THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2022

MODULE 2.05 – INDIA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

Given the facts in the case study, the capital gains arising in the hands of F Co. from the sale of the mutual funds are taxable in France as per Article 14(6) of the India-France Double Taxation Avoidance Agreement ("DTAA" or "DTT"), as France is the "residence" state of F Co. at the time of derivation of the gain.

F Co. is entitled to India-France DTT benefits by being a resident of France. Article 4(1) read along with Article 1 of the DTT extends treaty benefits to "…any person who, under the laws of that contracting state, is liable to tax therein by reason of his domicile, residence, place of management or any criterion of a similar nature."

The term 'liable to tax' is an undefined treaty term. Article 3(2) of the DTT provides that any term not defined under the DTT shall be accorded the meaning given under the domestic tax law of the Contracting States.

Section 2(29A) of the India Income-tax Act, 1961 ("IT Act" or "the Act" or "ITA")), inserted by Finance Act, 2021, defines the term 'liable to tax' consequent to which India can deny the treaty entitlement if no income-tax liability has been imposed upon F Co. in France. However, if a person is not subject to income tax because of any exemption pursuant to the imposition of liability, then the treaty benefit cannot be denied.

In other words, there has to be a liability of income tax in France which may or may not lead to the payment of tax due to an exemption in France.

Part 2

If at least one of the principal purposes of the arrangement (i.e., redomiciling to France) is to obtain the benefit of the treaty between India and France, the Principal Purpose Test (PPT) will get triggered.

The PPT test consists of two elements – the subjective element which is 'one of the principal purposes' for entering into the transaction/arrangement was to obtain a tax benefit, and the objective element which is 'granting that benefit is in accordance with the object and purpose of the relevant provisions' of a tax treaty.

The taxpayer cannot avoid the application of PPT by stating that the 'arrangement or transaction was not undertaken or arranged to obtain the benefits of the Convention'. Likewise, the tax authorities cannot uphold the application of this by comparing the actual transaction with an alternative transaction that might have resulted in higher taxes.

The various purposes for the arrangement/ transaction have to be weighed to reach a decision. The commentary to the PPT clarifies that the subjective element is not applicable when a principal consideration is not to obtain a treaty benefit. If the subjective element is satisfied, the taxpayer has to prove that 'granting that benefit is in accordance with the object and purpose of the relevant provisions' of a tax treaty.'

In this regard a useful reference may be made to the decision of Supreme Court of Canada in the case of Alta Energy Luxembourg S.A.R.L. (2021 SCC 49.) It opined that to determine whether a transaction is abusive, a two-step inquiry is required. Under the first step, the provisions relied on for the tax benefit are interpreted to determine their object, spirit, and purpose. In cases of treaty interpretation, this must be done with a view to implementing the true intention of the parties. Under the second step, a factual analysis determines whether the avoidance transaction at issue frustrates the object, spirit, and purpose of the provisions.

The subjective test of the PPT has to be seen as protecting the taxpayer acting in good faith, but also as a proxy for testing violation of object and purpose. If a particular structure is motivated by tax avoidance, that structure would be at odds with reality and, accordingly, would violate the object and purpose of the tax treaty (or of the relevant provisions thereof), unless the taxpayer could meet the burden of proof regarding the object and purpose.
In this case, the principal purpose can be ascertained by undertaking a detailed analysis of the facts and surrounding circumstances, such as:

- Board minutes of F Co. outlining the objectives/reasons for redomiciling;
- Advice from tax/legal professionals involved in advising the clients and correspondence by the client with the professionals;
- Whether F Co. is actually carrying on the wine business in France since redomiciling (the primary non-tax reason given above for redomiciling) and whether it has taken genuine steps to grow its business as compared to that in the UK, in line with the 'business strategy' referred in the above factual matrix;
- Whether it is carrying on a business (and to what extent) after the sale of mutual funds in March, say for 1-2 years after the sale of mutual funds;
- The proportion of assets held by F Co. in the form of mutual funds vis-à-vis other assets;
- It may be noted that the time gap between the change of domicile (July) and sale of mutual funds (next year in March) is also an important factor for consideration, especially since mutual funds can be liquidated easily and if tax benefit on sale was the only objective, the sale may have been undertaken earlier.

<u>Part 3</u>

The Preamble to India-France DTT, inserted as a result of Article 6 MLI, observes that the tax treaty intends to eliminate double taxation "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance …".

Clearly, the instant case is not tax evasion. The "tax avoidance" aspect of this structure can only refer to the change of residence of F Co. from UK to France. It is this, alone, that creates the opportunity for non-taxation of the gain. While this arrangement on its face could be seen as treaty shopping (without commercial reasons as discussed under Part 2), the sentence in the brackets "(including through treaty shopping arrangements …)" does not apply because it refers to "the indirect benefit of residents of third jurisdictions".

