Hot button issues in International Taxation

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Agenda

Part #1

Agenda

Part #2

Basics

What is international taxation?

- International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries
- Movement of people, goods, activities – Economic flows
- Every jurisdiction wants a share of the taxation pie!
- Allocation of taxing rights between jurisdictions (delineated as *source & residence*), with elimination of double taxation, is at the heart of international taxation

- **Source vs Residence**

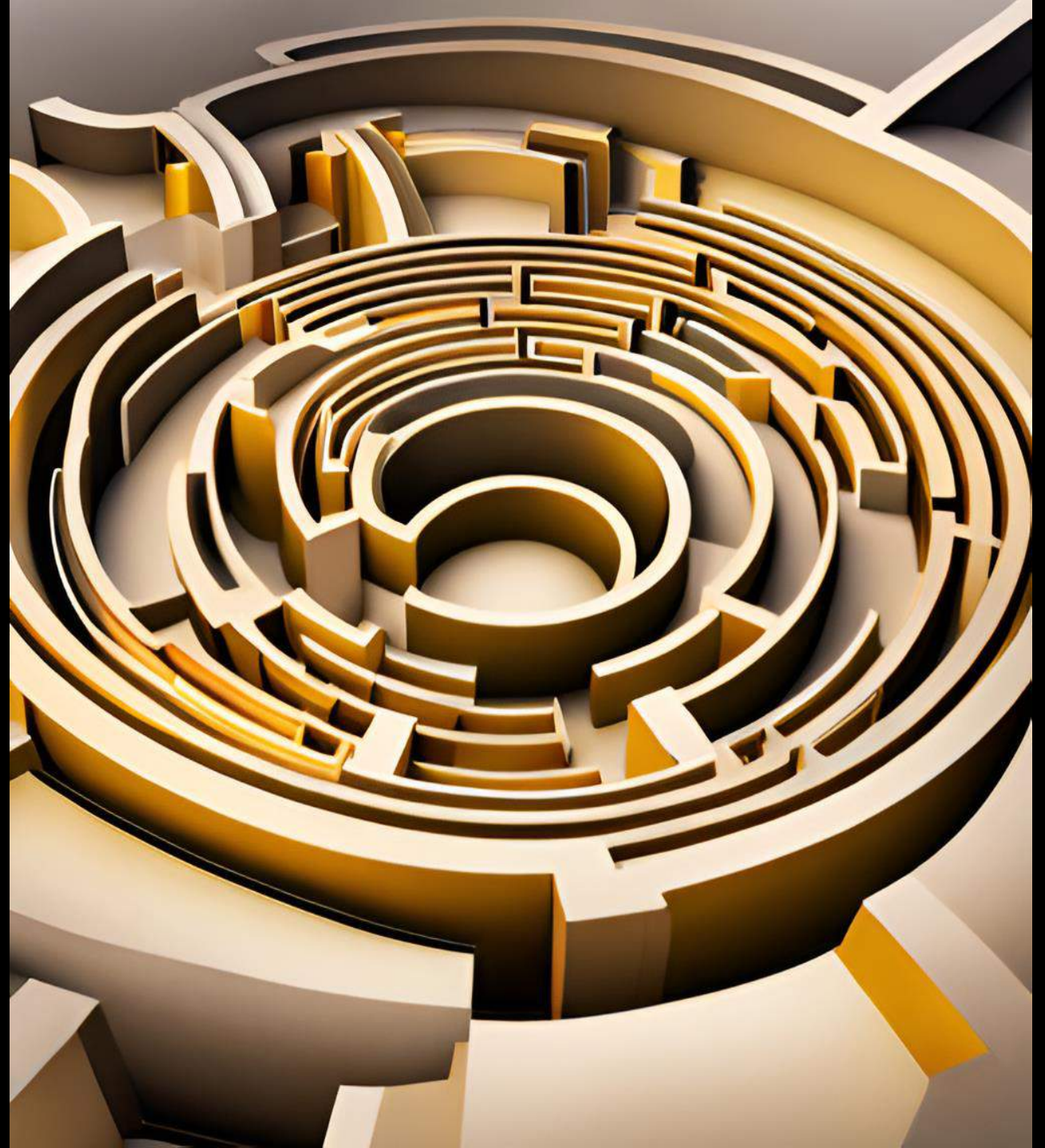
Residence: State where person earning such income resides

Source: State where income has its origin

- **Source vs Residence jurisdiction**

Residence: Income may be taxed under law of country because of nexus between country and person earning income, irrespective of the place where the income is earned

Source: Income may be taxed under tax law of a country because of nexus between country and activities that generate the income, with no reference to the residence of the taxpayer



