Answer-to-Question-_1_

Answer to Part 1

A non-resident is taxable in India if his/ her income accrues or arises in India (section 5 of the Income-tax Act, 1961 ("Act")) or if the income is deemed to accrue or arise in India (section 5 read with section 9(1) of the Act). In terms of section 9(1)(i) of the Act, income accruing or arising through a 'business connection' would be deemed to accrue or arise in India. Further, in terms of section 90(2) of the Act, a non-resident can choose to govern by the provisions of the Double Taxation Avoidance Agreement ("DTAA") signed by India with the country/ special region where such person is resident if the provisions of the DTAA are more favourable. In the instant case, MyCard Inc ("MCI") is incorporated in Delaware (ie the USA) and MyCard Pte Ltd ("MC Singapore") is a Singapore entity. It is presumed that these 2 entities are eligible for the benefits of the respective DTAAs entered by India, ie with the USA and Singapore.

Accordingly, in terms of the respective DTAAs, (business) income of such non-residents would be taxable only if there exists Permanent Establishment ("PE") in India.

Relevant facts of the case currently

• MC Singapore acts as the group's regional headquarters for the Asia Pacific, Middle East and Africa (APMEA) region and carries our the group's principal business of transaction processing and payment related services in APMEA region.

• The MyCard Business is structured as an open bankcard association, in which the cardholder and merchant relationship is managed principally by MC Singapore's customers - primarily banks and financial institutions, in the APMEA region. MC Singapore does not issue cards, extend credit to cardholders, etc. In other words, MC Singapore is concerned with provision of services in relation to functioning of card, payment processing, settlements, etc but does not by itself issues card to cardholders.

• MC Singapore has signed agreement with each Customer (i.e. banks and financial institutions) including those based in India , and accordingly provides services to the customers.

• MCI has setup a liaison office in India which acts as a communication channel between MCI and customer banks and solely carries out liaison activities.

• MyCard Service Pvt Ltd (MC India) rendered certain marketing, liaison and support services to MC Singapore.

• MC Singapore will charge transaction processing fees to its customers, will receive assessment fees for buling and maintaining a processing network that serves the needs of customers globally etc

• MC Singapore will also provide each customer with a MyCard Interface Processor ("MIP") that connects to the MyCard worldwide network and processing centres based in India and outside India. MC India owns and maintains the MIPs placed at customer's location.

Relevant case law

• At the outset, it may be highlighted that the current case is very similar to that of Mastercard Asia Pacific Pte Ltd, AAR, wherein it was held that under the overall terms of the agreement and activities being performed in India, Mastercard would likely have a PE in India and income from such PE to the extent attributable should be taxable in India.

Taxation under the Act

In terms of section 9(1)(i) of the Act, the activities being carried out by MC Singapore would likely trigger a 'business connection' as the source of income for MC Singapore is in India. It would be interesting to note decision of the Supreme Court in the case of Performing Rights Society wherein it has been held that if activities are carried out in

India, the source would be deemed to be in India. Analysis of DTAA provisions has been done in next part.

Similarly, MCI would also have a 'business connection' in India as it has set up a liaison office in India. However, it may be highlighted that as per Explanation 1 to section 9(1)(i) of the Act, activities only to the extent which are carried out in India shall be taxable in India. It would be important to note that MCI is carrying out mere 'liaison activities'.

Taxation under the DTAA

In terms of India Singapore DTAA, business income would be taxable in India only if the business is carried on by a PE is situated in India. PE is generally defined to mean a fixed place of business through which the business of enterprise is wholly or partly carried on. The provision requires that there should be a place of business, which should be fixed and business activity must be carried on from such a place.

In the current scenario, MC Singapore would be carrying out extensive activities in India which are detailed below.

(a) MC Singapore will provide each customer with MIP (ie processor being tangible asset of MC Singapore) that connects to the MyCard worldwide network and processing centres based in India and outside India. In other words, MC Singapore would be able to carry out its business activities through MIP which is located at customer's premises which is expected to be there for a sufficiently long period of time. Hence, all the conditions for fixed place PE gets satisfied.