While F Co. was previously a resident of a third jurisdiction (UK), they are no longer such a resident, and the facts demonstrate that the move of F Co. from UK to France was not tax-motivated in all the facts and circumstances.

The preamble is not a binding Article of the DTT, but simply an indication of the contracting states' intentions (as expressed by adopting the MLI.) It provides assistance as to how to interpret other Articles, including the new PPT, but is not a binding provision itself.

<u>Part 4</u>

Article 25(2) of the DTT stipulates that competent authorities have an obligation to endeavour to resolve MAP cases with a view to avoid taxation not in accordance with the provisions of the convention. This requires competent authorities to seek to resolve the case in a fair and objective manner, on its merits, in accordance with the terms of the convention and applicable principles of international law on the interpretation of treaties.

Although Article 25(2) does not place a duty on competent authorities to achieve a result in a MAP case, it no doubt entails a duty to negotiate. Once the competent authority receives a MAP request, it is under an obligation to consider whether the objection is justified and, if it appears to be justified, take action on it in one of the two forms provided for in paragraph 2, i.e., by providing unilateral relief or by initiating the bilateral stage of MAP.

The effectiveness of MAP in dealing with situations of double non-taxation scenarios depends on the specific facts and circumstances of the case and the provisions of the applicable treaty read with the provisions of MLI. Under Mutual Agreement Procedure, it is possible for competent authorities of both countries to take a consensus decision on the issue of double non-taxation.

Both the competent authorities may agree in this case based on the facts and circumstances that the decision to migrate/redomicile in France by F Co. was driven or not driven by tax consideration taking into account the relevant factors based on which PPT was evoked.

Question 2

Part 1

As per the provisions of section 90(2) of the ITA, any assessee having access to a tax treaty entered into by India with other countries shall be subject to the provisions of the ITA to the extent they are more beneficial. Thus, while evaluating the tax liability of a taxpayer who a resident of a country with whom India has a tax treaty, one needs to apply the provisions of the ITA or the tax treaty, whichever are more beneficial to the non-resident taxpayer. To access tax treaty, the assessee must obtain a Tax Residency Certificate (TRC) and also furnish Form 10F if all details as required are not available in the TRC.

Further, the benefit of lower tax rate under Dividends article is applicable only to a "beneficial owner". The concept of "beneficial owner" plays a crucial role in determining whether a recipient of income qualifies for certain treaty benefits. This concept is quite significant from the perspective of international taxation as most of the tax treaties adopt the concept or condition of beneficial ownership for granting concessional treatment to resident of another country - in particular, when it comes to Articles dealing with interest, dividend, and royalties.

The DTA or the ITA does not provide a specific definition of 'beneficial owner' or 'beneficial ownership' and in absence of specific definition, the term should be given an autonomous meaning basis domestic and international judicial precedents, legal dictionary meanings, Model Commentaries and basis the concept explained by eminent jurists. Candidates are expected to discuss on "beneficial owner" in detail including the meaning provided under OECD Model Commentary. ABC S.A. must satisfy that it is a beneficial owner of dividends.

India and France are signatory to MLI and India-France DTAA is a Covered Tax Agreement for the purposes of MLI. MLI has brought in a key test for denial of tax treaty benefit, viz. Principal Purpose Test ("PPT"). The PPT denies treaty benefits when, having regard to all relevant facts and circumstances, obtaining that benefit is one of the principal purposes for entering into a specific transaction or arrangement that resulted directly or indirectly in that benefit, unless if granting that benefit is not contrary to the object and purpose of the relevant provisions of the Covered Tax Agreement. Candidates may discuss Articles 6, 7, and Preamble of the MLI in this regard.

In the current set of facts, India-France DTAA provides for a reduced tax rate of 10%, which is inturn reduced to 5% by applying India-Columbia/ India-Slovenia/ India-Lithuania tax treaties. Hence, ABC S.A. would need to satisfy that obtaining tax benefit is not one of the principal purposes for investments being routed from France into Indian entity. One may also argue granting lower tax rate to dividend is not contrary to the object and purpose of the relevant provisions of the Covered Tax Agreement.

Part 2

India reintroduced the classical system of taxation of dividend income vide Finance Act, 2020 wherein dividends are now taxable in the hands of the shareholders. Erstwhile, dividends were taxed in the hands of the distributing company and the Indian company was liable to pay Dividend Distribution Tax on such dividends distributed to shareholders.

Tax withholding is required under section 195 of the Act when payment is to a non-resident/ foreign company. For applicability of section 195 of the Act, for withholding tax purposes, there should be an income chargeable in the hands of the recipient non-resident. The dividend income is now an income chargeable in the hands of the recipient as per section 9(1)(iv) of the Act.

As per Section 115A of the Act, dividend declared, distributed or paid by an Indian company to a non-resident company is taxable in India at the rate of 20% plus applicable surcharge and education cess.