DTAA’s

- International agreements entered into by two or more sovereign nations to avoid double taxation, facilitate exchange of goods and services and the movement of capital and persons, aid recovery of tax
- **Fundamentally, Treaties strike a compromise between source and residence taxation.**
  - Some rights to tax are given to the source, and the residence country is required to relieve double taxation either by giving a credit for such source taxes paid, or by exempting the relevant income from its taxes.
- Integral part of DTAA:
  - Protocol
  - Memorandum of Understanding
- Types of DTAA's:
  - **Bilateral,** Multilateral
  - Comprehensive, Limited

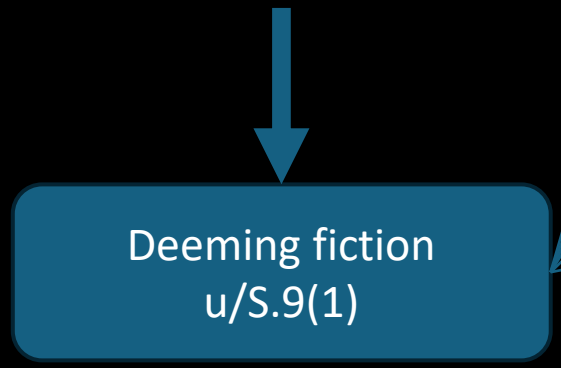
Deeming fiction– S.9

Charging Section – S.5:

S.5(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is **deemed to accrue or arise to him** in India during such year.



9(1)(i) Income accruing or arising directly or indirectly, through or from India	Article 7 r.w. Article 5 Business Profits r.w. PE
9(1)(ii) Salaries earned in India	9(1)(ii) Salaries earned in India
9(1)(iv) Dividend	Article 10 Dividends
9(1)(v) Interest	Article 11 Interest
9(1)(vi) Royalty	Article 12/13 Royalties
9(1)(vii) Fees for Technical Services (FTS)	Article 12/13 Fees for Technical Services (FTS)

Double taxation

USA Company (Payee/Licensor)

