Impact of Budget on International Tax
A change in direction

Income Tax

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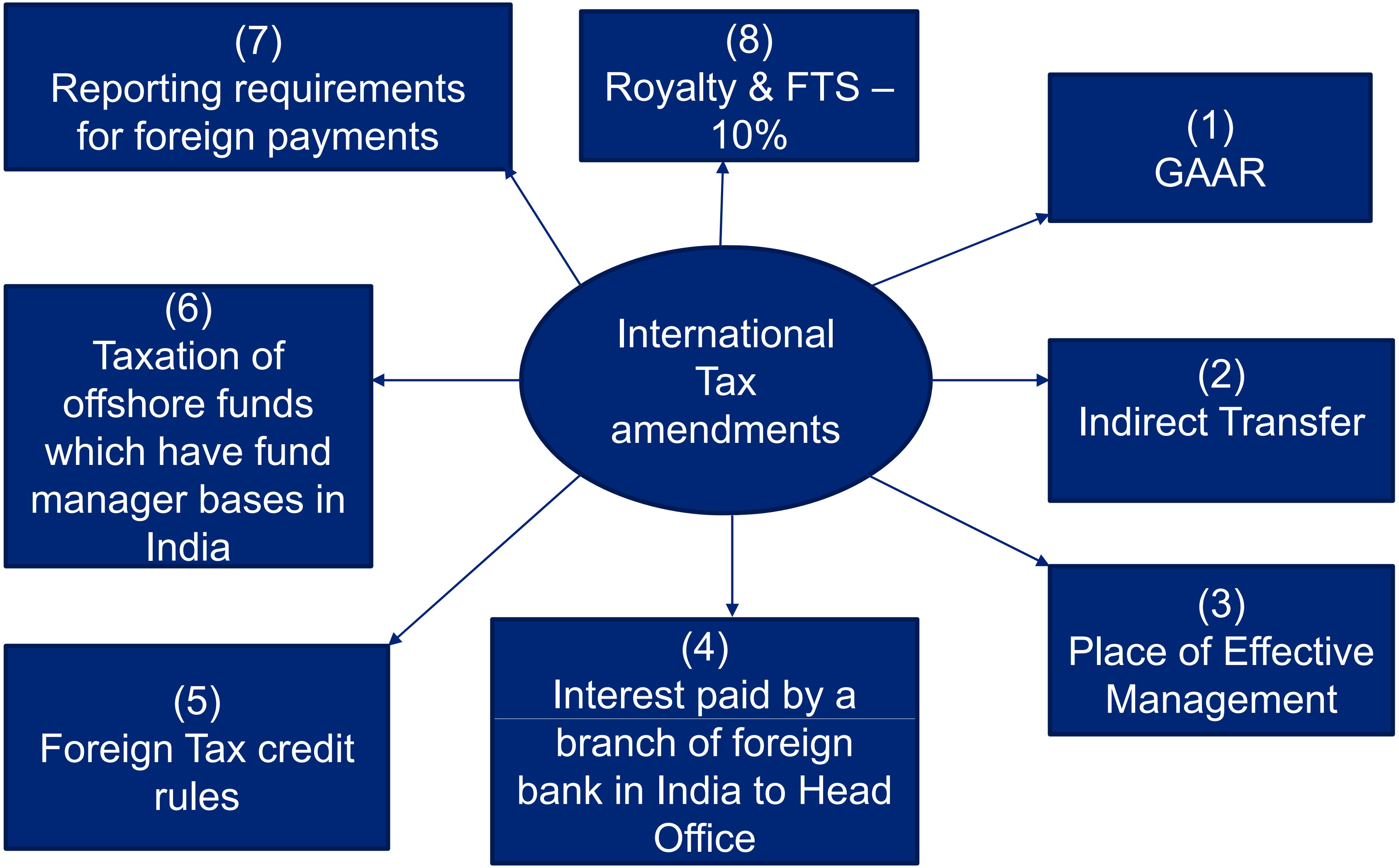
22 March 2015

International Tax Proposals



1 - GAAR

GAAR deferral

General Anti Avoidance Rule
Journey so far

August 2009	GAAR introduced for the first time in the Direct Taxes Code Bill, 2009
February 2012	Finance Act, 2012 introduced GAAR from 1 April 2012
May 2012	Post lot of concerns raised by the stake holders, amendments were proposed in GAAR provisions and the same were deferred to 1 April 2013
September 2012	A committee under the Chairmanship of Dr. Parthasarathi Shome was set up to examine GAAR provisions and provide suggestive guidelines
February 2013	Finance Act, 2013 further deferred GAAR to 1 April 2015
September 2013	Rules for GAAR notified – Investments prior to 31 August 2010 were grandfathered

GAAR deferral (Chapter X-A and section 144BA) (w.e.f. 1 April 2015)

- GAAR (Chapter X-A and Section 144BA) deferred by two years i.e. applicable to income earned from 1 April 2017
  - ➢ The deferment is stated to be in the wake of OECD BEPS project and India's active participant in the project.
    - ✓ GAAR provisions are implemented as part of a comprehensive regime to deal with Base Erosion and Profit Shifting (BEPS) and aggressive tax avoidance
  - ➢ No other changes have been announced
- Grandfathering benefits extended to investments made till 31 March 2017
  - ➢ Rules will need to be amended to reflect grandfathering

General Anti Avoidance Rule

Applicability of GAAR provisions

Existing Provisions

Particulars	Applicability of GAAR provisions
Investment prior to 31 August 2010	Not applicable
Investment post 31 August 2010 but till 31 March 2015	Applicable
Investment post 1 April 2015	Applicable

Proposed Provisions

Particulars	Applicability of GAAR provisions
Investment prior to 31 August 2010	Not applicable
Investment post 31 August 2010 but till 31 March 2017*	Not applicable
Investment post 1 April 2017	Applicable