As per the provisions of section 90(2) of the ITA, any assessee having access to a tax treaty entered into by India with other countries shall be subject to the provisions of the ITA to the extent they are more beneficial. Thus, while evaluating the tax liability of a taxpayer who a resident of a country with whom India has a tax treaty, one needs to apply the provisions of the ITA or the tax treaty, whichever are more beneficial to the non-resident taxpayer. To access tax treaty, the assessee must obtain a Tax Residency Certificate (TRC) and also furnish Form 10F if all details as required are not available in the TRC.

Since ABC S.A. is a resident of France, ABC India would need to analyze applicability of India France DTAA (assuming TRC and Form 10F are made available). ABC India would also need to study applicability of India France DTAA in light of “beneficial owner” condition and “PPT under MLI”.

Under Article 11 of India France DTAA, the rate of tax on dividends is 10%. Further, India France has entered into a Most Favoured Nation (MFN) clause by way of Protocol to the DTAA according to which if under any Convention, Agreement or Protocol signed after 1 September 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends and certain other payments, to a rate lower or a scope more restricted than the rate of scope provided for in the DTAA, the reduced rate or scope on the said items of income will also apply under the DTAA.

The applicability of MFN has been of vide debate and there have been various jucidial precedents such as Concentrix Services Netherlands B.V. vs. Income Tax Officer (TDS) [(2021) 127 taxmann.com 43 (Delhi)], Apollo Tyres Ltd. vs. CIT [(2018) 92 taxmann.com 166 (Karnataka HC)], Nestle SA (W.P.(C) 3243/ 2021 dt 4 June 2021), etc. which have largely held the following:

- The protocol forms an integral part of the DTAA. Therefore, no separate notification is required for application of the protocol.

- The Courts noted that construct of the protocol is such that in certain cases there could be difference between the dates on which the DTAA is executed between India and the third country and the date when such third country becomes a member of OECD. In such case, the limit on the lower rate of tax or the scope more restricted contained in the DTAA with the third country can apply when the third country becomes a member of the OECD.

- While interpreting international treaties including DTAAs the rules of interpretation that apply to domestic or municipal law need not be applied, for the reason, that international treaties, conventions and tax treaties are negotiated by diplomats and not necessarily by people instructed in the law.

- Various countries (apart from India) have already adopted this favourable position.

However, recently, the Indian Central Board of Direct Taxes (CBDT) recently issued Circular No 3/2022 which attempts to clarify India’s official position on non-applicability of MFN clause under India France DTAA on various arguments including that benefit of MFN is not automatic but must be provided by way of notification, the country whose benefit is being granted should be a member of OECD at the time of entering the DTAA, etc.

While CBDT has clarified its position, various interpretations highlighted are in divergence with the rulings by various High Courts in India. It is accepted principle of law that circulars are binding on tax authorities but not on assessees.

Accordingly, where all other conditions are satisfied, ABC India may adopt lower rate of 5%.

<u>Part 3</u>

Various options available to ABC S.A. include:

- ABC S.A. to approach the Income Tax Department under section 197 of the ITA requesting lower TDS rate of 5% on dividend income to be received from ABC India.

- To file an advance ruling before Board for Advance Ruling (earlier Authority for advance ruling).

Part 4

ABC S.A. has earned income from India for which it would need to file tax return in India under section 139 of the Act. Accordingly, ABC S.A. would need to obtain PAN and file tax return in India. Candidates can discuss provisions of section 139A of the Act.

Additionally, benefit of section 115A(5) of the Act is not applicable as the tax withholding rate is likely to be lower than the rate referred to in section 115A of the Act as ABC S.A. will be taking benefits of DTAA.

PART B

Question 3

Part 1

At the outset, there is no doubt that sums paid by I Co. to G Co. are covered under the definition of 'royalty', both under the provisions of the IT Act as well as the DTA.

The provisions dealing with chargeability-to-tax of income in the nature of 'royalty' are embodied under clause (vi) of sub-section (1) of Section 9 of the IT Act.

As per specific deeming provisions of sub-clause (b) posited under the aforesaid clause, income in the nature of royalty is liable to tax in India if the payer-entity is resident of India. In other words, royalties paid by I Co. to G Co. for use of a licensed trademark shall be deemed to arise, and on that premise, be chargeable-to-tax in India under provisions of Section 9(1)(vi)(b) of the IT Act, read together with fundamental charging provisions of Section 5 of the IT Act.

Having said that, the later limb of sub-clause (b) to Section 9(1)(vi) carves out an exception to the basic rule. It excludes from the scope-of-taxation any royalties paid by a person resident in India, provided:

(*A*) Such royalties relate to a business or profession carried on by the resident-entity outside India, or

(*B*) Such royalties are paid by the resident entity for purposes of making or earning income from sources outside India

In the facts of the instant case, the entire chain-of-activity pertaining to sale-purchase of goods is undertaken outside India. Viewed from that perspective, the gamut of trading activity per se constitutes a comprehensive stream of business operations that takes place outside India.