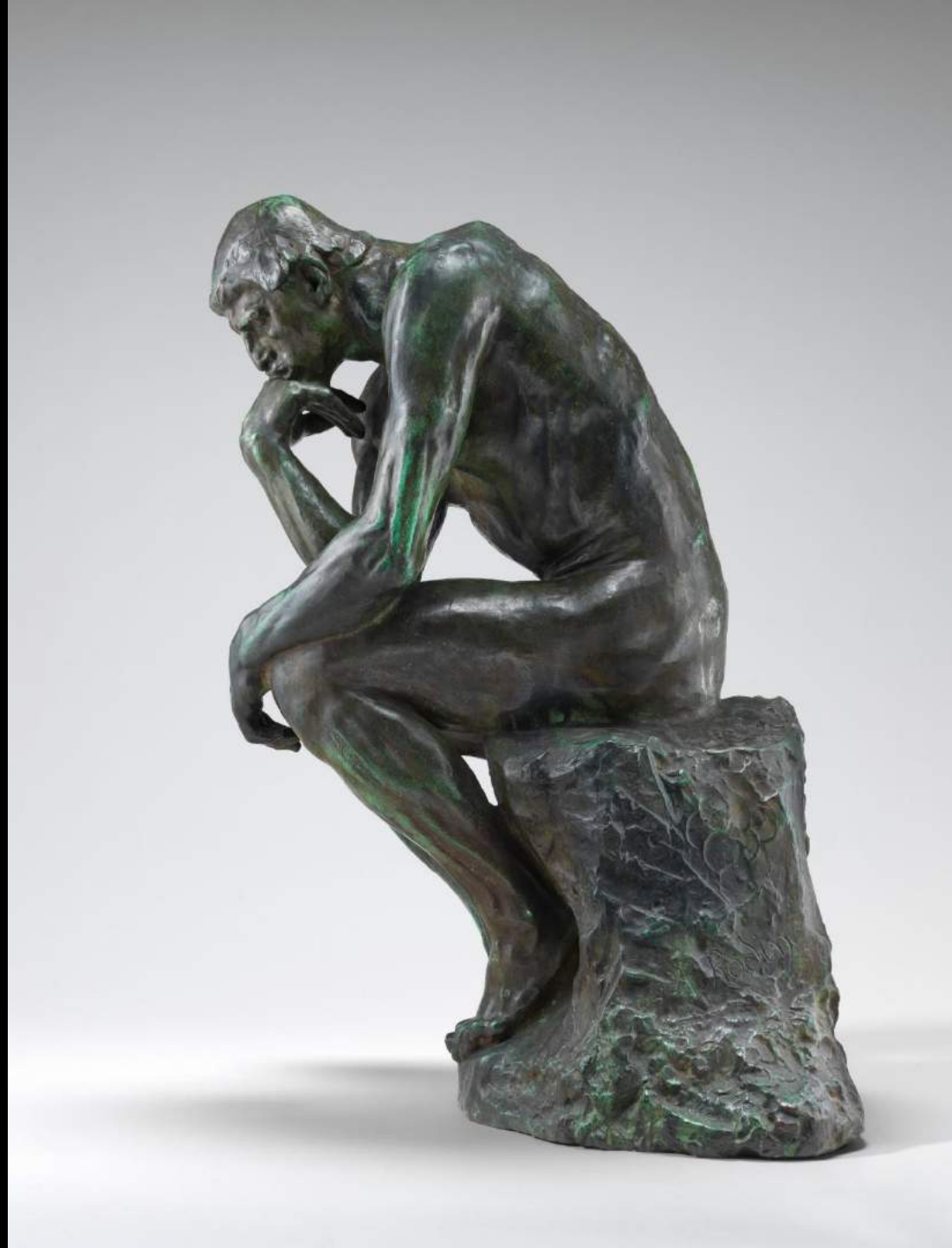
Residence country tax

on royalty income

Indian Company (Payer/Licensee)

Source country tax

TDS deposited



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Act vs. DTAA: A constant battle

- Act provisions and DTAA articles are always to be considered
- In many cases, the relevant DTAA may have beneficial provisions which can be invoked
  - **S.90(2)** - taxpayer has option to be taxed under Articles of DTAA or domestic law, **whichever are more beneficial**
  - DTAA has Articles for eliminating double taxation (credit or exemption)
- But…
  - New amendments and levies challenge the power and usefulness of DTAA's
  - Over time, there is a unilateral exercise to get around the limitations of the DTAA as we shall see later in the lecture

Income Tax vs. DTAA Overview

Type of income of NR	Income Tax Act	DTAA
Business Income	S.9(1)(i) – Business connection / PE	Article 7 r.w. Article 5
Royalties	S.9(1)(vi) and S.115A	Article 13
FTS	S.9(1)(vii) and S.115A	Article 13
Capital Gains	S.9(1)(i) and S.45	Article 14
Profession	S.9(1)(i) - Fixed base	Article 15 (Independent Personal Services)
Salary	S.9(1)(ii) and S.115A	Article 16 (Dependent Personal Services)
Dividend Income	S.9(1)(v) and S.115A	Article 11
Interest	S.9(1)(iv) and S.115A	Article 12

Tax Treaty Models

- OECD Model**:** Residence Based
- UN Model : Source Based
- US Model : For US treaties
- Andean Model

Bird's eye view of International Taxation disputes in India

S.4: Total income of previous year of every year shall be charged at prescribed rates

S.5(2): charging section – income of **NR** (per **S.6**)

- *accrues* or arise or
- ***deemed to accrue or arise*** (S.9) or
- *received in India* or
- ***deemed to be received*** *in India*