* As per the Finance Ministers Speech and Memorandum to the Finance Bill, 2015 investments made up to 31 March 2017 are proposed to be protected from the applicability of GAAR provisions by amendment in the relevant rules

2 – Indirect Transfer

Background

- The provisions on taxation of "indirect transfer" of shares of an Indian Company were introduced by the Finance Act 2012 in the Income-tax Act, 1961 ('the Act') with retrospective effect from 1 April 1962. The said provision on indirect transfer was primarily introduced in the Act to overrule the landmark ruling of the Honorable Supreme Court of India in the case of Vodafone International Holdings BV
- ***<u>The brief facts of the Vodafone ruling are as under:</u>***
- In February 2007, Hutchison Telecommunications International Limited (Cayman Islands) sold 100% of its holding in CGP Investments (Cayman Islands) to Vodafone International Holdings BV (Netherlands) for a consideration of USD 11.2 billion.
- The Indian tax authorities inter alia contended that the underlying asset transferred pursuant to the above transaction was a "controlling stake" in Hutch Essar Limited (i.e. an Indian operating company), which was indirectly held by CGP Investments.
- Accordingly, they proceeded to levy tax on this transaction based on the contention that Vodafone International Holdings BV was under an obligation to withhold Indian taxes when making payments to the Hutch Group.

Background

- Based on the facts, the Honorable Supreme Court of India held that indirect transfer of shares of the Indian operating company would not be taxable in India and therefore there was no obligation for Vodafone International Holdings BV to withhold tax on the sale consideration. The key observations of Supreme Court ruling are as under:
  - Hutchison Telecommunications International Limited is not liable to tax in India since the Indian tax authorities do not have jurisdiction to tax the offshore transaction involving sale of CGP shares, being a capital asset situated outside India
  - Thus, Vodafone International Holdings BV is not liable to withhold tax at source
  - Post the aforesaid ruling the Government of India vide Finance Act, 2012 brought a retrospective amendment in the Act to tax indirect transfer of shares of an Indian company. The said retrospective amendment created confusion in the minds of the investor community not only in India but also outside India.

Key challenge in taxability of indirect transfer

- Even after introducing the provision governing taxability of indirect transfer of Indian company's shares, still there was an ambiguity with regards to the applicability of the said amendment. Three main challenges with respect to tax on indirect transfer of shares of an Indian company are listed hereunder:
  - The term "substantially" was not defined in the Act;
  - No clarity was provided on the methodology for computing the capital gains; and
  - Method of valuation was not prescribed

Expert Committee recommendation

- Parallel to introduction of indirect transfer provision, the Government of India introduced a separate chapter on General Anti Avoidance Rules (GAAR). An Expert Committee was formed to discuss and address concerns of stakeholder in implementing GAAR under the chairmanship of Dr.ParthasarathiShome.
- Later, an additional issue was referred to the Expert Committee to analyze the provisions dealing with taxability of income arising from indirect transfer of shares of an Indian Company.
- Based on the discussion with various stakeholders, the Expert Committee issued a draft report and made several suggestions.
- Further, recently, the Delhi High Court in the case of Copal Partners Limited, Jersey (Copal–Jersey) briefly analysed the indirect transfer provisions under the Act. The Delhi High Court took a stand that the term substantial shall mean 50% or more for testing the applicability of indirect transfer.
- The Delhi High Court, *inter alia*, drew inference from the recommendations of the Expert Committee DIT(International Tax) v. Copal Research Limited [TS-509-HC-2014(DEL)

Budget proposal relating to indirect transfer of shares

- ***Considering the recommendations made by the Expert Committee and the concerns raised by the various stakeholders, it is proposed to amend the provisions of the Act, with effect from 1 April 2016, as follows:***

  - The share or interest shall be deemed to derive its value substantially from the assets located in India, if on the specified date, the value of such assets represents at least 50% of the fair market value of all the assets owned by the company or entity. However, the indirect transfer provisions would not apply if the value of Indian assets does not exceed INR 10 crore.

  - Value of an asset shall mean the fair market value of such asset without reduction of liabilities, if any, in respect of the asset.

    - The specified date of valuation shall be the date on which the accounting period of the company or entity, as the case may be, ends preceding the date of transfer.

    - However, if the book value of the assets of the company on the date of transfer exceeds by at least 15% of the book value of the assets as on the last balance sheet date preceding the date of transfer, then the date of transfer shall be the specified date of valuation.

    - The manner of determination of fair market value of the Indian assets vis-a vis global assets of the foreign company shall be prescribed in the rules.

    - The taxation of gains arising on transfer of a share or interest deriving, directly or indirectly, its value substantially from assets located in India will be on proportionate basis. The method for determination of proportionality shall be prescribed in the rules

Budget proposal relating to indirect transfer of shares

- ***<u>The indirect transfer provisions shall not apply in a case where the transferor of share or interest in a foreign entity (along with associated enterprises) if:</u>***
  - Transferor does not hold control or management rights; or
  - Share capital or interest in the foreign company or entity, directly or indirectly, holding the Indian assets does not exceed 5% of the total voting power or total share capital or total interest.
- Capital gains on overseas merger/ demerger wherein the shares of an Indian company may be transferred indirectly shall be exempted subject to fulfillment of certain conditions.
- It shall be mandatory for the **Indian entity** to furnish information relating to the offshore transactions which shall have the effect of either directly or indirectly modifying the ownership structure or control of the Indian company or entity. In case of non-compliance, penal provisions shall be attracted.