(b) MC Singapore will receive assessment fees for buling and maintaining a processing network that serves the needs of customers globally, will help in clearing and settlement process for every payment transaction (even for transactions occurring in India, ie the source would be in India). In other words, MC Singapore would be carrying out its business activities in India.

(c) The MIPs are owned by MC India and placed at customer's location. The way MC Singapore is utilizing the MIPs, it appears that MC Singapore would be able to exercise control over MIPs, thereby exercising control over MC India. In other words, this would trigger a subsidiary PE for MC Singapore.

Additionally, as per Article 5(5) of India Singapore DTAA, a service PE is created where an enterprise furnishes services (other than fees for technical services) through employees or other personnel if the activities continue within the contracting state for more than 90 days in aggregate in a fiscal year. In the current case, MC Singapore would be providing services to its customers through MC India on a continuous basis and hence service PE provisions are also triggered.

In case of MCI, it may be noted that the liaison office would be doing only communication, i.e. liaison activities and will not have any control over premises of customers, over MIPs, or over MC India. Hence, MCI may not have a PE in India in view of 'preparatory and auxiliary' exemption under India USA DTAA.

Conclusion

In the current case, MC Singapore would have a tax exposure in India and the activities create a Fixed Place PE as well as a service PE. However, MCI does not have a PE exposure in India currently.

Answer to Part 2

In terms of India Singapore DTAA, Article 7(2), attribution of profits to a PE is based on 'separate enterprise' concept. In other words, there shall be attributed to a PE the profits which it might be expected to make if it were a distinct and separate enterprise engaged in same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Accordingly, as much as the profits which are expected to meet an 'arm's length payment' which an independent enterprise would have earned from similar transaction, that much amount needs to be attributed to the activities of PE in India. This principle has been accepted by the Supreme Court in various cases including Formula One WorldChampionship case.

So long as the payments meet arm's length criteria, no additional attribution of profits is warranted - this has been held by the Supreme Court in Morgan Stanley decision.

However, it is interesting to note that in the current case, MC India renders certain marketing, liaison and support services to MC Singapore and would ideally be getting compensated for the same based on FAR analysis (ie functions performed, assets used, and risks assumed). However, in the present case, there needs to be a separate study of functions performed, assets used, and risks assumed by the PE of MC Singapore which would determine whether the compensation already being paid by MC Singapore meets the 'arm's length principle' or not. The attribution principles state that both the transactions of MC India in a separate capacity and a PE of MC Singapore needs to be tested separately based on the FAR analysis.

Conclusion

Based on the discussion in answer for part 1, it appears that the PE of MC Singapore would be undertaking more functions and assuming more risks and hence, there would likely be some attribution of profits to the PE of MC Singapore.

Answer to Part 3

As per section 195 of the Act, any person responsible for payment of 'income' to a non-resident, must withhold taxes as per rates in force. Accordingly, if there is any income element enshrined in the payments being made, withholding provisions would stand triggered - this has been held by Supreme Court in GE India case.

In the current case, MC Singapore has a PE in India and hence payments of processing fee and assessment fees would be treated as income from such PE. Accordingly, the customers would be required to withhold tax in India. Separately, the payments may also be treated as fees for technical services under the DTAA and hence, withholding provisions may accordingly trigger.

It would be advisable if MC Singapore applies for a withholding tax ruling under section 195(3) to get an upfront certainty as the income may be taxable at 40% plus surcharge and cess (but on net basis).

Answer to Part 4

Currently, it has been concluded that the tax liability is fastened both under the Act and DTAA for MC Singapore. Separately, withholding tax provisions would also trigger.

Accordingly, it would make no difference if MC Singapore is a resident in a country with which India does not have a DTAA.