Accordingly, a view may be adopted that royalties paid by I Co. to G Co. are covered by the exclusion referred to under (*A*) above.

However, the tax authorities may challenge the aforesaid view on the basis that the condition with regard to 'business being carried on outside India' gets fulfilled when the taxpayer is perceived to be maintaining some kind of an office, establishment or anchored presence on a foreign soil from where day-to-day business activities are conducted in a routine fashion. The tax authorities may argue that the aforesaid condition presupposes some kind of formal presence of the resident-taxpayer in a foreign territory that is engaged in carrying out all the vital functions necessary to give it the character of an enterprise. In other words, the tax authorities may say that the words "carried on" includes within its womb primordial ability of being able to conduct, handle and manage day-to-day business affairs with a reasonable degree of independence.

Accordingly, in the eyes of the opposing view, the words "carried on" indicate that the business activities must exist in form of a self-propelling enterprise largely taking care of its own needs and busy catering to routine entrepreneurial callings. However, in the facts of our case, handling of the day-to-day affairs, as well as management/ control of the buy-sell transactions rests entirely within India. In that sense, I Co. does not have a business presence or footprint outside India.

Accordingly, the tax authorities may take a position that the royalties paid by I Co. to G Co. do NOT relate to what may be viewed as "business carried on outside India", as understood in common parlance, and accordingly, such royalties may be denied the benefit of exemption referred to under (*A*) above.

The next step is to examine the applicability of the exclusionary provisions referred to under (*B*) above to the facts of the instant case. We have been given to understand that the licensed trademark presents a unique selling proposition that is gaining popularity in many parts of the world. The licensed trademark is fully complemented by proprietary cutting-edge manufacturing technology, and together they contribute towards the success of the licensed product. An authorized user of licensed-trademark must buy the covered product only from a party who is authorized to function as a licensed-manufacturer. In that sense, proprietary manufacturing technology and unique trademark go hand-in-hand. The proprietary manufacturing technology behind FROZENTM is exclusively available with G Co.
In the background of the above facts, from I Co.'s point-of-view, the entire business proposition of making a foray into the South African market presents itself as a virgin source of income existing beyond the frontiers of India. In one sense, the words 'source(s) of income' refers to factors that are considered to be vital in bringing a business opportunity to life. These are factors that occupy privileged status on the canvas of enablers/ functions/ activities necessary for running a successful business.

In the facts of our case, THREE crucial factors necessary for exploiting the commercial opportunity of entering the South African market, namely, a willing customer in FOODIE, privileged access to the club of licensed-manufacturer(s) and the person authorized to sub-license the trademark, viz. G Co., all exist outside India. By entering into the trademark license agreement with G Co., I Co. is able to create commercial apparatus of an enduring character that enables it to serve unsatiated demand from FOODIE and also future demand from similar clients worldwide.

In other words, from I Co's viewpoint, the tripod consisting of THREE vital extensions (as described above), all of them anchored outside India, may be perceived to be a 'source of income' or 'germination ground' where potential business opportunities could be turned into commercial reality. Viewed in that light, there is no doubt that the 'source-of-income' of the triangular buy-sell activity involving G Co./ I Co./ FOODIE lies exclusively outside India. Further, since I Co.'s trademark licensing arrangement with G Co. acts as the biding glue for purposes of creating the abovementioned tripod by orchestrating vital extra-territorial factors, it may be said that royalty payments to G Co. are covered by the exclusionary provisions referred to under (*B*) above.

One may also refer to the decision of Hon'ble Supreme Court of India in the case of GVK Industries Ltd. v. Income Tax Officer [(2015) 54, Taxmann.com, 347 (SC)] expounding the principles and applicability of "source based" taxation.

In view of the facts of the case and discussions in the paragraphs above, it may be possible for I Co. to assert that the royalties paid by it to FCo are not taxable in India by virtue of the exemption granted under Section 9(1)(vi)(b) of the Act.

Part 2

At the outset, section 90 of the IT Act provides an option to the taxpayer to be governed by the provisions of the Act or DTA whichever is more beneficial.

Coming to the DTA, Article 13 ("Royalties and Fees for Technical Services") does grant the source State (India, in the instant case) a right to tax the royalty income. However, Article 13(2) inter alia prescribes that the royalty shall be taxed in accordance with the law of source State/India, i.e. the Act.

Since, in the facts of the instant case, the royalty is not chargeable to tax under the Act itself by virtue of exemption granted under Section 9(1)(vi)(b) of the Act, no taxability of royalty income can be tied under the DTA.