Amendments explained in nutshell

- Indirect transfer provisions will apply only if, as on *“specified date”*, the following conditions are satisfied cumulatively –
  - Value of assets located in India > INR 10 Cr **and**
  - Value of assets located in India is at least 50% of the value of all assets owned by the company which is subject of transfer
- Gross value of all assets (tangible or intangible) to be considered
  - No reduction for liabilities, if any, in respect of the assets
- Valuation of assets based on FMV of assets –
  - But, method for determining FMV (e.g. DCF, NAV) to be prescribed in the rules
- Taxation in proportion to the value of Indian assets
  - Method for determination of proportionality proposed to be prescribed in the rules

Amendments explained in nutshell

- Step 1:
  - Determine 'specified date' on basis of book value of assets of FCo/Entity of which shares / interest are being transferred
  - Book value ascertainment has no role under Step 2

- Step 2:
  - Determine if FMV of India located assets (without liabilities) is ≥50% of FMV of all assets of F Co / entity as of specified date, as determined in Step 1

- Step 3:
  - If test of Step 2 fulfilled, amount reasonably attributable to assets located in India to be determined as per prescribed method

Specified date

- Specified date for FMV valuation is generally - the end of the "accounting period" of FCo preceding the date of transfer.
  - ➢ But it is date of transfer if the <u>book value</u> of assets of F Co / FE as on date of transfer exceeds the <u>book value</u> at preceding year end by 15%
- What is "accounting period"?
  - ➢ Generally, period of 12 months ending on 31 March
  - ➢ If foreign company/entity regularly adopts other accounting period for tax compliance in its country of residence or for shareholders' reporting, such other date is the accounting period
  - ➢ Accounting period can be shorter than 12 months in year of foundation or cessation
  - ➢ If the foreign company/ entity ceases to exist before the end of accounting period, the accounting period to end with the date cessation
- Specified date relevant for determining FMV proportion of Indian assets
- Specified date not for relevant for determining 'small' shareholder exemption

Illustration for determining as of specified date

- Assumption: Date of transfer of FCo is 31 August 2015

Particulars	Situation 1	Situation 2	Situation 3
BV of FCo as of 31.3.2015	1000	1000	1000
BV of FCo as of 31.8.2015	3000	1100	300
Specified Date for FMV determination	**31.8.2015**	**31.3.2015**	**31.3.2015**

- "Specified date" values are based on book value
  - Will Book value exclude revaluation? Arguably, book value is net of amortization and depreciation

- Determination of whether >15% value threshold is breached will necessarily require preparation of balance sheet of F Co as of the date of transfer

  - Profits / losses during intervening period will impact calculation

- Indirect transfer trigger arises if FMV of Indian assets as of the "specified date" is ≥50% of the total FMV of assets of F Co

- Not clear if 'book value' of assets needs to be reckoned with or without value of liabilities

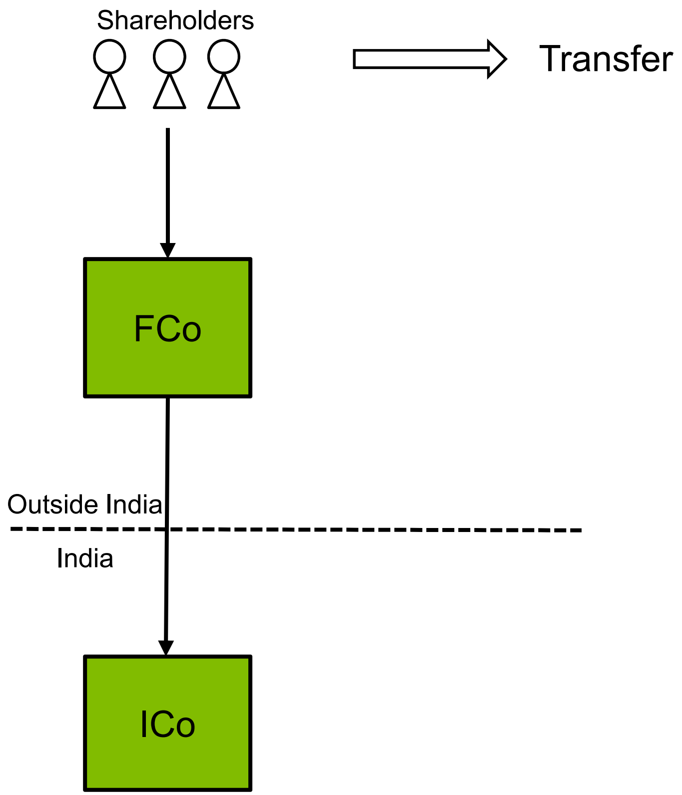
Determining if F Co / FE value from India assets ≥ 50%

- India tax trigger on transfer of F Co share / FE interest if value of India located assets as on specified date if > 10 Cr. and represents 50% of fair value of all assets of F Co / FE
- Specified date may be different from date of transfer
- Fair value of assets to be considered without reduction of liabilities in respect of assets
- Fair value to be determined as per prescribed rules
- Para 28.4 of OECD Commentary on Article 13(4) dealing with indirect transfer of immoveable property reads as follows:

  *"……………… **The determination of whether shares of a company derive more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State will normally be done by comparing the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company (whether or not secured by mortgages on the relevant immovable property)"***

- Consideration of liabilities in threshold determination is perceived to encourage tax avoidant strategy of shifting liabilities
- Exclusion of liabilities create unique challenge as demonstrated in next two slides