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Answer-to-Question-2

Answer to Part 1

India introduced the 'indirect transfer provisions' under section 9(1)(i) of the Income-tax Act, 1961 ("the Act"), to tax transfer of India assets indirectly, post the decision of Supreme Court in Vodafone International case wherein it was held that such transfers would not be taxable in India in absence of specific provisions under the Act and the court refused to adopt a 'look through' approach.

As per these provisions, as asset or capital asset being any share or interest in a company or entity regoisted or incorporated outside India shall be deemed to be and shall always deemed to be situated in India if the share or interest devices directly or indirectly its value substantially from the assets located in India (explanation 5 to section 9(1)(i) of the Act). Further, 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 - (i) exceeds INR 10 cr and (ii) represent at least 50% of value of all assets owned by the company or entity as the case may be.

In the current case, the Indian business (ie the factories being the asset in the present case) account for 80% of the assets of Nexus. Accordingly, the second threshold would be met. Assuming the value of the Indian assets, is more than 10cr as on the specified date, the shares in nexus would be deemed to be located in India and the provisions of indirect transfer would stand triggered. Further, as per the provisions of Article 14 Capital Gains of India UK DTAA, capital gains is taxable in each contracting state as per their respective domestic laws.

Hence, any 'transfer' of assets or shares in Nexus could become taxable in India as per its domestic law.

In India, any extinguishment or relinquishment of shares is also covered within the definition of transfer 9section 2(47) of the Act). Accordingly, extinguishment of shares upon merger would be taxable unless relieved by other exemption provisions.

Further, in a domestic merger in India, the transaction is generally exempt in the hands of the shareholder if certain conditions prescribed under section 2(1B) of the Act are satisfied. Similar exemption has also been carved out under section 47(viab) of the Act according to which any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company referred in Explanation 5 to section 9(1)(i) of the Act which derives its value substantially from the share or shares of and Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if -

(A) at least 25% of the shareholders of amalgamating foreign company continue to remain the shareholders of the amalgamated foreign company; and
(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

In the inkstand case, Nexus owns a branch which owns 2 factories in India - however, the exemption carved above under section 47(viab) of the Act is in relation to 'shares of Indian company'. Hence, the exemption would not be available under this section as shares of Indian company are not getting transferred and the transaction would be treated as 'transfer'.

Non-discrimination clause

Under the non-discrimination clause under India UK DTAA (Article 26(1)), the nationals of a Contracting State shall not be subjected in the other Contracting state to any taxation or any requirement connected therewith which is other or more burdensome than the taxation or any requirement connected therewith to which nationals of that other State is similar circumstances are or may be subjected.

The benefit of this non-discrimination clause will not be available owing to the following:

• The Indian law already exempts transfer by way of amalgamation in certain circumstances covering where value is derived substantially from India. The taxation has come owing to non-satisfaction of certain conditions enshrined therein. Accordingly it cannot be considered as discriminatory as the provisions would apply equally to nationals of both the nations.

Answer to Part 2

Since it has been determined that the merger transaction is taxable in India and no relief is available under India UK DTAA as well, the transaction would be taxable as income in the hands of Vector. Vector holds the shares in Nexus which are deemed to be located in India by virtue of section 9(1)(i) of the Act. Accordingly, it would be treated as transfer of shares on account of merger/ amalgamation has happened in India. Since the transfer is of shares which are located in India, the same is treated as taxable in India.

Section 45 of the Act charges capital gains to tax. The proportionate amount of the fair market value of assets being received by Vector on account of merger would be taxable in the hands of Vector as capital gains.

Answer to Part 3

Similar to answer above, the transaction would be taxable in the hands of Frankie who owns 16% in Nexus and charged to capital gains tax.

However, the case would be different for Robert who owns 4% of equity in Nexus. As per explanation 7 to section 9(1)(i) of the Act, no income shall be deemed to accrue or arise to a non-resident for transfer of shares outside India of any share in a company registered or incorporated outside India (referred to in Explanation 5), if at any time in the 12 months preceding the date of transfer, the transferor does not hold the rights of management or control in relation to such company nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be.