Based on the discussion above, a plausible view may be taken that the royalty being paid/to be paid by I Co. to G Co. is not taxable in India, both under the Act as well as the DTA.

Part 3

The tax withholding on royalty payments to non-residents is governed by section 195 of the IT Act. Sub-section (2) of section 195 of the IT Act (see extracts below) provides that the payer may seek an advance determination from the tax authority as to whether or not the sums to be paid to the non-resident are chargeable to tax in India.

Accordingly, I Co. may consider filing an application under Section 195(2) of the IT Act with the tax authority to obtain a NIL withholding tax certificate/order for making outward remittances to G Co.

However, before such an application is lodged, I Co. must ensure that it has all documents, data, and paperwork in connection with the current matter, since these may be required to be placed on record before the tax authorities during the course of processing of the application.

Where any such order is issued, I Co. shall need to, until such certificate is cancelled by the jurisdictional tax authority, deduct income tax at the rate specified in such certificate or deduct no tax, as the case may be.

The above determination/ certification is provisional and subject to subject to final assessment during the course of audit. The order under section 195(2) of the Act is valid for the relevant tax year for which the application is lodged.

Question 4

Part 1

The total income of a non-resident includes all income from whatever source derived which (a) is received or is deemed to be received in India and (b) which accrues or arises or is deemed to accrue/ arise in India.

In terms of section 9(1)(vi) of the ITA, income by way of royalty is deemed to accrue or arise in India as per the provisions of the said section. Though a non-resident may be liable to tax in India by virtue of the provisions of the Act, the tax liability is determined by keeping in mind the relevant provisions of the DTAA (that India has entered into with the country of which the foreign company is a resident) if the same is more beneficial.

In terms of Explanation 2(v) to section 9(1)(vi) of the Act, royalty includes “the transfer of all or any rights (including the granting of a licence) in respect of any copyright”. Further, as per Explanation 4 to section 9(1)(vi) of the Act, the royalty, inter-alia, includes the payment of consideration (including a lump sum consideration) in regard to the transfer of all or any rights in respect of any right, property or information including the right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred. Based on this, software payments could be taxed as royalty since the use of a computer software is specifically covered under the definition of royalty as per the Act and may attract withholding tax.

However, the meaning of the term royalty as per Article 13 of the India-UK DTAA is restrictive when compared to the Act. The term is generally applicable if it is for the use of, or right to use inter-alia any copyright, secret formula or process. It becomes essential to understand what is meaning of the term “use or right to use” and “copyright”. It also needs to be understood whether there is distinction between a “copyright” and a “copyrighted article”. Transfer of copyright is completed when any of the rights mentioned in the Copyright Act, 1957 (“ICA”) is transferred to the buyer and in contrast copyrighted article means no such right is transferred and a product/ license is provided for limited use of such product.

The Supreme Court of India in the case of Engineering Analysis Centre of Excellence Private Limited v CIT (Civil Appeal Nos. 8733-8734 of 2018) dt March 2, 2021 along with multiple clubbed appeals held that a copyrighted article being computer software is not taxable as royalty under the DTAA definition and accordingly no tax withholding is warranted under section 195 of the Act.

In the current set of facts, Best Plc is intending to license software to other hotel chains for management of their hotel bookings, and Best Plc intends to retain the copyright in the software. It appears that Best Plc would be merely providing copyrighted software to clients and hence relying on aforementioned arguments and decision, no tax withholding may be warranted. In case there is any customization/ grant of copyright, the transaction may be subject to royalty taxation.

Part 2

At the enactment stage of Finance Act, 2020, India introduced an amendment to Finance Act, 2016 to expand the scope of EL to cover gross consideration received by non-resident e-commerce operators. This EL will apply at the rate of 2% on the gross consideration received or receivable by the non-resident e-commerce operator from specified transaction where such receipts exceed INR 20 million during the relevant FY.

The details of the newly introduced EL and relevance to current facts is as follows:

Trigger of EL in India

- Non-resident e-commerce operator who owns, operates or manages digital or electronic facility or platform in connection with India operations;

- Non-resident who sells advertisement to another non-resident which targets an Indian resident customer or a customer who accesses the advertisement through internet protocol (IP) address located in India;

- Non-resident who sells data, collected from an India resident person or from a person who uses IP address located in India.

In the current set of facts, ABC Plc is the ‘non-resident e-commerce operator’.

Specified services/ transactions on which EL is applicable

- Online sale of goods owned by the non-resident e-commerce operator;

- Online provision of services provided by the non-resident e-commerce operator;

- Online sale of goods or provision of services or both, facilitated by the non-resident e-commerce operator;

- Any combination of activities listed above.

In the current context, it is important to understand that for EL to be applicable in the current transaction there should be “online sale of goods” or “online provision of services”. Additionally, the e-commerce operator shall “own, operate or manage digital or electronic facility or platform”.

