Answer-to-Question-_1_

Entities -
UK based Walnut PLC Mauritius based Mauritius Co and its wholly owned subsidiary Walnut India

1) Extent of Mauritius Co eligiblity -

As per provisions of Article 9 of DTAA b/w India - Mauritius, and section 92A of the income tax Act, 1961 ('the Act hereafter') , Mauritius CO is Associated Enterprise (AE) of Walnut Co. All transfer pricing provisions of the Act are applicable to the transactions between these teo entepises.

Section 195 of the Act requires for deduction of tax as per rates in force on payment of any sum of interest chargeable to tax under the Act as per rates in force.

Article 11 of the treaty pertaining to interest states that interest arising in a contracting state and paid to a resident of other contracting state may be taxed in other state , however contracting state may charge it up to 7.5% of gross amount if interest.

Thus taking benefit of the provisions of Article 11 of the DTAA, interest paid to Mauritius can be charged to tax in India only up to 7.5%.This rate is 15% in case of India - UK DTAA and thus lower.

However, if provisions of CHapter XA prtaining to General anti

avoidance rules (GAAR) as per section 95 of the Act can be invoked, which are applied over and above treaty benefits. These can classify this transaction to be an imperssible avoidance agreement on the basis of substance over form, on the basis of following -

- all decisions of Mauritius Co. are actually taken and first approved by Walnut Co. and then executed in Mauritius
- MAuritius co. actually has no employees etc.
- bank accounts are also operated remotely by Walnut Co.

If such a case is made by the income tax authorities, no treaty benefits will be available to Mauritius Co.

However, Mauritius company does have excess cash balance- it may be investigated how that came about.

2) Rate of withholding tax -

As per Indostar capital judgement given by Indian court, it falls upon Indian authorities to prove that the arrangement entered into is for the purposes of only tax avoidance and is a sham. If the same is not done, the assessee may not be denied a nil or lower deduction certificate if applied for.
As per section 195 of the Act, tax is to be withheld as per rates in force given in relevant Finance Bill for the year. (20% as of now)
As the rate is to be beneficial of the Act and treaty, the same should be withheld at 7.5%.

However, if it is proven that the arrangement is a sham transactions, provisions of GAAR wil override treaty and tax will

-

be deducted at20%.

3) Tax compliance obligations -

1. Information to be shared as per Form 10F prescribed in section 90(5) and Tax residency certificates u/s 90(4)
2. Proof of beneficial ownership of interest amount paid in terms of who controls the final ammount received in its application.
3. Compliance with provisions of Section 94B of the Act pertaining to thin capitalisation

4. Transfer pricing related compliance -
Form 3CEB to be filled, information to be timely provided,

5. Country by country reporting compliance as per provisions of Section 286 of the Act

6. For UK it also needs to prove that Walnut India is actually not its PE in any way to ensure no profit attribution happens in India

7. tax withholding -
at 7.5% for Mauritius
at 15% for UK

4) Tax treatment of interest paid -

In line with BEPS requriement, As per provisions of section 94B of the Act, known as thin capitalisation rules, any interest paid in excess of 30% of EBITDA to associated enterprises is to be disallowed as deduction claimed by the payer for purposes of the

Act. This is a specific anti abuse provision.

Year Ending 31.3.2025 -

EBITDA - 40 million

30% of EBITDA - 12 million

actual interest cost - 80 million

Excess to be disallowed - 68 million (80-12)

Amount of interest allowed as deduction - 12 million

Year ending 31.3.2026 -

EBITDA - 110 million

30% of EBITDA - 33 million

actual interest cost - 70 million

Excess to be disallowed - 37 million (70-33)

Amount of interest allowed as deduction - 33 million

This is a notwithstanding clause.

--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

HS plc -UK
LO - India

1) HS plc has PE in India?

- As per clause (iiia) in section 92F, permanent establishment is a fixed place of business from where an enterprise carries on business wholly or partly.
- Section 9(1)(i) of the Act expands on what constitutes business connection, as per Explanation 2 introduced vide Fin Act 2018 -
a. habitual exercise in India, of authority to conclude contracts on behalf og the NR or habitually concluding contract or playing principal role in conclusion
b. maintains stock of goods from which regularly delivers goods on behalf of NR, without the authority
c. habitually secures orders in India, mainly or wholly for NR.