Assuming that Robert does not have any rights of management or control in Nexus, and since he holds less than 5% of shares in Nexus, the indirect transfer provisions are not triggered. Hence, there is no India tax implications for Robert in the present case.

Also, the increase in share portfolio values of Frankie and Robert to the extent of US$ 2 million and US$ 500,000 respectively post the transaction is of no consequence.

Answer to Part 4

As highlighted earlier, the indirect transfer provisions are triggered if the value of assets located in India exceeds INR 10 cr and represents at least 50% of the value of all the assets owned by the company or entity.

In the present case, post the merger transaction, Vector would be holding the Indian branch and its assets directly which will account only 20% of total assets of Vector. Since this does not satisfy the requirement of explanation 6 to section 9(1)(i) of the Act in relation to more than 50% interest, the shares of Vector would not be deemed to be located in India.

Accordingly, any transfer of shares of Vector by the shareholders to any entity would not be taxable in India.

Answer to Part 5

As highlighted above, Vector would derive only 20% of its value from assets located in India and hence the shares of Vector would not be deemed to be located in India. Consequently, any transaction undertaken by Vector should not have a tax implication in India if there is no source related to India.

In the current scenario, Vector would be sold to Mauritius subsidiary (i.e. M) who will inject additional funds into Vector through subscription to Vector's redeemable debentures which would be redeemed in successive trances over the next 5 years.

It is important to note that funding of Vector would not have any nexus with India and hence there would not be any tax implication of either subscription of redeemable debentures or their subsequent redemention.

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Answer-to-Question-3

Answer to Part 1

A non-resident is taxable in India if his/ her income accrues or arises in India (section 5 of the Income-tax Act, 1961 ("Act")) or if the income is deemed to accrue or arise in India (section 5 read with section 9(1) of the Act). In terms of section 9(1)(i) of the Act, income accruing or arising through a 'business connection' would be deemed to accrue or arise in India. Further, in terms of section 90(2) of the Act, a non-resident can choose to govern by the provisions of the Double Taxation Avoidance Agreement ("DTAA") signed by India with the country/ special region where such person is resident if the provisions of the DTAA are more favourable. In the instant case,E Smart UK ("UK entity")is incorporated in UK and it is presumed that it is eligible for the benefit under India UK DTAA .

Accordingly, in terms of the DTAA, (business) income of such non-residents would be taxable only if there exists Permanent Establishment ("PE") in India.

Relevant case law

• At the outset, it may be highlighted that the current case is very similar to that of E Funds IT solution case wherein the Delhi High Court (and subsequently the Supreme Court) upheld non-existence of a PE in India despite the close connection between Indian entity and the non-resident, as the 'right to use' test and 'disposal' test were not satisfied.

Facts of the case

In the current case, UK entity has set up a subsidiary in India, i.e. E Smart India. The employees of E Smart India after getting trained undertake first cut media campaigns for E Smark UK's clients, supervised by senior employees of UK entity. The Indian employees also conducted research on all aspects of the social media profiles of th produced endorsed by UK em nitty clients. The activities were confined to background research on the endorsed products and were based on instruction received from UK entity. The UK entity has paid an arm's length fees to E Smart India.

E Smart UK sent its employees to India on deputation for 40 days in FY 2018-19. They reported to CEO of E Smart India but were paid salaries by UK entity.

Whether PE exists?

In terms of India UK DTAA, business income would be taxable in India only if the business is carried on by a PE is situated in India. PE is generally defined to mean a fixed place of business through which the business of enterprise is wholly or partly carried on. The provision requires that there should be a place of business, which should be fixed and business activity must be carried on from such a place.

Additionally, the place of business must be at the disposal of the non-resident entity.