Impact of liabilities
Case study 1



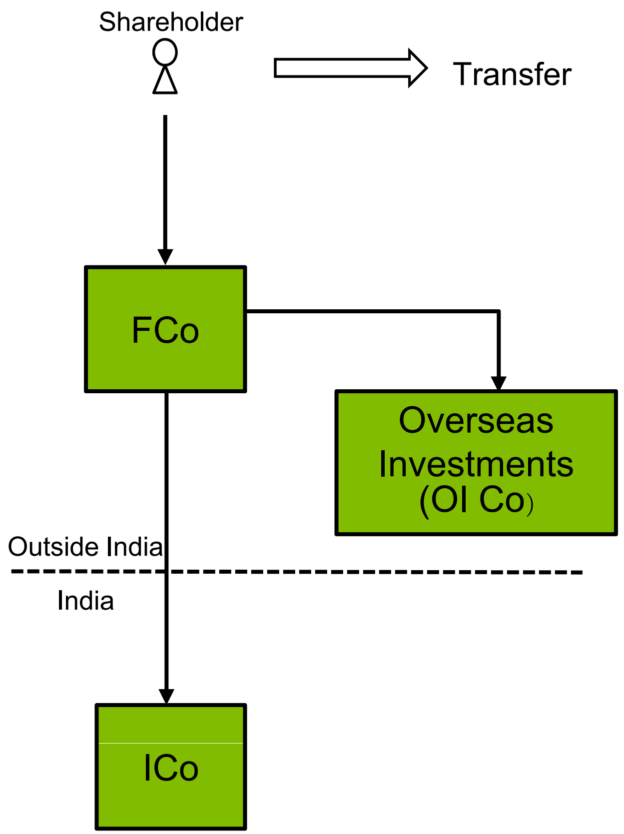
- Shareholder transfer shares of F Co which directly holds I Co
- Consider following (FMV)

	FCo	ICo		FCo	ICo
Capital	700	200	Other Assets	500	1000
Liabilities	-	800	I Co Investment	200	
Total	**700**	**1000**	**Total**	**700**	**1000**

On gross basis, Indian assets ≥ 50% of total assets of F Co

- Tax trigger arises u/s. 9(1)(i) unless protected by treaty

Impact of liabilities – Case study 2



- Shareholder effects transfer of FCo shares
- Consider following stand alone balance sheets (At FMV)

	FCo	OICo	ICo		FCo	OICo	ICo
Capital	5000	1500	1000	Other Assets	2500	2000	5000
Liabilities		500	4000	Overseas Investment	1500	-	
				ICo Investment	1000	-	
Total	**5000**	**2000**	**5000**	**Total**	**5000**	**2000**	**5000**

- In terms of net value, ICo value is 1000 in overall group net worth of 5000
  - However, if liabilities are ignored, ICo assets are 5000 in overall gross assets of group of 9500
- Will shareholder trigger tax in India?
- How will gain be reasonably attributable to India?

Small shareholder exemption

- Small shareholders
  - Transfer of a share/interest in a foreign company / entity (F Co / FE) which **directly** owns the Indian assets* and the transferor, either individually or along with its AEs**, -
    - neither holds any right of control or management of the transferred F Co / FE;
    - nor holds voting power/ share capital/ interest > 5% of the total voting power or share capital of F Co / FE
  - Transfer of shares/interest in a foreign company / entity (F Co / FE) which **indirectly** owns the Indian assets* and the transferor, either individually or along with its AEs**
    - neither holds the right of control or management of F Co / FE;
    - nor holds any rights in, or in relation to, F Co / FE which would entitle the transferor to exercise management or control in a company/entity which *directly* holds Indian assets;
    - nor holds such % of voting power/ share capital/ interest in FCo/FE which results in holding (either individually or along with its AEs) voting power/ share capital/ interest > [5% of the total voting power or share capital of a company/entity which *directly* holds Indian assets]
    - 5% interest in Fco/FE may still represent miniscule indirect interest of a shareholder in ICo

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* At any time in the 12 months preceding the date of transfer

** AE to be determined as per S.92A (TP provisions)

Tax neutrality for foreign merger/demerger involving indirect transfer

- Proposed introduction of S.47 (viab)/(vicc) to neutralise ‘indirect transfer’ for
  - Amalgamating foreign company
  - Demerger involving two foreign companies
- Exemption for foreign amalgamating company (FCo) if
  - 25% parity of shareholding continues in amalgamated company
  - FCo triggers no tax in its country of incorporation
- Exemption for foreign demerged company (FCo) if
  - 75% parity of shareholding continues in resulting company
  - FCo triggers no tax in its country of incorporation
  - Demerger need not be u/s 391/394 of Cos Act, 1956
- Provisions comparable to s.47(via) and (vic) apply to direct transfer of shares of Indian company in case of amalgamation/demerger of two foreign companies
- Cost and holding period substitution granted to amalgamated company/ resulting company
- No tax neutrality however for shareholder of the amalgamating / demerged company

Reporting obligations

- Reporting obligations exist on Indian concerns through or in which Indian assets are held by foreign company/entity (S.285A)
  - Detailed reporting requirements proposed to be prescribed in the rules
  - Reporting is for the purpose of determination of any income accruing or arising in India
  - Apparently, the information is to be furnished after the transaction is completed and tax trigger is attracted
  - Reporting requirements exist also of China, where
  - Reporting may be done by the transferor, transferee and/ or the transferred Chinese enterprise
  - Tax authorities may request information from the transferor, transferee, the Chinese enterprise or the person that participated in planning
- Failure to report attracts penalty (S.271GA)
  - 2% of the transaction value, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern
  - INR 5,00,000, in any other case
- Considering the levy of 2% penalty, S. 285A may impliedly cover such transactions which result in direct or indirect transfer of management or control right of an Indian concern

Indirect Transfer – Room for ambiguity

- Room for ambiguity and litigation on account of disparity in the proposed provisions for exemption of capital gains provided on 'indirect transfer' of shares and already existing provisions relating to 'direct transfer' of shares. The same is depicted as under:-

Particulars	'Direct transfer' of shares under a scheme of amalgamation	'Indirect transfer' of shares under scheme of amalgamation
Amalgamating company	Exempt from capital gain tax under Section 47(vi) of the Act	Proposed to be exempt from capital gain tax under Section 47(viab) of the Act
Shareholder	Exempt from capital gain tax under Section 47(vii) of the Act	Ambiguous

Is amendment prospective?