- This section has been amended to align it with Article 5 on Permanent establishment of the DTAA between India UK so as to ensure assessee can not take benefit of lower threshold in either. As per Article5 a PE will not arise if actvities are of preparatory and auxilary nature.

Thus both now have anti-fragmentation requirement too to prevent

avoidance.

On the basis of these following types of PE may arise -
1. Fixed place PE - if company has a fixed place for its disposal in India for carrying out its core work
2. Agency PE - if the second entity in India acts completely and wholly on behalf of the UK company
3. Service PE - if UK company sends its employees through deputations or secondment and they are present in India for a certain amount of time.

As per Foreign Exchange Management, Rules 2000 on Liason offices, a company is allowed by Reserve Bank of India to have a Liason office to the extent that it aids the work of the main office through communication. No activities in the nature of sales, trades , investment etc. are to be effected by them.

In the Supreme Court of India judgement in case of GE India inc, it was seen that while GE India Inc. has only a liason office in india, the following activities were in fact effected through the office -
- Sales and conclusion of sales, conclusion of contracts and negotiation for same by the local LO
- Employees were deputed from head office to provide assistance with fixed terms in India etc.

In this case it was ruled that a PE arises in India as the Liason Office was doing more that the activitites as required by law.

In the case of Morgan Stanley judgement too, the Supremen Court held the subsidiary in India to be a service PE on account of its

employees being sent to India.

In our existing case a similar parralel might be drawn -
- Size of LO office has grown
- India country manager is developing and executing sales strateg in India, reporting on Indian trends etc.
- Sales and marketing employees are not just meeting existing and potential customers, activley overseeing preparation of RFP
- Resopnsing to RFP, preparing tenders and submissions etc.
- Employees in India are actually employees sent by UK company on deputation and appointment by their hand and then seconded to India
- the contract contains details of continued payments from UK, leave approval from UK signifying effective control from UK of employees
- Indian judgements now allow use of Linkedin as a proof of where the employee actually works which in this case in UK
- Expenses for LO were actually not incurred by themselves which means the transaction is not at arms length.

2) How to mitigate risks?
Following activities are permissible if done by the Liason Office as per combined reading of Article 5 and Explanation to section 9(1)(i) -
- using the office for storage or display of goods or merchandise belonging to UK company
- maintaining stock of goods or merchandise belonging to the enterprise solely for the purpose of storage and display
- maintaining stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise

- solely for purpose of purchasing goods or merchandise or collecting information
- solely for purpose of advertising, for supply of information or for scietific reasearch, being activitites solely preparatpry or auxiliary to main busienss

Thus, the following activities may be allowed to continue -
- promotion of products
- developing and expanding teams
- reporting on indian trends
- discovering and tracking opportunities
- assisting marketing initiatives
- maitaining high level of knowledge
- strong customer relationship management whole cycle

The following maybe reworked -
- Employees may be locally hired instead on being brought on deputation from UK co.
- These local hires should be as per contractual norms set up in India
- Employees FROM UK co. should take lead on deciding terms of sales agreement, details of RFP Proposal, development of sales strategy etc.
- Employees sent from UK should not stay beyond 182 days in India to prevent attraction of service PE creation.
- FInances of LO may be separately maintained and reporting under Form 49 to be strict.
- UK company to pay LO at arms length for all activities undertaken by it and LO to incur its own expenditure

3) compliances if PE arises in India?

- As per provisions of Article 7 of the DTAA, that amount of profit as arises from business activity in India will have to be offered to tax in India
- Provisions of Section 115JH of the income-tax Act will be complied with
- Compliance has to be ensured with provisions of transfer pricing and to ensure all activities with the UK company are at arms length as per Article 7 and section 92C of the Act.

--------------ANSWER-2-ABOVE---------------

--------------ANSWER-3-BELOW---------------

Part B

Answer-to-Question-_3_

1) POEM of Farma Dubai in India -

Article 4 of India-UAE treaty states that for other than individual , person being resident of both states, shall be deemed to be a resident of the state in which its place of effective management is situated.

As per section 90 of the Act, terms which are not defined in the treaty will have the same meaning as given in the law of the contracting states.