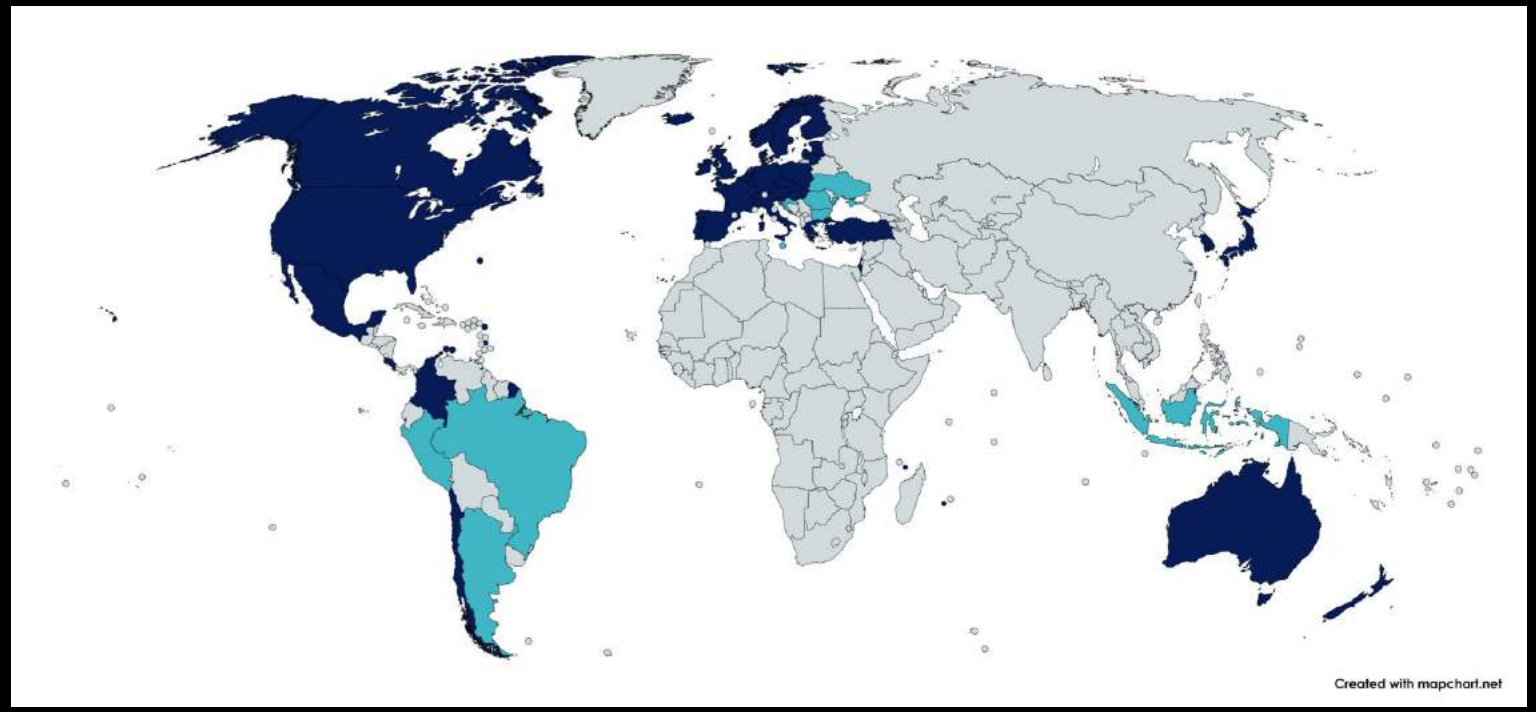
S.9: deeming provisions

(OR)

Relevant DTAA

- Typically, Article 7 r.w. Article 5 (Business profits r.w. Permanent Establishment), or
- Need to apply relevant Article depending on type of income (ex: Article 12 Royalties/FTS)

S.195: Machinery provision: tax on "sums chargeable" as per "rates in force"



MFN

MFN

Most Favoured Nation (MFN) clause in a DTAA is provision that ensures that *a* Contracting State receives the same treatment that the *other* Contracting State offers to *any third* State.

If the other contracting state provides a lower tax rate or other favourable tax treatment to a third state, the contracting state must receive the same tax treatment (provided that certain conditions are met)

Favourable tax treatment can be Rate, Scope etc.

- Example: India-France <-> India-UK

MFN clause: Different routes

Three types of routes typically

Automatic route: Where the reading of Protocol, if you give a better treatment to somebody else in parity group, same will apply to me also

Self-operational clauses: nothing to be done

SC in Nestle: Different interpretation.