- To the extent the amendment seeks to define substantial value parameter, amendment will, arguably cover the past years
- The prescribed valuation methodology may be urged by taxpayer to be clarificatory and hence applicable to the past years.
- To the extent the amendment provides for concessions and exemptions, amendment may not protect or impact the past years
  - Small shareholder exemption
  - Threshold limit of Rs.10 Crore
  - Proportionate basis of taxation
  - Exemptions proposed under S 47
  - Provisions concerning specified date as the reference date for 50% threshold trigger
- Taxpayer may not be bound by norms of value adoption on a net of liability basis

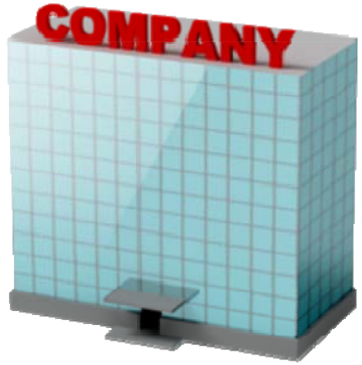
Indirect Transfer – Issues not addressed

- Recommendation of the Expert Committee that the amendment should be applied prospectively not accepted
- Calculation of cost of shares or interest – still a grey area
- Intra-group transfers other than amalgamation and demerger not covered
- No exemption granted in case of FIIs, PE Investors and listed foreign entities
- Threshold for excluding small investors kept at 5% as against 26% as recommended by the Expert Committee
- No clarification that the provisions shall be applied only to the taxpayer who earned capital gains from indirect transfer (and not to the transferee or its representative assessee)
- No clarification as to non-levy of interest and penalty
- DTAA protection would continue to be available, wherever applicable

Proposed amendments to be applicable from FY 2015-16

3 – POEM

Place of Effective Management (POEM)
[Sec. 6(3)] [w.e.f 1 April 2016]



Existing Provisions under the IT Act	Proposed Provisions under Finance Bill 2015
A company is said to be resident in India if: • It is an Indian company; • During that year, the control and management of its affairs is situated wholly in India	A company is said to be resident in India if: • It is an Indian company; • Its place of effective management, **at any time** in that year, is in India

Place of Effective Management (POEM)
[Sec. 6(3)] [w.e.f 1 April 2016]

- Apprehension: Very high threshold of residency leads to creation of overseas shell companies controlled in India but hold one board meeting outside India
- In order to align the 'residency' concept with International standards (Article 4(3) of OECD MC and India's DTAA's with other countries) the concept of Place of Effective Management (POEM) is now sought to be introduced by Finance Bill 2015.
- Meaning of POEM
  - A place where key management and commercial decisions are made
  - Place where decisions are, in substance
  - Decisions are necessary for the conduct of the business of an entity as a whole
  - Decisions may be made at any time in the relevant year
- The definition of POEM under Finance Bill, 2015, DTC, 2013 and OECD are similar.
- Set of guiding principles for determination of POEM are proposed to be issued for the benefit of the taxpayers as well as for tax administration

Place of Effective Management (POEM)
[Sec. 6(3)] [w.e.f 1 April 2016]

- POEM to be determined having regard to the nature of business
  - For investment holding company, investment decision may reflect ‘management and commercial’ decision concerning conduct of business entity as a whole
- ‘Whole of the year’ v. ‘At any time in the year’
  - Wider rule when compared with existing ITA provision
- Concept of POEM was first introduced in DTC 2010 wherein it was defined widely and provisions were ambiguous
- POEM is a fact based exercise
  - Need for adequate documentation and thrust to prove the same is on the Taxpayer

POEM

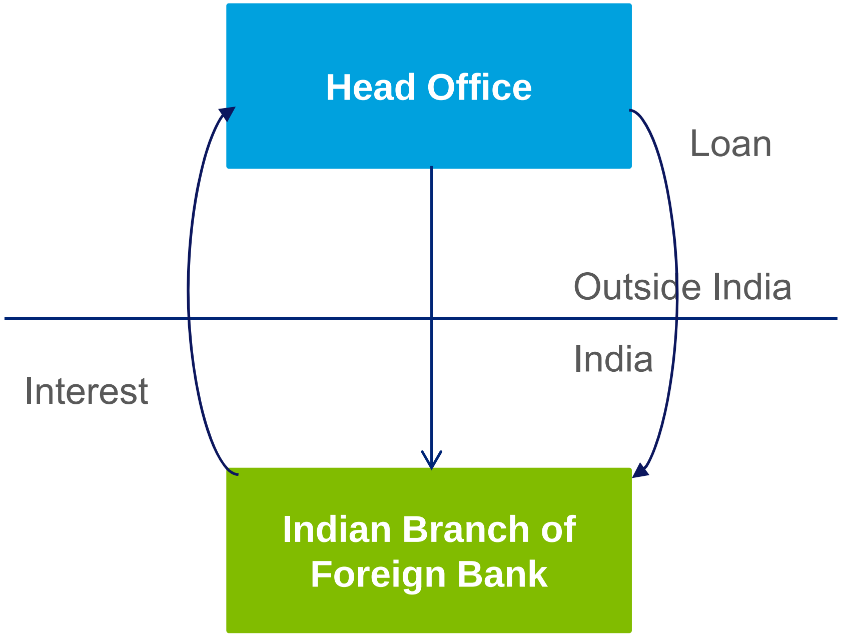
- It is possible that directors of the company may hold a board meeting via video conferencing for taking key managerial and commercial decisions. These directors may be present in various countries including India at the time of board meeting**. In this connection, reference may be made to observations made by the Delhi ITAT in case of Radha Rani Holdings (110 TTJ 920).**
- In the aforesaid decision, the Delhi Tribunal observed that "in the days of technological advancements conducting meetings by telephonic conversations or video conferencing process is very much prevalent in the world and, therefore, the actual presence of a person at the exact place of meeting or conference may not be necessary. The board resolution may also be by way of circular suggestion". The Delhi Tribunal accepted the claim of the tax payer that board meeting was held in Singapore based on the minutes of the meeting authenticated by the Indian High Commission in Singapore.
- There may be a situation where a foreign company is considered as resident of foreign country due to place of its incorporation or registration in that country. If POEM of such company is in India, a foreign company will be resident of that country as well as of India. In such a case, a tie breaker rule provided in double taxation avoidance agreement (DTAA) entered into by India with the foreign country needs to be examined.