Booking of hotel rooms

In the current fact pattern, though Best Plc owns, operates, or manages, a digital platform, it is possible to argue that such platform is not for online provision of services. The service being provided currently is for stay in hotel room and not for merely booking. No convenience fees is charged and hence provisions of equalization levy may not be triggered.
Having said this, there are arguments possible that what is likely to be taxed is online provision of services which could cover both digital services and physical services. Due to nascent stage of law, contradictory view cannot be completely ruled out and candidates are free to express contrary view with justification.

Provision of software services

In case of software services, Best Plc owns, operates, or manages, a digital platform through which the software licenses are sold. Best Plc would operate the software via cloud and provide software as a service to other hotel clients. It appears the said services would qualify to be covered under the provisions of equalisation levy on the understanding that the same is not taxable as royalty/ fees for technical services under the Act read with India UK DTAA.

PART C

Question 5

Part 1

An arrangement involving or including round-trip financing is an instance of a commercial substance being said to be statutorily absent. Sub-section (2) of Section 97 of the IT Act outlines the arrangement(s) involving round-trip financing. The relevant provision warrants transfer of funds among the parties to the arrangement, and such transfer not having any substantial commercial purpose other than obtaining a tax benefit.

It is however not necessary that these funds come back to the origin of its journey. Other key features of round-trip financing vis-à-vis GAAR provisions are as under:

- Sub-section (2) of Section 97 of the IT Act dealing with round-trip financing is illustrative and not exhaustive;

- Round-trip financing necessarily involves a series of transactions;

- The parties in the round-trip financing need not necessarily be connected parties. Since the participation of one could be to facilitate the obtaining of tax benefit by another, such facilitating parties may be categorized as an accommodating party.

Round-trip financing as defined under section 97(2) of the IT Act deals with funds. Funds for this purpose are defined to include cash or cash equivalents. Any right or obligation to receive or pay cash or its equivalent is also covered. Accordingly, round-trip financing may cover implicit or explicit guarantees which facilitates the movement of funds.

The arrangement described above is apparently the one whose main purpose is to bring money out of reserves in S Co. to India without payment of due taxes. In the given facts, the loan was granted by X Ltd. based on security of S Co's deposits. The tax benefit is the saving of taxes on income to be received from S Co. by way of dividend or deemed dividend.

The arrangement disguises the source of funds by routing it through X Ltd. bank. X Ltd. bank may also be treated as an accommodating party. Hence the arrangement shall be deemed to lack commercial substance under section 97 of the IT Act that qualifies to be treated as an impermissible avoidance agreement under section 96 of the IT Act for the purposes of invoking GAAR provisions by the Indian Revenue Authorities.

Part 2

Consequently, upon invocation of GAAR provision, in the case of R Co., the loan amount would be treated as dividend income received from S Co. to the extent reserves are available in S Co; and no expense by way of interest would be allowed in the hands of R Co.

In the case of X Ltd, exemption from tax on interest under the DTT may not be allowed as X Ltd is not a beneficial owner of the interest, provided the DTT has an anti-avoidance rule of beneficial ownership.

If such an anti-avoidance rule is absent under the DTT, then GAAR may be invoked to deny treaty benefit as the arrangement will be perceived as an attempt to hide the source of funds of S Co.

Part 3

Tax Officer

- The Tax Officer may examine arrangements for an Impermissible Avoidance Arrangement (IAA) inquiry;
- He or she could refer the arrangement to the Principal Commissioner or Commissioner of Income Tax for him or her to declare it as an IAA, if he or she considers such reference necessary.

Principal Commissioner/Commissioner of Income Tax (CIT)

- If the CIT is of the opinion that GAAR is to be invoked, he or she will issue a show-cause notice to the taxpayer;
- The taxpayer is to furnish his or her objections within the period mandated in the notice (this period not exceeding 60 days);
- If satisfied that the arrangement is an IAA, the CIT will refer the matter to the Approving Panel;
- If satisfied that GAAR need not be invoked, the CIT will pass an order favouring the taxpayer.

Approving Panel

- The Panel will provide the taxpayer the opportunity to be heard;
- No invocation of GAAR is required if the Approving Panel is satisfied with the explanation or submission provided by the taxpayer;
- If it is not satisfied, the Approving Panel will issue directions declaring an arrangement an IAA;
- Directions will be passed within six months from the end of the month on which the reference was received from the Commissioner.

Part 4

GAAR/Chapter X-A provisions shall not apply to:

- Arrangement(s) where the quantum of tax benefits arising are below a monetary limit of INR 30 mn in aggregate for all parties in a transaction in a particular year;
- Arrangements involving certain specified transactions by or with Foreign Institutional Investors;
- Arrangements entailing income accruing or arising to a person from the transfer of an investment made before 1 April 2017.