In the current case, E Smart India is providing its services to the UK entity and despite the close connection, the same may not be construed as PE of the UK entity. As per Article 5(6), a subsidiary cannot be a PE of holding company just by virtue of control or management or shareholding.

In the current case, the premises of E Samrt India is arguable not under the control of UK entity and hence the same may not be treated as PE of UK entity given the 'disposal test' and 'right to use' test are not satisfied. Reliance can be placed on Supreme Court decision in the case of Efunds IT Solution.

Further, it is important to note that even if the PE exists, there will not any additional profits attribution so long as the transaction between the UK entity and E Smart India is on arm's length basis. Reliance can be placed on the decision of the Supreme court in the case of Morgan Stanley.

Conclusion

Owing to the above discussion, there may not be any tax implications in India for UK entity as such. Further, since E Smart India is already getting remunerated on an arm's length basis, there is no further tax implications on this as well.

Answer to Part 2

Deputation of employees in India could lead to potential PE problems for UK entity in case the employees have right to use the premises in India and satisfy the disposal test.

In the current scenario, the employees are in India only for 40 days. additionally, it appears that they are here for stewardship activities. In such a case, there may not be any fixed place PE exposure as held in Efunds IT Solution and Morgan Stanley cases by the Supreme Court of India.

Where, there is a creation of service PE, there may not be any further tax implication so long as the Indian entity is remunerated on arm's length basis as held in Morgan Stanley by the Supreme Court of India

Answer to Part 3

Any income to be taxable in India should have a source from India or it should be deemed to accrue to arise in India.

Section 9(1)(v) of the Act contains rules in relation to deeming of accrual or arising of interest income in India. Any interest is taxable in India, where borrower is a non-resident only if the same is utilized for a business or profession carried on by such person in India. Granting of loan by the UK entity to E Smart India may not be construed as carrying out business in India as the term business should denote continuing tendency. Hence, payment of interest by UK entity to a bank in UK will have not any consequences.

Whereas, when the E Smart India makes a payment to UK entity, the same would be deemed to accrue or arise in India by virtue of section 9(1)(v)(b) of the Act as the monies are utilized by E Smart India for a business in India. E Smart India would need to withhold tax at the rate 15% (gross rate under Article 12 of India UK DTAA; Indian rate being higher at 20% plus surcharge and cess) [it is presumed that provisions of section 194LC and 194LD of the Act are not applicable].

The capital subscription in E Smart India by UK entity would be subject to transfer pricing provisions. In recent case such as Shell and Cairn the Indian tax authorities have argued that subscription of share capital is an international transaction subject to transfer pricing and the same should correspond to arm's length pricing. However, reliance can be placed on decision in the case of Vodafone (b y Bombay High Court) wherein it has been held that capital subscription cannot be subject to transfer pricing as the same would not tantamount to 'income' in the hands of recipient currently, UK entity being non-resident. The Indian tax authorities have decided not to appeal this decision to the Supreme Court of India.

Answer to Part 4

The payment of access fees for automated software platform can be characterized as income only if it falls under section 9 of the Act. Section 9(1)(vii) of the Act coverers fees for technical services. The same is defined to mean services in connection with managerial, technical and consultancy services.

The Indian Courts have generally held that payment of fees for services which do not involved human intervention or involves minimum human intervention is not taxable under section 9(1)(vii) of the Act - Supreme Court in Bharti Airtel and Kolkata Income Tax Appellate Trinunal in Rights Florist case laws.

Hence, there will not be any India tax consequence of access fees. However, Indian tax authorities are likely to ligature this issue and hence it is advisable to move for an advance ruling in the present case.

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Answer-to-Question-5

Answer to Part 1

In the present case, GM (ie Gokul Mauritius) is held by GI an Indian company. In terms of section 6(3), post amendment, an overseas company is treated as resident in India is its place of effective management (POEM) is situated in India.