Place of Effective Management (POEM) [Sec. 6(3)] [w.e.f 1 April 2016]

Types of tax payers likely to be affected by PoEM	Transactions likely to trigger PoEM	Ambiguity in PoEM
Foreign companies having Indian branches	Board meeting in India	Any decision in India?
Foreign subsidiaries of Indian parents	Decision taken by a Director in India	Place where functions are performed vs. place where decisions are taken?
Overseas company having global reporting structure with an India connection	Regional roles e.g. Group CEOs / CFOs sitting in India and approving decisions for foreign affiliates	Actions to be taken by the entity as a whole are determined?
Regional headquarters	Functions carried on in India by Global Procurement Cell of foreign companies	Can presence in another country be used to demonstrate absence of PoEM in India?

4 – Interest paid by branch to HO

Source rule for interest received by Foreign Banks



Based on judicial precedents, presently interest received by Foreign HO / overseas branches from Indian Branch (Indian PE) of the foreign bank is claimed as not taxable under the IT Act, being payment received from self

- Kolkata High Court in the case of ABN Amro Bank NV (2012)(343 ITR 81)
- Mumbai ITAT Special Bench in case of Sumitomo Mitsui Banking Corporation (2012)(136 ITD 66)

It is proposed that any interest payable by Indian PE to HO or any overseas PE of the foreign bank will be deemed to accrue or arise in India and chargeable to tax

Rationale of the amendment

- Under treaty, interest paid by PE to HO and other branches allowed as deduction treating the PE as an independent enterprise
- CBDT Circular No. 740 dated 17 April 1996 clarified that India branch of foreign company is separate taxable entity

Interest by Indian Branch to its Head Office (HO)

Particulars	**Pre- amendment**		**Post-amendment w.e.f 1.4.2015**
	Non-Treaty scenario	Favourable Treaty scenario	Treaty as well as non-treaty scenario
Income of PE in India	100	100	100
Less: Interest payment to HO	-	20	20
Taxable income of the PE	100	80	80
Income of the HO	-	Nil	20

Source rule for interest received by Foreign Banks

- The interest received by HO will be taxed in addition to any income attributable to the Indian PE
- Indian PE will be deemed to be a person separate and independent of the HO and overseas PE
- Indian PE is required to deduct tax at source from such interest payments
- Failure to withhold tax shall attract levy of interest and penalty
- These amendments will be effective from 1 April 2016

Source rule for interest received by Foreign Banks

Key Considerations

- Taxation of interest received by HO / overseas branches

<table>
<tr><th colspan="2">Under the IT Act</th><th colspan="2">Under the Tax treaty</th></tr>
<tr><td>Section</td><td>Rate</td><td>Article</td><td>Rate</td></tr>
<tr><td>115A</td><td>20% (*)
(on gross basis)</td><td rowspan="2">Article 11</td><td rowspan="2">5%/10%/15%
(on gross basis)</td></tr>
<tr><td>115A not applicable</td><td>40% (*)
(on net basis)</td></tr>
</table>

(*)plus applicable surcharge and education cess

Note: It could be contended that Article 7 of tax treaty ought not to apply as HO and PE are considered separate entities

- Whether Indian Branch can be considered as an ‘Indian concern’?
  - Joint Official Liquidator of Bank of Credit & Commerce (Overseas) Ltd. v. Joint Commissioner of Income tax, Special Range 32 [2006] 6 SOT 391 (Mum), wherein it was held that meaning of an ‘Indian concern’ in section 115A should be taken as a business carried on in India which may include a business carried on in India even by a non-resident
- The proposed amendment could also cover interest paid on Nostro Accounts

5 – Foreign Tax credit Rules

Foreign Tax Credit Rules to be prescribed (w.e.f 1 June 2015)

- At present, no specific rules available in relation to manner of granting of Foreign Tax Credit (FTC) under the ITA in respect of doubly taxed income
  - Relief by way of FTC is provided in DTAAs in respect of countries with which India has entered into an agreement under S. 90 and S. 90A
  - In respect of countries with which India has not entered into any agreement, FTC is provided in S. 91 wherein the credit is restricted to the an amount calculated at the rate of income tax in foreign country or Indian income tax rate on doubly taxed income, whichever is lower
- No clarity on computation of FTC, such as whether credit should be computed after aggregating income country wise, year wise, year of claim of FTC etc
- ***Clause (ha) inserted in section 295 to empower CBDT to make rules for providing procedures of computing such relief or credit against the assessee's Indian income tax liability***
- ***The said amendment will be effective from 1 June 2015***

6 – Taxability of offshore funds managed by fund managers in India

Taxability of offshore funds managed by fund managers in India – S. 9A [effective from 1 April 2016 (i.e. AY 2016-17)]

- Under S.6 of the Act the test of residency of a person other than an Individual to be determined on the basis of location of its "control and management" or place of effective management
  - An offshore fund may therefore be considered as an Indian resident, if its fund manager is situated in India
- Under the Act, S.9(1)(i) provides that income from business connection shall be deemed to accrue or arise in India.
  - This provision applies to NR as well
  - 'Business connection' presupposes an element of continuity between the business of NR, and the operations/ activities carried out in India.
- Presence of a fund manager in India has a risk of creating a business connection in India for offshore funds
- Under a DTAA a PE is often defined to include place of management
  - Presence of fund manager in India can therefore be considered as resulting in a place of management of the offshore fund in India, resulting in a PE presence in India

Taxability of offshore funds managed by fund managers in India- S.9A

- Where a business connection or PE is constituted in India, income attributable to operations/ PE in India becomes taxable in India
  - Income earned offshore may also be attributed to such operation/PE in India and hence may be taxed in India
  - Fund managers are hence hesitant of locating in India
  - In the budget speech relating to Finance (No.2) Bill, 2014, finance minister highlighted the need to encourage fund managers to shift to India
  - FB 2015 has now proposed a specific regime based on international best practices to encourage fund managers to locate in India
  - As per the specific regime provided under newly inserted S.9A
    - **Eligible** investment fund carrying on fund management activity through an **eligible** fund manager will not constitute business connection in India
    - Such a fund shall not be treated as a resident of India, merely because fund management activities are undertaken by an eligible fund manager on its behalf in India
    - Specific regime, is applicable only in case of eligible investment fund managed through an eligible fund manager.

