tax treaty obligations.
Undertaxed Payments Rule ('UTPR')	This rule kicks in especially in cases where IIR is inapplicable. As per UTPR, the MNE Group will allocate top-up tax to group entities in the ratio of deductible payments made by such companies to the entity located in low-tax jurisdiction. IIR has priority over UTPR.
Subject to tax Rule ('STTR')	This Rule triggers when the covered payment is subject to nominal rate of tax in payee jurisdiction. For example, if the payment is taxable at 5% in payee jurisdiction, as per STTR, additional withholding tax of 4% will apply in the payer jurisdiction (irrespective of the tax treaty rate).

OECD Two Pillar Approach

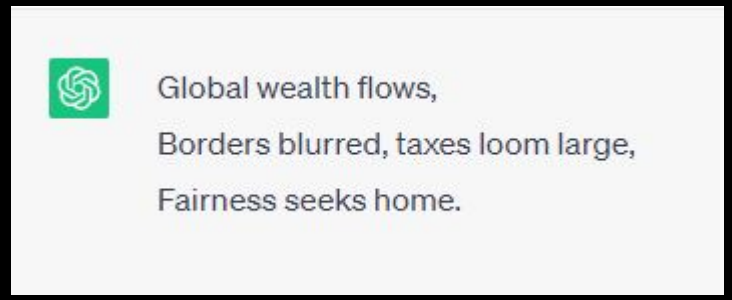
- The Multilateral Convention ('MLC') will require all parties to withdraw all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future.
- No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.
- **India would withdraw its Equalisation levy provisions** in sync with the commitment agreed to by the members of the Inclusive Framework.
    - Expected to increase tax collection via Two Pillar!

A final surprise!

(Almost) All images in this PPT were AI generated!
Craiyon - https://www.craiyon.com

Tables were using Tome App (AI)
http://tome.app/vulcantech

And I asked ChatGPT for a *haiku* on int'l tax



Thanks!
Vikram
vvikram@gmail.com
vvikam@saprlaw.com

Sources

- TDS on Foreign Remittances: A 360degree perspective by Vikram, MCCI 2020
- Workshop on International Taxation, SIRC Bangalore Permanent Establishment and Business Profit, 18 Oct 21, KPMG
- Overview of DTAA by Neetu Vineyek, Hiten Sutar, WIRC
- BEPS & MLI – OECD /G20 Project by Harshal Buta, WIRC
- Interpretation of DTAA post MLI by Vyomesh Pathak, WIRC
- Nuances of MFN clause, CTC
- E-Handbook on MLI for Begineers, WIRC
- MLI Note for Discussion, CTC
- MLI Ratification, Impact on Indian Tax Treaties, Deloitte
- Various online talks and presentations (WIRC, SIRC, KPMG, Deloitte, EY, PwC etc.)
- Google, Craiyon, Tome, Nightcrawler, Pixabay, etc.