Answer-to-Question-_1_

Part 1

India tax consequences of proposed transaction of sale of LCV devision to another group Company

Transaction involves sale of equity shares of I Co. 1 in India to I Co. 2 in India

Legal provisions

In India, in terms of Section 6 of the Income Tax Act, 1961 (hereinafter referred as ITA), in respect of Non resident entity, income deemed to accrue or arise in India is taxable in India.In terms of **Section 9(1)(i)** of the ITA, all income accruing or arising whether directly or indirectly, through or from any business connection in India or thorugh or from any property in India or through or from any asset or source of income in India or through the transfer of capital asset situated in India shall be deemed to accrue or arise in India. Further capital asset si defined under ITA as including any rights in an Indian Company including rights of management and control. **Explanation 5 to Section 9** provides **territorial nexus** (as affirmed by Supreme COurt in the case of **GVK Industries v Union of India)** to the taxation of such capital gain by providing that capital asset shall be deemed to be located in India if the share derives directly or indirectly its avlue substantially from the assets located in India. Further as per Explanation 6(a) to Section 9(1)(i) of the ITA, shares are deemed to arrive its value substantially from the assets located in India if on specified date the value of such assets excess INR 10 crores and represent atleast 50% of the value of assets owned by the Company.

F Co. is an entity registered in laws of Singapore. Thus, it is a non resident entity. I Co. 1 is a wholly owned subsidiary of F Co. thus, all shares of I Co 1 are owned by F Co. Further small shareholder exemption provided vide Explanation 7 to Section 9(1)(i) of the ITA will not be available in this case. THus, in present case, as per provision sof Indian ITA, capital gain arising in hands of F Co. on acount of transfer of shares of I Co. 1 to I Co. 2 can be subject to tax in India.

Part 2

F Co. can claim benefit of DTAA. In terms of Section 90(2) of the ITA, the provisions of ITA shall apply to the extent they are more beneficial to that assessee (i.e. F Co.). In terms of Article 13 (4A) of the India - Singapore DTAA, gains from alienation of shares acquired before 1 April 2017 in a Company which is resident of contracting state shall be taxable only in the Contracting state in which the alienator is the resident. However, this benefit is subject to the provisions of GAAR as incorporated in the ITA pursuant to BEPS Action Point 6. Section 90 (2A) of the ITA provides that provisions of GAAR supersede the above provision of Section 90(2) of the ITA.

Part 3

Article 24A categorically restricts the benefit under Article 13(4A) if the affairs were arranged with the primary purpose to take advantage of the benefits.

The India Singapore DTAA was amended in 2016 protocol to allow taxation of capital gains by source country. However, this is applicable for shares acquired on or after 1 APril 2017. India and Singapore are both signatory to Multilateral Insitrument (MLI) to implemenet BEPS Action Plant 6. THus treaty benefit is subject to Principal Purpose Test (PPT) that has two parts :

a. resonable to conlude test
b. Objective and purpose test.

Also, as per provisions of Section 96 and 97 of the ITA, impermissible avoidance agreements means the agreement where the main purpose is to obtain treaty benefit and creates:

a. rights and obligations not otherwise created at arms length transactions;
b. lacks commercial substance;
c. results in misuse of provisions of law;
d. is entired into by means or in manner which are not ordinarily applied in bonafide cases.

Thus, Indian tax authroties may invoke GAAR.

BEPS Action PLan 6 categorically states that where arrangement is linked to core commercial activity and its form is not driven by consideration of obtaianing tax treaty benefit, it is unlikely to trigger PPT.

IN the present case, if F Co. is able to substantiate that sale of shares is not for obtaianing tax treaty benefit, which is evident from below observations:

a. Sale price is supported by independent valuer report;
b. annual expenditure on the opertaions in Singapore ahs exceeded $200,000 each year for 24 months preceding the sale of shares.

Thus, it is possible to argue that PPT may not be applied and benefit of India - Singapore DTAA will be available.

Part 4

Fo Co. can explore the below options:

1. to approach Income Tax Department under Section 195(2), Section 195(3) or under Section 197 requesting lower witholding tax certificate.

2. Filing advance ruling before Board of advance ruling in terms of Section 245 N - 245 V of the ITA.

Answer-to-Question-2

Part 1

In terms of Article 5 of the India UK DTAA, Permanent Establishment can be created either through any of these:

1. Fixed Place PE : THere should be place of buisness (office, branch, factory workshop etc.) with some degree of permanency through which the business of enterprise is carried on. To qualify as Fixed Place PE, there should be:
a. active business conducted through fixed place in India by S Co. ;
b. Disposal test where S CO. should have legal right over business premise in India.