- Notification if issued is out of abundant caution

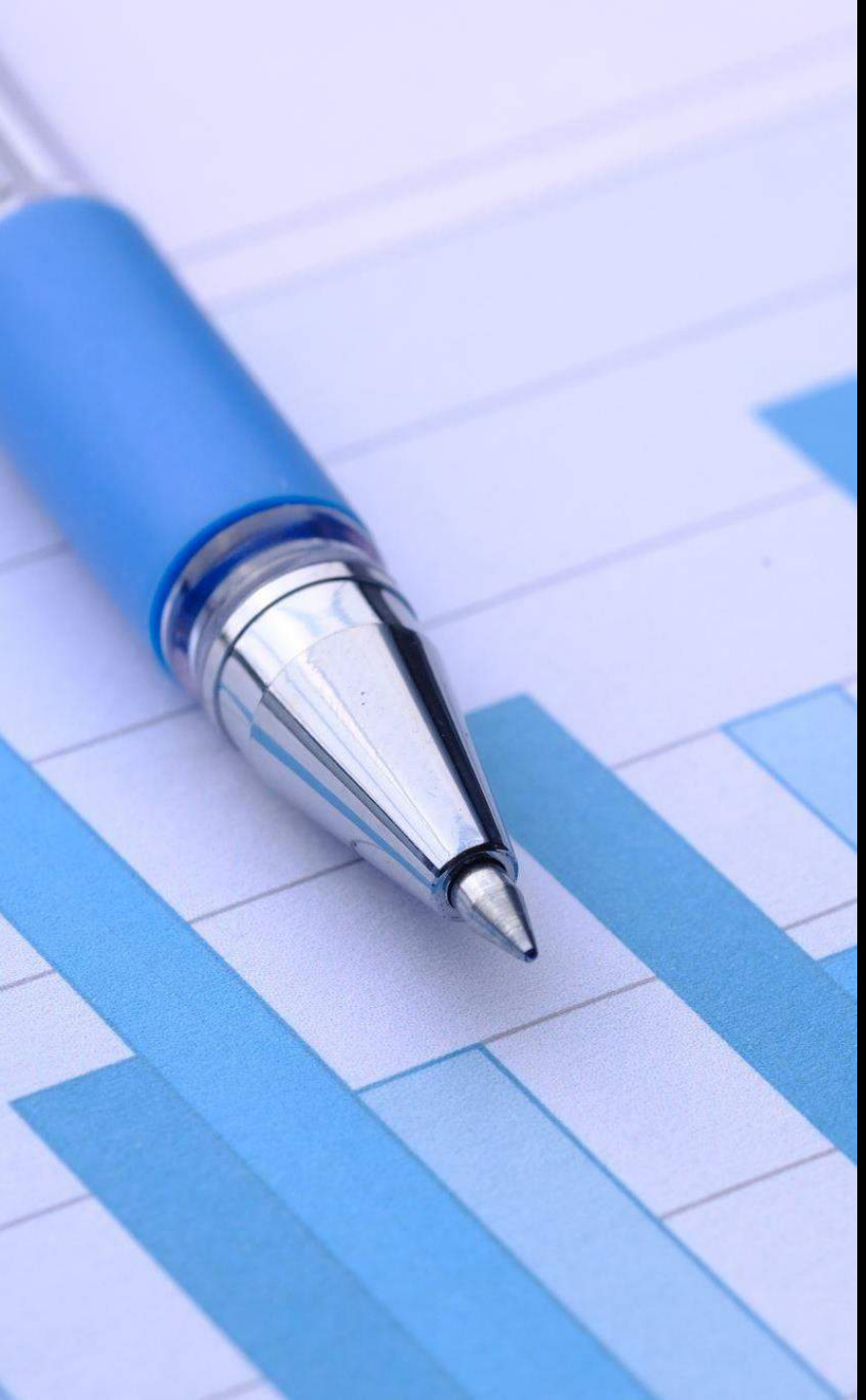
India-France, India-Hungary

Mixture of automatic + negotiation route:

India-Swiss treaty: Rate follows automatic route, Scope requires further negotiations

Inform/Negotiation route:

India-Philippines: Inform treaty partner. Negotiations will likely happen thenceforth



MFN Example #1: Automatic route (India-Sweden, India-NL)

Protocol : Clause IV Ad Articles 10, 11, 12

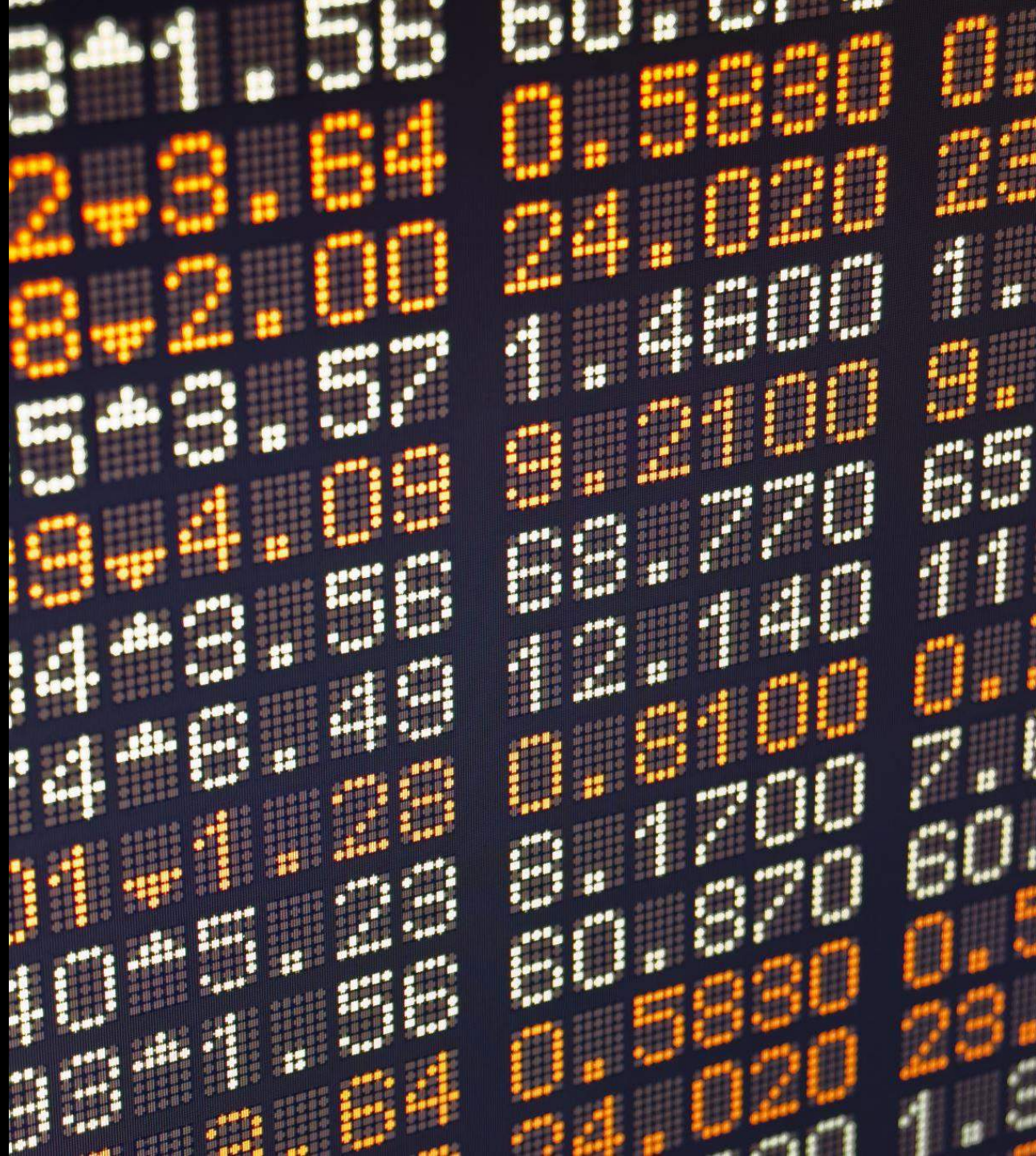
*"2. If after the signature of this convention under any Convention or Agreement between India and a third State which **is a member of the OECD** India should limit its taxation at source on **dividends**, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.""*