For the purpose of deciding POEM, firstly there has to be active business test satisfaction. According to this mode than 50% of income should not be from passive source and:

(a) less than 50% of the assets should be situated in India and
(b) less than 50% of total employees should be situated or be resident in India and
(c) payroll expenses incurred on such employees should be less than total of 50% of total payroll expenditure

In the current case, GM performs financial services worldwide and has a turnover of 50 million USD annually for last 5 years. Though first limb is satisfied (i.e. more than 50% income is not from passive source), 60% of GM employees are resident in India consuming nearly 60% of payroll expenses. Hence, the active business outside India test is not satisfied.

Accordingly, we should now look at persons who actually make the key management and commercial decision for conduct of company's business. It is said that GM's board of directors consists of 11 members, consisting of 4 nominees of GI, 1 employees - these 5 are residents in Mauritius, Mr Gokul (Indian resident), 5 CPAs from the USA. People outside Mauritius attend board meetings by way of video conferencing.

In current circumstances, since the company's Board regularly meets and males decision outside India, the POEM of GM would not be India and hence GM would not resident for India tax purposes.

Answer to Part 2

GI pays vortex, A UK resident company, for services relating to marketing of financial services on developing strategic commercial relationship with banks/ financial institutions in the UK. For this Vortex is paid commission.

The payment would be subject to withholding tax in India under section 195 of the Act only of the amount is taxable as income under the Act.

The payment of commission may not be treated as 'fees for technical services' as held by Delhi High Court in the case of Eon Financials. Further, the Supreme Court in Toshuko Ltd had held that commission payment to a non-resident for a business outside India is not taxable in India. Accordingly, a better view is that such amount may not be taxable in India in absence of a Permanent Establishment ("PE") in India.

However, it is likely that thew tax authorities will dispute this and try and tax as income from other sources even under the DTAA, owing to negative rulings in the case of Sanofi by AAR.

Answer to Part 3

Any payment not specifically covered takes the colour of the underlying transaction. Hence, the severance payment to Vortex may not be taxable as the same should be treated on par with commission payment.

Hence, the severance payment may not be taxable in India in absence of a PE.

Further, as mentioned earlier, it is likely that the tax authorities will dispute this and try and tax as income from other sources even under the DTAA.

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Answer-to-Question-6

Answer to Part 1

Based on the work carried out by the OECD under with the held of G20 nations for Action Plans on Base Erosion and Profit Shifting (BEPS), slew of measures have been identified to address treaty shopping issues, artificial avoidance of permanent establishment, etc.

As per Action Point 15, OECD has released multinational instrument (MIL) which would held amend tax treaties of various nations at one go as there are thousands of tax treaties which would have to otherwise individually amended by diplomatic means which would be a never ending task. MIL is an innovative way to amend tax treaties.

Under this approach, each country (both member and non-member countries of OECD) must ratify the MIL and deposit instrument of ratification with the OECD which would act as the custodian for MLIs.

Each country must submit to accept the minimum thresholds envisaged in BEPS package for this.

Accordingly, India should accept the minimum thresholds and deposit the instrument of ratification with OECD to amend its bilateral treaties using MLIs.

Answer to Part 2

As per the OECD guidance, Principal Purpose Test (PPT) is akin to a treaty-GAAR (general anti avoidance rules). Along with Limitation on Benefits clause (LOB), these would act as effective measures to stop enterprises from taking treaty benefits which should not be granted in cases of tax evasion and avoidance. These will stop enterprises from taking treaty benefits in non-deserving case.

The PPT and LOB test should ideally run in sync with any domestic any avoidance rules. The purpose of GAAR under Indian domestic tax law ot deny benefit of transactions where main purpose is a tax benefit and lacks commercial substance.

If PPT test is satisfied, ideally the anti abuse provisions =under the domestic tax law must not be applied. This would be based on good faith principle of interpreting treaties as per VCLT. However, the GAAR provisions have been introduced under a non-obstante clause under the Income tax Act and hence the same can still override the treaty provisions.