In the present case, S CO. does not have any fixed place of buisness in India, thus no risk of PE on above grounds. Also, services which are preparatory and auxillairy in nature are excluded from PE. Thus, if activities of S Co. will qalify as preparatory or auxiliary the same would not qualify as PE.

The above position is also supported by teh Supreme Court ruling in the case of **DIT (Intl tax) vs. Samsung Heavy Industries**. The SC in this case relied on the following principles:

a. Profits of foreign establishment are taxable only when it carries on its "core business" in India.

b. Fixed place of business which is of preparatory or auxiliary character in the trade of business of the enterprise is not PE under Article 5.

In coming to these conclusions, SC relied on earlier decisions of **Hyundai HEavy Industries Ltd (2007 case), Morgan Stanley and Co (2007 case), IShikawajma Harima Heavy Industries**.

Service PE

In terms of Article 5 (2)(k) of India - UK DTAA , furnishing of services including managerial serives consitute PE except if such services are covered under Article 13 royalty and fee for technical services. In the present case, employees of S. Co. will travel to India for quality control, productiona nd procurement teams. This does not qualify as managerial activities. In terms of Article 13(4) of the India UK DTAA, fee for technical services means payment of any kind to any person which make available technical knowledge, experince, skill know how or processes. In the present case, personnelf or quality, production will make available their technical skills and transfer their technical know how. Thus, such services more likely to qualify as fee for technical services and be covered under Article 13.

However, there is liklihood that Indian tax authorities will argue such services as managerial services and seek to tax profit attributable to S Co. in India on account of service PE in India.

Agency PE provisions not relevant in present case.

Part 2

Buisness of L Co depends on the know how transferred by S Co. Thus, in trems if Section 92A of the ITA and thus transfer pricing provisions to determine arms length price will be applicable.

If transaction is between S CO and I Co. and more than 90% of raw material is supplied by S Co to I Co. , the same would qualifya s Associated enterprise under Section 92A and transfer pricing provisions will apply to determine the arms length price.

Part 3

TP method : Transaction Net Margin Method which relies on net margins.

Answer-to-Question-__5_

Part 1

Pursuant to BEPS Action Point 6, Indian Government has introduced GAAR provisions. GAAR provisions (Chapter XA of ITA) can be invoked if:

a. specific tax benefit arising to all parties in arrangement is exceeding INR 3 crores.
b. provisions are applicable for AY 2018-19 and onwards

In terms of Section 90(2A) of ITA, GAAR overrides the beneficial provisions of DTAA. GAAR overrides the provisions of ITA.

IN terms of Section 96 and 97 of the ITA, GAAR can be invoked if arrangement is impermissible avoidance arrangement or an arangement that lacks commercial substance. An arrangement is an impermissble avoidance arrangement if it satisfies the below twin conditions:

1. Primary condition : Main purpose is to obtain tax benefit;
2. Tainted element presence test
    Test 1 : creates rights or obligations which are not ordinarily created between persons dealing at arms length;

Test 2: results, directly or indirectly in the misuse or abuse of the provisions of ITA;

Test 3 : Lacks commercial substance or deemed to lack commercial substance;

Test 4 : is entered into or carried out by means or in a manner which are not ordinarily employed for bonafide purposes.

Thus an arrangement is impermissible avoidance arrangement if it satisfies the primary condition and one of the tainted elemnt test.

In the present case, the allocation of price to different parts of the contract is decided in such a manner as to reduce tax liability. This will be considered as impermissble avoidance arrangement as it satisfies primary condition and test 1 referred above.

Consequences of invoking GAAR

GAAR may be invoked in this cae and prices will be reallocated to different parts of contract to avoid under and over valuation.

As a process prescribed under Section 144BA, AO will make reference to CIT regarding the arrangement. CIT will form an opinion to invoke GAAR. if objections filed by assessee, and CIT is not satisfied with the response, CIT will refer the case to Approving Panel. Approving panel rpovides opportunity of hearing to assessee and issues instructions to AO. These directions are binding on assessee, AO and CIT. No appeal shall lie against sich directions. However, appeal can be filed before ITAT against order of AO.

Part 2

Theoretical scenario in which GAAR provisions cannot be invoked:

1. If F Co. and I Co. are related parties (associated enterpises) in terms of Section 92A of the ITA, then GAAR cannot be invoked as specific transfer pricing regulations will apply.

2. In case aggregate tax benefit is less than INR 3 crores.

Part 3

Specific Anti avoidance Rules (SAAR) relate to aprticular area of tax law. These were set up to address specific concern, known arrangemnets of tax avoidance like transfer pricing provisions contained in Section 92 of ITA, Section 40A(2), Section 64, Section 93 etc. they relate to particular area of tax law.