MFN Example #2: Mixture of Automatic & Negotiation route

India-Swiss Confederation Protocol

*In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services), if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD signed after the signature of this Amending Protocol, India **limits its taxation at source** on dividends, interest, royalties or fees for technical services to a rate lower than the rate provided for in this Agreement on the said items of income, **the same rate** as provided for in that Convention, Agreement or Protocol on the said items of income **shall also apply** between both Contracting States under this Agreement as from the date on which such Convention, Agreement or Protocol enters into force.*

*If after the date of signature this Amending Protocol, India under any Convention, Agreement or Protocol with a third State which is a member of the OECD, **restricts the scope** in respect of royalties or fees for technical services than the scope for these items of income provided for in Article 12 of this Agreement, then Switzerland and India **shall enter into negotiations** without undue delay in order to provide the same treatment to Switzerland as that provided to the third State.]*



MFN Example #3: Inform route India-Philippines

4. With reference to Articles 8 and 9 if at any time after the date of signature of the Convention the Philippines agrees to a lower or nil rate of tax with a third State the Government of the Republic of the Philippines shall without undue delay ***inform the Government of India*** *through diplomatic channels* ***and the two Governments will undertake to review these Articles*** *with a view to providing such lower or nil rate to profits of the same kind derived under similar circumstances by enterprises of both Contracting States.*

Crux of the MFN issue

Whether there is any right to invoke the MFN clause when the third country with which India has entered into a DTAA with was not an OECD member yet (at the time of entering into such DTAA)?

And if so, what is **effective date** for granting the favourable treatment - either from DTAA was initially signed with Lithuania (2013) or from when Lithuania became OECD member (2018)?

Whether the MFN clause is to be given effect to automatically or if it is to only come into effect after a Notification is issued by Indian Govt?

Is India obligated to issue a notification u/S 90 to amend India-Netherlands DTAA to incorporate the new provisions?

MFN History: DCIT vs. ITC Ltd. (2002) 82 ITD 239 (Cal)

- **Installation and Commission fees not FTS?** India-UK/India-USA/India-Switzerland has 'fees for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property'.
- **India-France vs India-UK/India-USA/India-Switzerland.** Both scope (make available) and rate were different
- But **CBDT Notification SO 650(E), dt. 10.7.2000 [(2000) 244 ITR (St) 134}:** While Indian Government made amendment to Indo-French DTAA **with respect to the lower rate of withholding tax envisaged in the said tax treaties** as compared to rate in Indo-French DTAA for FTS etc, it has **NOT** taken note of the favourable provisions contained in tax treaties signed by India with OECD member countries!!
- *"It is difficult to comprehend as to how the Central Government can unilaterally amend, in exercise of the powers under Section 90 of the IT Act, a bilateral agreement that a DTAA inherently is, but, for the present purposes and for the reasons we shall now state, it is not even necessary to be drawn into that controversy about legality of the aforesaid notification"*
- Did not deal with legality of Notification as it was issued after impugned AY. But held lower rate to be applied is not dependent on any further action by the Governments (i.e no need for Notification) to incorporate India-UK/India-US/India-Switzerland rates.
- Ruling appears to have been accepted by Department since it was not agitated before HC (even though tax effect involved was above monetary limits).