Question 6

Part 1

The agreement stipulates IN Co. to pay the fee ‘net of tax’ to F Co. In other words, the withholding tax is to be borne by IN Co. In light of Section 195A of the IT Act, in such instances, for the purposes of deduction under Section 195 of the IT Act, the amount of fee shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under the agreement. This is also referred to as grossing-up under the common parlance.

However, in the instance case, IN Co. can avail the exemption from aforesaid grossing-up since the underlying agreement satisfies the prescribed conditions as available under Section 10(6A) of the IT Act.

Accordingly, the amount on which IN Co. will be required to withhold tax is ₹ 100 mn.

Part 2

The effective rate for tax withholding [IT Act read along with the India-France DTT] is as follows:

Tax rate as per Section 195 read along with section 115A of the IT Act

10.92%, i.e., 10% Basic Rate + Surcharge [5%] + Cess [4% on Tax + SC]

Tax rate as prescribed under the India-France DTT [Article 13(2)]

Tax not to exceed 10% of the Gross Amount

On a cursory glance, it appears that since the rate of 10% prescribed under the DTT, being more beneficial to IN Co, may be considered for the purposes of withholding tax under Section 195 of the IT Act.

However, in the instant case, since the arrangement is net of tax, the ‘gross amount’ for the purposes of computing the effective rate under the DTT shall be ₹ 111.11 mn [i.e., 100/90*10], 10% of which works out at 11.11%.

Since the rate of 10.92% under the IT Act is more beneficial to IN Co., the same may be considered for the purposes of withholding tax under Section 195 of the IT Act read along with section 90 of the IT Act.

Question 7

Part 1

Residential status for the three siblings in the previous year (2020-21) is as follows:

Person	Residential Status	Reasoning
Ms. Ranya	Resident in India	Since her stay in India during PY 2020-21 exceeds 182 days, she qualifies as a Resident by virtue of Section 6(1)(a) of the IT Act.
Ms. Shilpa	Non-Resident	Since her stay in India during PY 2020-21 is less than 182 days and during the last 4 PYs exceeds 365 days, she fails to satisfy both the conditions prescribed under Section 6(1)(c) of the IT Act read along with Explanation 1(b) to Section 6(1) of the IT Act. The period of 120 days is irrelevant since the total income from India is less than ₹ 1.5mn.
Mr. Tanvir	Non-Resident	Neither the condition of Section 6(1)(a) nor Section 6(1)(c) is satisfied.

Part 2

Residential status for the three siblings in the previous year (2020-21) is as follows:

Scenario	Residential Status	Reasoning
Ms. Ranya	Resident in India	Since her stay in India during PY 2020-21 exceeds 182 days, she qualifies as a Resident by virtue of Section 6(1)(a) of the IT Act.
Ms. Shilpa	Not Ordinarily Resident	Since her stay in India during PY 2020-21 is more than 120 days but less than 182 days, and during the last 4 PYs exceeds 365 days, she satisfies both the conditions prescribed under Section 6(1)(c) of the IT Act read along with Explanation 1(b) to Section 6(1) of the IT Act. Since in this case, Ms. Shilpa’s total income is more than ₹ 1.5mn, she will qualify as a ‘not ordinarily resident’ by virtue of section 6(6)(c) of the IT Act.
Mr. Tanvir	Non-Resident	Neither the condition of Section 6(1)(a) nor Section 6(1)(c) is satisfied.

Question 8

Part 1

As per the Act, transfer of shares in UK Co2 by UK Co1 can trigger 'indirect transfer' provisions, if the shares of UK Co2 derive substantial value from assets located 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 through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

Further, as per Explanation 5 to section 9(1)(i) of the ITA, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Accordingly, if UK Co2 derives its value substantially from the assets located in India (i.e. ICo), UK Co2 would be deemed to be situated in India. Further, in terms of Explanation 6(a) to section 9(1)(i) of the ITA, the share or interest, referred to in Explanation 5, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if, on the specified date, the value of such assets:

- exceeds INR 100 million; and
- represents at least 50% of the value of all the assets owned by the company or entity.

Since the value of ICo exceeds INR 100 million and UK Co2 owns assets in India only including I Co (i.e. Indian assets represents more than 50% of the value of all the assets owned by UK Co2), the conditions of Explanation 5 and 6 to section 9(1)(i) of the ITA stands satisfied.

Candidates can also discuss whether India can levy taxes on income/ gains from outside India and the decision in the case of GVK Industries v Union of India [332 ITR 130].

Accordingly, the proposed transaction would be taxable in India.

Part 2

Various compliances which need to be undertaken are discussed as follows:

By ICo

ICo, whose shares are being indirectly transferred, would need to furnish requisite information in Form 49D within specified timelines.