Taxability of offshore funds managed by fund managers in India- S.9A

- Conditions to be fulfilled for a fund to be treated as an eligible investment fund
  - Fund should not be a person resident in India;
  - Fund should be a resident of a country or territory with which India has a treaty or an agreement u/s 90(1) and 90A respectively;
  - Aggregate participation or investment in the fund, directly or indirectly, by persons being resident in India should not exceed 5% of the corpus of the fund;
  - Fund and its activities should be subject to applicable investor protection regulations in the country/ territory where it is established/incorporated or is a resident;
  - Fund must have minimum 25 members who should not be connected directly or indirectly
  - Any member of the fund along with connected persons should not have any direct/indirect participation interest exceeding 10% in the fund
  - Direct/indirect participation interest of 10 or less members along with their connected persons should be less than 50%

Taxability of offshore funds managed by fund managers in India- S.9A

- Conditions to be fulfilled for a fund to be treated as an eligible investment fund (Cont..)
  - Investment of the fund in an entity not to exceed 20% of the corpus
  - No investment to be made in associate entity
  - Monthly average corpus of INR 100 Crs. In the year of establishment, corpus should not be less than INR 100 Crs at the end of relevant FY.
  - Fund should not control/manage directly/ indirectly any business in India
  - Fund not to be engaged in any activity directly or through an agent which constitutes a business connection in India, other than activities undertaken by eligible fund manager
  - Remuneration paid to fund manager should be at arm's length

Taxability of offshore funds managed by fund managers in India- S.9A

- Conditions to be fulfilled to qualify as eligible fund manager:
  - Fund manager should not be an employee of the fund or a connected person of the fund,
  - Fund manager must be acting in the ordinary course of his business,
  - Fund manager along with connected person should not be entitled to more than 20% profits of the eligible investment fund
  - To be registered as a fund manager or investment advisor in accordance with specified regulations
  - Specified regulations means SEBI (Portfolio Managers) Regulations, 1993 or the SEBI (Investment Advisers) Regulations, 2013, or such other regulations made under the SEBI Act, 1992 which may be notified by the Central Government
  - The person along with the contact person not to be entitled to >20% of profits of the eligible fund from transactions carried out by the fund through fund manager
  - If a fund manager ceases to be eligible, the benefits envisaged u/s. 9A shall cease to apply to the fund
  - Perceived to be restrictive provision and may not be of help to funds which are not sufficiently broad based

Taxability of offshore funds managed by fund managers in India- S.9A

- S. 9A would not have impact on the normal computation of income of fund manager.
  - Fund manager is likely to be taxed in India on income earned in India
- The fund will pay tax on income other than the income which is protected by business connection role of fund manager.
- Additional reporting requirement on the eligible investment fund to provide information about the fulfilment of conditions specified u/s. 9A within 90 days from the end of the financial year
  - Failure to furnish such statement would attract a penalty of Rs. 5 Lakh under a newly inserted s. 271FAB
  - Additional documents and information as prescribed, to be maintained
  - Penalty of INR 5L for default of furnishing information

7 – Reporting requirements

Reporting requirements u/s 195(6) (w.e.f 1 June 2015)

- Proposals in the FB 2015

Amendment to S.195(6)

- To amend S. 195(6) to provide that person responsible for paying any sum whether chargeable to tax or not, to a NR is required to furnish the information in such form and manner as may be prescribed.

- Memorandum explains that mechanism of 195(6) reporting is to attain twin objectives

  - *Ensuring deduction of tax at appropriate rate from taxable remittance*
  - *Identifying remittances on which tax was deductible but the payer has failed to deduct*
  - *Present provisions of 195(6) which cover only taxable payments which defeat object of identifying TDS defaults*

Reporting requirements u/s 195(6) (w.e.f 1 June 2015)

- Impact of FB 2015 proposals
  - Proposal clearly made for strengthening enforcement on foreign payments , to monitor and track remittance made to NRs outside India.
  - Onerous obligations cast on Indian taxpayers to do reporting whether payments taxable or not. Penal provisions amplifies the above.
  - With new law, practical difficulties to arise due to tremendous proliferation of compliance burden including CA Certificate (unless relieved) in respect of payments such as
    - Payment for imports other business payments
    - Remittances towards gifts or education
    - Reporting required for payments made on foreign trips
    - Payments made at overseas restaurants,
    - Payments made for online shopping owned by NRs
    - Payment to NR's branches in India
    - May apply equally to payment between NRs or involving branches of NR in India
    - May apply even if covered by S.195(2)/(3) or 197 order
    - Amendment to be in conflict with present Rule 37BB which clearly lays down application to taxable payment.
    - One can expect amendment to rule 37BB and forms 15CA/ CB also

Reporting requirements u/s 195(6) (w.e.f 1 June 2015)

New Penalty provision introduced

- Penalty under new S. 271I of INR 1 Lakh for non-submission or inaccurate submission of information under 195(6)

- No penalty imposable if it is proved that there was ‘reasonable cause’ for the default (S. 273B)

8 – Royalty & FTS

Royalty & FTS

(w.e.f 1 April 2016 i.e. Tax year 2015-2016 and AY 2016-2017)

- Reinstate the erstwhile tax rate of 10% from existing rate of 25% on payments made to non-resident tax payers on income in the nature of Royalty & Fees for Technical services (FTS) earned from India.
- The trend of the tax rates on royalty and FTS under Section - 115A of the Income Tax Act, 1961 has been as under:

Period	Tax Rate#
Agreements upto 31 May 1997	30%
Agreements from 1 June 1997 to 31 May 2005	20%
Agreements from 1 June 2005 to 31 March 2013	10%
Payments from 1 April 2013	25%
Payments from 1 April 2015	10%*
*Proposed rate by Finance Bill, 2015	Â

Plus Surcharge and Education Cess

Contd….