MFN History: Steria case (W.P.(C) 4793/2014, 28.07.2016 Delhi HC)

- Before AAR, Steria contended that as per Clause 7 of the Protocol of **India-France DTAA** the more restrictive definition of FTS in the India-Portugal, India-UK DTAA, must be read as forming part of the India-France DTAA as well. **AAR held against assessee.**
- **Notification of 10.7.2000 of India-France Protocol MFN benefit** consciously omitted "make available" present in India-Portugal and India-UK both DTAA's signed after France and who were OECD Members at that time!
- Delhi HC reversed AAR view holding that a **Protocol is considered as part of the treaty itself and does not have to be separately notified** for the purposes of application of the MFN clause
    - The AAR had concluded that **even though** conditions set out in MFN clause were satisfied, benefit could not be availed unless specific notification by GoI effectuating the benefit under MFN clause was issued

MFN Controversy: Concentrix case

- 21.1.1989: India-Netherlands DTAA
- 27.3.1989: Notified
- 30.3.1989: Subsequent amendment
- 2020: Concentrix and Optum BV applied under S.197 seeking certificate of lower deduction of tax @ 5% on remittance of dividends but issued certificate @ 10%
  - Dividend article of India-NL DTAA: dividend paid by Indian entities to residents of Netherlands liable to tax not exceeding 10%
  - However, Protocol to India-NL DTAA has MFN clause which provides if India enters into a DTAA on a later date with a third country, which **"is"** an OECD member, providing a beneficial rate of tax or restrictive scope for taxation of dividend, interest, royalty, etc. a similar benefit should be accorded to India-NL DTAA as well.

*"2. If after the signature of this convention under any Convention or Agreement between India and a third State which **is a member of the OECD** India should limit its taxation at source on **dividends**, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.""*

MFN Controversy: Concentrix case
Slovenia, Colombia, Lithuania

- DTAAs signed subsequently by India with countries like Slovenia, Colombia, Lithuania (third countries) provide for lower rate of 5% tax for dividend taxation, subject to certain conditions. Accordingly, if MFN clause were to be applicable, the rate under India-NL DTAA may be claimed to be reduced to 5%.
- **However, these third countries were not OECD members when their respective DTAAs were entered into with India.** Instead, these countries became OECD members only at a later date.

MFN Controversy: Concentrix case Delhi HC view

"16. However, the principle of parity kicks-in, only if the following conditions are fulfilled:

i. First, the third State with whom India enters into a Convention/DTAA should be a member of the OECD.

ii. Second, India should have, in its Convention/DTAA, executed with the third State, limited its rate of withholding tax, on subject remittances, at a rate lower or a scope more restricted, than the rate or scope provided in the subject Convention/ DTAA.

Once the aforementioned conditions are fulfilled, then, from the date on which the Convention/DTAA between India and a third State comes into force, the same rate of withholding tax or scope as provided in the Convention/DTAA executed between India and the third State would necessarily have to apply to the subject DTAA. "

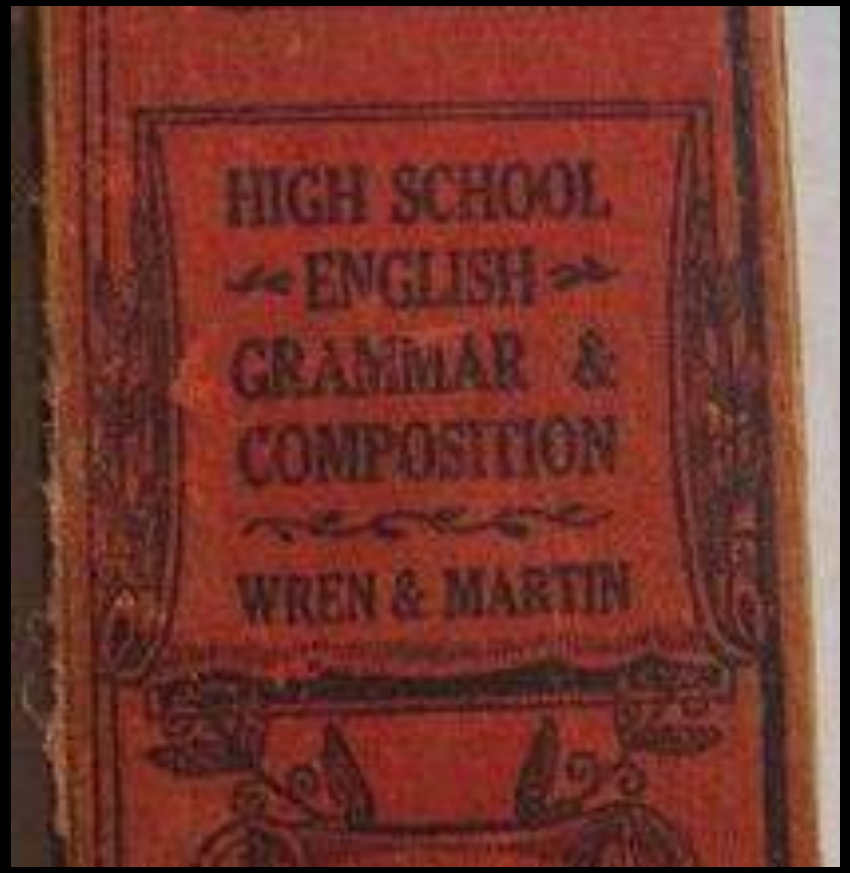
Delhi HC dismissed Revenue's argument of inapplicability of MFN clause.