By UK Co3

In terms of section 195 of the ITA, the buyer at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier, is required to withhold taxes at the rates in force and deposit the same with the Government. This requirement would extend to the transaction between UK Co1 and UK Co3 (despite both being foreign companies). The various compliances in this regard would include as follows:

- UK Co3 to withhold appropriate taxes while making payment (or crediting in the accounts) to UK Co1 for purchase of shares in UK Co2.

- UK Co3 to remit the taxes it withheld to the Indian Government within permitted timelines. Various tax withholding provisions such as filing of tax withholding returns (and consequently applying for Tax Deduction Account Number), issuance of Form 16A, etc. would trigger.

- UK Co3 would also need to obtain/ file Form 15CA/15CB with the Income Tax Department in terms of section 195(6) of the ITA.

By UK Co1

UK Co1 has earned income from India. Following compliances would need to be undertaken by UK Co1:

- UK Co1 would need to file its income-tax return in India within the time limits permitted under section 139 of the ITA. For this, UK Co1 would also need to apply for a Permanent Account Number (PAN) if it does not possess already.

- UK Co1 would need to obtain and furnish a report in Form 3CT (duly signed and verified by an accountant) certifying the income attributable to assets located in India.

Various penalties could apply if the aforementioned compliances are not undertaken. Further, it is important to note that prosecution proceedings may also apply in the hands of UK Co1 (in terms of section 276CC of the ITA) if it fails to furnish its income-tax return in India.

In case UK Co3 fails to withhold taxes from UK Co1, the India tax authorities can hold UK Co3 as an 'assessee in default' under section 201 of the ITA and recover from UK Co3 taxes along with interest and levy penalty separately. Further, in terms of section 163 of the ITA, UK Co3 can be treated as an 'agent' of UK Co1 and taxes can be recovered from UK Co3 as it is being recovered from UK Co1.

Part 3

Yes, the transaction would not be considered as transfer under the ITA due to section 47(via). Candidates may discuss the said section.

Question 9

Part 1

In terms of section 9(1)(i) of the Act, all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

As per section 90(2) of the Act a non-resident entity is eligible for DTAA benefits. Under the DTAA, current transaction may be taxable in India only if a business income arises out of a PE (generally Fixed Place PE, Service PE, and Agency PE) or the same is taxable as Royalty or FTS.

Candidates should discuss applicability of all 3 PEs and also what can constitute a Fixed Place PE (i.e. place of business, permanent, disposal, and business activity).

The OECD Commentary states that a permanent establishment begins to exist as soon as the enterprise commences to carry on its business through a fixed place of business. The 'core business' of the foreign enterprise should be conducted through the place of business. Such place of business should be at 'disposal' of the enterprise.

In case of employees working from home, following could lead to creation of fixed place PE:

- Home office used on a continuous basis for carrying on business activities;
- Rent and other similar expense being borne by the overseas entity. Even if the overseas entity does not pay rent for the premises, if no other premises is provided for the employee to work this could lead to an inference that there is a PE;
- Long duration presence of employees;
- Conduct of core business activities indicates effective use of premises.

Having said the above, there are points indicating non-existing of disposal test as well such as the home of the employee not being controlled by the employer.

In a recent Danish decision [Case SKM2017.213.SR], Court adopted a liberal approach to hold that PE was created in a house of sales manager since he carried out core business of employer (German company) from his home. PE was seen to be held even though neither employer required the sales manager to work from his home, nor did it reimbursed for furnishing or setting up a home office.

Additionally, Fixed place of business which is of preparatory or auxiliary character in the trade or business of the enterprise is not a PE under Article 5. However, this may not apply in the present case.

Candidates can also discuss Service Place PE and whether the same would be constituted or not.

In conclusion, there is high risk of PE exposure in the current place if the work is not of a preparaoty or auxiliary character. Candidates may discuss about preparaoty or auxiliary character and make appropriate assumption basis the question provided.

Part 2

A non-resident’s TDS obligation has to be evaluated on the basis of whether such non-resident has taxable presence in India. Additionally, in terms of section 204(v) of the ITA (as amended by Finance Act, 2020), meaning of person responsible for paying under tax withholding sections includes “in the case of a person not resident in India, the person himself or any person authorised by such person or the agent of such person in India including any person treated as an agent under section 163”.

Accordingly, Flexible Co may be liable to withhold taxes under section 192 upon payment of salary to the employee in India. In case Flexible Co is unable to do so, it can hire an agent in India to perform the task. If Flexible Co does not comply with the tax withholding provisions, it can be deemed to be an assessee in default and consequences can follow.

One additional option available to Flexible Co is that it asks the employee to deposit advance taxes on salary being paid by it and it can obtain a chartered accountant certificate and file Form 26A in terms of proviso to section 201(1) of the ITA (the said proviso has been amended vide Finance Act, 2019 to grant relief to non-residents as well). In such case, Flexible Co will not be considered as assessee in default but only interest would apply from the date on which such tax was deductible to the date of furnishing of return of income by such employee.