By virtue of Section 100 read with non -obstante clause (with which Section 95 begines) GAAR overrides SAAR. In circular 7 of 2017 dated 27 Jan 2017, Central Board of Direct Tax (CBDT) clarifies that both GAAR and SAAR can co-exist as may be necessary in facts and circumstances of the case. It is internationally accepted that SAAR may not address all situation of abuse and there is need for GAAR in domestic legislation.

Answer-to-Question-6

Part 1

In terms fo Article 1 of the India US DTAA, DTAA is applicable to residents of one or both the Contracting States.

In the present scenario, M is resident of both India and UNited States. Thus, tie - breaker rule as provided in Article 4(2) of the India - US DTAA is to be followed.

Criteria a. permanent home

As per Article 4,if a person is resident of both the states, then he is considered as resident of state in which he has permanent home. M owns a accomodation in US thus he has permanent home in US. ALso, he is staying in company provided accomodation in India as he is in Indai since last 3 years, thus he has permanent home in India as well.

Personal and economic relations

Article 4 of India US DTAA further provides that if resident ahs permanent home in both the states, then he is considered as residnet of contracting state in which he has Personal and economic relations closer. In US, parents and spouse of M are residing. He also visits US twice a year. His children are studying in US. He has immovable property in US. His employment is with F CO US as his social secutiry benefits are still provided in US. Thus, his economic and personal relations are closer in US. Thus, he will be considered as resident of US for India US DTAA.

Mutual agreement procedure

Lastly, if there is still dispute regarding residency, India and US can settle the same through MUtual AGreement Procedure.

Answer-to-Question-4

PArt 1

X Inc of UK is selling software and related hardware to A Ltd in India. In terms of Section 6 read with Section 9(1)(vi) of the ITA, income shall be deeemd to accrue or arise in India if income is by way of royalty payable by person who is a resident (A ltd in this case), where the royalty is payable in respect of any rights, property or information used or services utilised or the purpose of business or profession carried on by such person in India.

In the present case, A Ltd is paying royalty for earning buisness income.

Further royalty (as amended vide Finance ACt 2020) is defined to include "consideration received for the transfer of all or any rights in respect of copyright ....." Further,Explanation 4 to Section 9 clarifies that payment received from transfer of all or any right to use software including granting of license for computer software is royalty.

However, the meaning of royalty assigned in DTAA is is different from what is assigned in Income tax Act. Thus, in view of Supreme Court decision n case **of Engineering Analysis Centre of Excellence P Ltd, there is difference in transfer of copyright**

and copyrighted article. If there is no transfer of copyright and only copyrighted article is given, there is no royalty. In terms of India UK DTAA, benfit of above decision will be available as royalty definition is similar to what is captured and discussed from DTAA perspective in this decision.

Also, in present case, if it is established that software is embedded in hardware, then reliance can be placed on Delhi High COurt decision in the case of **CIT vs ALcatel Lucent Canada (Del) wherein HC observed that where payment is made for hardware in which software is embedded and software does not have independent functional existence, no amount can be attributed to royalty.**

In view of above as there is no income chargeable to tax, there is no requirement of witholding of taxes under Section 195 of the ITA.

Part 2

Yes, A Ltd can deduct witholding tax under Section 195 @ 10% as given in Section 115A of Incoem Tax ACt and can claim refund of TDS. Procedure of refund is clarified by CBDT in Circular No. 790 dated 20 April 2000. Amount can be refunded with prior approval of Chief COmmissioner of Income Tax or Director General of Income Tax concerned to A Ltd. No interest under Section 244A of ITA will be payable on such refund.

Part 3

Provisions in Income Tax ACt

As per Section 6, income accruing or deeemd to accrue in India is taxable for non -resident. Section 9(1)(i) specifies that incoem accruing through buisness connection in India is deeemd to accrue or arise in India. Explanation 2 to Section 9(1)(i) clarifies the term business connection as any business activity carried out through person who acting on behalf of non resident:

a. has habitually exercises in India an authority to conclude contract or habitually plays principal role leading to conclusion of contract or;

b. has no authority but habitually maintains in India a stock of goods from where delib=vers on behalf of non resident;

c. haitually secures orders in India.

In view of above, activities of X Inc. could qualify as business connection in ITA.

Provisions of INdia UK DTAA

Article 5(4) as modified vide MLI, also stipulates that agent can create PE in India of X Inc provided he is not independent agent acting in course of buisness. In this case, while A ltd is securing order, negotiating prices basis price list, maintaining stock of goods however, he is not the sole agent of X Inc. He is working for others as well. Thus, he is independent agent.

Here a view is possible that PE will not arise in view of DTAA provisions (applicable as more beneficial to assessee in view of Section 90(2) of ITA).

Part 4

If PE exists, yes in terms of Article 7, profit is to be attributed and same needs to be at arms length. Authorised OECD approacha nd 2010 Report on Attribution of profits specifcally provide for this.