As per Explanatio to section 6(3) of the Act, POEM means a place where key management and commercial decision that are necessary for the conduct of business of an entity as a whole are, in substance made. This has been introduced vide Finance Act, 2016 and subsequently, CBDT Circulars no. 6,8 and 25 of 2017 to details what does and does not constitute POEM.

In this case, turnover of the company is more approximately Rs. 1 billion (10% of Rs. 10 billion), being more than Rs. 50 crores, as required for ascertainment of POEM, the following factors indicate that POEM of Pharma Dubai, a subsidiary of Indian co., is actually in India -

- Board of Directors of Pharma Dubai has set aside and delegated

all its powers to CEO

- This CEO is actually not the CEO of Pharma Dubai but of India, implying key managerial decisions, which are delegted to and taken by this CEO, are actually arising from India
- In terms of remuneration of the CEP and marketing head too one can see their relative importance for the enterprise.

Thus it can safely be concluded that POEM of Pharma DUbai is in India. It is a resident company for the purposes of section 6 and thus all its income that accrues or arises or deems to accrue or arise anywhere in the world, will be chargeable to tax in India. However, it may be noted that this exercise to check POEM is to be done on an annual basis.

ASSUMPTION - There is a standard DOuble taxation avoidance agreement between India and Kenya (As copy not provided)

POEM of Farma Kenya in India -

In this case, turnover of the company is more approximately Rs. 1.5 billion (15% of Rs. 10 billion), being more than Rs. 50 crores, as required for ascertainment of POEM.

From the Circulars issued by government of india it can be seen that even if for accounting purposes income of a company is included in India it doesn’t directly mean thats its POEM is in India.

Further, it can be seen that the key managerial and commercial decisions, other than day to day functioning of the co. , i s also taken by its Board which has more local persons to Indian persons in the ratio of 2:1.

It has also appointed key senior management personnel who are working in Kenya.

It can be concluded that Pharma Kenya does not have POEM in India.

2) Pharma Dubai has POEM in India -

a) Applicable rate is the rate in force for companies as given in Finance Bill read in conjunction with section 115JH of the Act which states that all other provisions of the Act pertaining to unabsorbed depreciation etc. shall apply to it.

As per Para E of First Schedule to Finance Bill 2024, in case of domestic company where gross receipt in PY is more than 400 crore (4 billion), rate of 30% will be applied.

Yes, as per provisions of Article 25 (2) of the DTAA read with section 90 of the Act, the company will be eligible for relief in India.

b) Section 195 of the Act requires that tax be deducted at rates in force by a resident on payment of any sum chargeable to tax under the provisions of this Act.
While by UAE Dubai becoming an India resident company under section 6 on account of its place of effective management being here, it is not necessary that -
- the payments it makes in home country are in the nature of income for other party
- or are chargeable to tax in India as per provisions of Indian

income-tax Act.

Thus UAE Dubai will need to comply with provisions of S.195 only if it is making a payment of sum in the nature of income to an entity which in non-resident for India but has certain income that is accruing or arising in India or deeming to accrue or arise in India as per section 5 of the Act and thus this income is chargeable to tax in India for this NR.

c) Business losses of an Indian resident company (not being losses in the nature of speculation business) are allowed to be carried forward as pr provisions of section 72(3) for a period of eight assessment years immediately succeeding the assessment year for which the loss was first computed.
Thus FY 2023-24 is AY 2024-25.
Eight AYs up to which same is allowed is - till AY32-33 or FY 31-32.

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Part C

Answer-to-Question-_7_

Cross Shipping PTE (Singaporean)

As per Article 8 of DTAA between India and Singapore gives taxing right on profits derived by an enterprise of Singapore from operation of ships in international traffic to be taxable only in Singapore.

As per Article 44B(1) of Income tax Act, an assessee being a NR, engaged in business of operation of ships, will pay a sum of 7.5% of aggregate specified amounts as profit from gains of business and profession.

this specified amount is defined in 44B(2)as amount paid or payable whether in India or out of India on account of carriage of passengers, livestock, mail or goods shipped at any port in India etc.

Sub-rule 1 of Article 24 on limitation of relief in the DTAA states that if the income is taxable in Singapore on the amount remitted or received, and not the full amount, the deduction shall apply to amount so remitted and not the total.