Royalty & FTS

Rationale given each time a change happened:

- **Budget Speech 1997 - reduction from 30% to 20%**

"There has also been a demand from the corporate sector that the tax rate of 30 per cent on royalty and technical services fees payable to foreign companies is too high and acts as a hindrance to the transfer of technology. I, therefore, propose to reduce this rate to 20 per cent" .

- **Budget Speech 2005 - reduction from 20% to 10%**

"To encourage technological up-gradation, I propose to reduce the withholding tax on technical services from 20 per cent to 10 per cent"

- **Budget Speech 2013 - increase from 10% to 25%**

"The rate of tax on royalty in the Income-tax Act is lower than the rates provided in a number of Double Tax Avoidance Agreements. This is an anomaly that must be corrected. Hence, I propose to increase the rate of tax on payments by way of royalty and fees for technical services to non-residents from 10 percent to 25 percent. However, the applicable rate will be the rate of tax stipulated in the DTAA"

- **Budget Speech 2015- reduction from 25% to 10%**

"Today I see a lot of young entrepreneurs running business ventures or wanting to start new ones.

Â They need latest technology.

Â Therefore, to facilitate technology inflow to small businesses at low costs, I propose to reduce the rate of income tax on royalty and fees for technical services from 25% to 10%."-

Royalty & FTS

Particulars	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Whether PAN available?	Yes	Yes	No	No
Whether TRC available?	Yes	No	Yes	No
Tax rate as per DTAA#	5%	5%	5%	5%
Tax rate under section 115A of the IT Act*	10% (25%)	10% (25%)	10% (25%)	10% (25%)
Applicable Tax rate	5% (5%)	10%* (25%*)	20% (20%)	20% (25%*)

Hypothetical
* Plus surcharge and cess
Note: Figures in bracket represent existing tax rates

- Treaties providing for a tax rate of 10% will still be relevant since, it is inclusive of surcharge and education cess, and is thus, the final tax rate
- If an NR taxpayer is eligible for treaty rate of 10% (which is inclusive of SC and Cess), higher withholding rate of 20% may be applicable under S. 206AA (if NR recipient does not possess/ furnish a valid PAN)
- However, payment in excess of ALP may still be taxable at the rate provided under S. 115A (if there is a specific provision akin to article 12(8) of India-US DTAA)
- Reduce the tax outflow for non-resident tax payers in countries with which India has not entered into DTAA.

Others

Extension of sunset clause

Sec 194LD – Interest payable to FIIs and QFIs

- Currently section 115A read with section 194LD of the IT Act provides for concessional rate of tax @ 5% (plus applicable surcharge and education cess) on interest payable to FIIs and QFIs till 31 May 2015
- This concession has been extended for interest payable up to 30 June 2017

MAT relief for FIIs (s. 115JB) (w.e.f. 1 April 2016)

- Currently MAT applicability to foreign companies not having presence in India is a controversial issue pending for adjudication before SC
- As per newspaper reports, SCN invoking MAT issued on FPIs[1]/ FIIs enjoying special concessional tax regime under s. 115AD
- FA 2014 made income from sale of securities for FPIs/ FIIs liable to be taxed as capital gains.[2]
- FB 2015 proposes to provide relief effective from A.Y.: 2016-17 to FPIs/ FIIs from MAT qua income from capital gains on securities (other than STCG on non- STT paid transactions)
  - Relief is by way of reduction of income from book profit with corresponding add-back for relatable expenditure;
  - No complete exemption from MAT on lines of life insurance companies.
- STCG on non- STT paid transactions liable to tax @ 30% for FPIs/ FIIs and hence MAT protection not necessary.
- Method of extending relief to FII from book profit will generate controversy [3] on:
  - Interest income of FIIs taxable @ 5% u/s. 194LD;
  - MAT applicability to PE investors and foreign companies (eg.: Royalty, FTS @ 10%, LTCG u/s. 10(38), etc.) having no presence in India.
  - MAT applicability to FPI/ FII capital gains income in past years.

[1] All FPIs are notified as FIIs under the IT Act.
[2] Even derivative transactions deemed to be capital gains
[3] However, Treaty protection may still be available.

Definition of GDR (S. 115AC) (w.e.f. 1 April 2016)

- S. 115AC provides for concessional tax rate of 10% for non-resident on income earned by way of interest on specified bonds, dividend on Global Depository receipts (GDRs) and capital gains arising from transfer of specified bonds/ GDRs purchased in foreign currency
- Section 47(viia) exempts capital gains on transfer of bonds or GDRs referred to in section 115AC(1) made outside India by a non-resident to another non-resident
- The term “GDR” under section 115AC(1) derives its meaning as per Explanation to section 115ACA(1)(a)
- It is proposed to amend the definition of GDR in section 115ACA to mean an instrument in the form of a DR or certificate created by the Overseas Depository Bank outside India and issued to investors against the issue of:
  - Ordinary shares of issuing company which is listed on a recognised stock exchange in India; or
  - Foreign currency convertible bonds of issuing company
- This amendment will take effect from the 1 April 2016
- Taxation of transfer of GDRs between two non-residents and on conversion with underlying unlisted shares of Indian companies remains uncertain

ANY QUESTIONS ??

THANK YOU