1) Cross SG is liable to tax only its international shipping income in Singapore i.e. the income earned from shipping of

outbound and inbound routes and NOT domestic routes. Cross SG is not liable to pay tax on this Income from international shipping in India as all rights in article 8 are with the resident country.

Income from domestic routes has accrued or arisen in India as per section 9(1)(i) to this non resident company and same may be offered to tax as per provisions of section 44B of the Act above. This is because income is accruing or arising, whether directly or indirectly, from an ASSET and SOURCE if income in India.

2) No, view taken by the AO is not sustainable as Article 24 of the DTAA also states that relief of tax paid has to be limited to the amount remitted only in the case where income is taxable in Singapore on amount remitted or received and not accrued i.e on receipt basis.

In such a scenario, as the Singapore IRS has stated that such income is chargeable to tax on accrual basis and not receipt basis - taking the more beneficial interpretation between treaty and law - it can be concluded that AO’s view is incorrect.

However, the AO can choose to invoke provisions of Chapter XA ie. GAAR to show that the whole arrangement is a sham transaction entered into only with main purpose of tax avoidance as -
- the benefical owner of the amount earned is not based out of Singapore
- if on investigaation it is found that no tax is being paid in Singapore on shipping income then it is clearly a tax avoidance arrangement which is impermissible as per section 95 of the Act.

Here the AO can apply substance over form to deny treaty benefit to cross SG.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

1) As per provisions of section 92(2) any income arising from any international transaction between associated enterprised shall be computed having regard to the arms length price.

As per 92A(2), these companies SG and MY being wholly owned subsidiaries of ESG India, a re associated enterprises of ESG India.

Explanation to 92(1) states that it is clarified that allowance for any expense or interst arising from an international transaction shall also be determined to be at arms length.

Further, Explanation to sub-section (2) of 92B clarifies that international transaction shall include capital financing, including any type of long term short term borrowing, lending or guarantee, purchase or sale og marketable securities or any type of advance, paymnts or deferred payment or receivable or ANY OTHER debt arising during the course of business.

In light of such wide ambit definition of capital financing, short term working capital advance given is covered as international transaction as is the interest on such advances and AO is correct in this regard.

This is a benefit extended to the AE.

TPO can be justified in making such adjustment only after a complete FAR and comparability analysis is done to understand -
A. If more functions are being performed by SG and MY and more risk is being taken by them, the terms of the credit cycle are more likely to favor them
B. What is the comparable credit cycle in the industry with other

If after making working capital adjustment with industry comparables, as proposed by OECD TPG, and making other adjustments to ensure there are no material differences between the comparables, it is found that the claim of assessee that net profit margins from export transactions is higher than its comparables, then no adjustment should be made.

Due care should be taken to select own comparables, remove loss making ones etc. to conclude the analysis.

2)The share capital injected into ESG MY and ESG SG is in the nature of only share capital and not non-convertible preference shares or equity which has conditions ttached.

Then to see if the same is in the nature of international transaction as per section 92B which states that such transaction has to be in nature of purchase, sale or lease of tangible or intabgible property or provision of services or lending or borrowing money or any thing implicating profits, income, losses or assets of such enterprises.

However, as share capital on a consolidated basis is not

affecting assets of the ESG india, which the SG and MY being its wholly owned subsidiaries, the same is not an international transaction and thus need not be reported.

When there is a violation in reporting by assessee of its international transactions in Form 3CEB, penalty under section 271G of the Act, of 2% of transaction value is levied.

3) Interest transaction -
ESG India to MY - benchmark plus 300 bp
Bank overdraft rate - 13%

The borrowing of ESG Indiafrom Indian bank for working capital is not comparable to the transaction of borrowing by MY from ESG.

This is because the nature of work is materially different betweent the two companies and resultant credit risks are different and ability to pay is also different.

True comparables would be -
- Other Working capital loans taken from ESG MY - External CUP method
- Other working capital loans advanced by ESG India - External CUP method

4) Transactions -
ESG India to Indian clients - X%
ESG India to SG - X+20%
ESG India to MY - X+10%

Yes, an internal Comparable under the CUP method is most reliable

as it accounts for risks of the company as against external transactions and ensure maximum material similiarity.

As nature of functions performed by ESG MY and ESG SG are similar and risks associated with both are similar, they should be treated as comparable to one another.