- Observing date of OECD membership of third State is from when benefits can kick in

MFN Controversy: Concentrix case: Delhi HC
Delhi HC view of "… which *is* a member of the OECD …"

- Delhi HC held that "is" is both autological and heterological
  - Expresses a property that it possesses, heterological is opposite ie it does not describe itself. ("English", "Word" vs "long")
- Delhi HC followed **how the other contracting State [i.e., the Netherlands] has interpreted the provision**:
  - *"*Decree of Feb 28, 2012

    … Under the most favored nation clause in the Protocol to the Convention, this event has the effect that, with retroactive effect to July 21, 2010, a rate of 5 per cent will apply to participation dividends paid by a company resident in the Netherlands to a body resident in India."
- Delhi HC held that **principle of Common Interpretation** to be followed so that there is consistency in the interpretation of the provisions by the tax authority and courts of the concerned contracting State
  - Followed Lord Denning's *Corocraft Ltd. vs. Pan American Airways Inc., [1968] 3 W.L.R. 1273, 1283*



MFN Controversy: Unilateral Decrees Netherlands, France, Switzerland

International Fiscal Affairs, Netherlands (Decree No IFZ 2012/54M dated 28.2.2012) (“lithe decree")

Bulletin Officiel des Finances Publiques-Impot by DGFIP, France on 4.11.2016 (“lithe bulletin ")

Federal Department of Finance, Swiss Confederation on 13.8.21 (“lithe publication").

- Unilateral decree/bulletin of The Netherlands and France declare tax rate on dividends under their respective DTAAs with India stands modified to lower tax rate of 5% if holding > 10% under the MFN clause after India-Slovenia DTAA with retrospective effect from when Slovenia became member of the OECD being 21st July, 2010.
- Unilateral publication of Swiss Confederation declares tax rate on dividends under their DTAA with India stands reduced to 5% if holding > 10% under the MFN clause after India entered into a DTAA with Lithuania and Colombia effective 5th July, 2018 and 28th April, 2020 respectively when they became members of OECD

MFN Controversy: CBDT Circular 3 of 2022 dated 3.2.22

- Unilateral decree/bulletin/publication do not represent shared understanding of the treaty partners on applicability of the MFN clause
  - "Not with the object/purpose enshrined in respective DTAAs"
- Application of concessional rates/restricted scope from the date of entry into force of the DTAA with the third State and not from the date the third State becomes member of the OECD
  - Intention of the MFN clause in the Protocol of the DTAAs is not to give the benefit of India's DTAA with the third State which was not a member of DECO when India entered into DTAA with i
- Requirement of notification under Section 90 of the Income-tax Act, 1961
  - "India has not issued any notification importing the benefit of treaties with Slovenia, Lithuania and Colombia to treaties with The Netherlands, France or the Swiss Confederation"
- No selective import of concessional rates under MFN clause
  - 5% and 15% split rate of dividends based on direct holding to be adopted as per Slovenia Lithuania treaty

FOR MFN: ALL THE CONDITIONS TO BE FULFILLED

1. The second treaty (with third State) is entered into after the signature/ Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first State;
2. The second treaty is entered into between India and a State **which is a member of the OECD at the time of signing the treaty with it;**
3. India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of the relevant items of income; and
4. **A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State**, as required by the provisions of sub-section (1) of Section 90 of the Income Tax Act, 1961.

MFN Controversy: Nestle Delhi HC case

- In the revenue's appeals in Nestle what was considered by the Delhi High Court, were provisions of the **India-Switzerland** DTAA and its three protocols.

"3. Consequently, a certificate under Section 197 of the Income Tax Act, 1961 will be issued in favour of the petitioner, indicating therein, that the rate of tax, on dividend, as applicable qua the petitioner is 5% under India-Swiss DTAA."

MFN Controversy: SC in Nestle SA & Ors Revenue position

- **Articles 253** (read with Entries 13, 14 and 15 of List I of the Seventh Schedule) of the Constitution, Parliament has exclusive power to legislate in respect of any treaty or convention, entered into by India, with any other nation; such treaty can only be entered into in exercise of executive power of the Union
- Relied upon the decisions in ***Gramaphone Co. of India Ltd v. Birendra Bahadur Pandey & Ors.*** ***and Union of India (UOI) v. Azadi Bachao Andolan & Ors.***
- **Relied upon S.90.** In absence of any law, mere entering into treaty or convention or protocol cannot give rise to any right. Thus, trigger to MFN can happen when India enters into a treaty with other nations which happens to be member of OECD at the time of entering the treaty with India and if DTAA provides for more favourable treatment. Even in such case there must be Notification to give effect.
- Submits Protocol executed between India and Netherlands notified on 30.08.1999 and was itself triggered by the benefit granted to the India-USA 1990 DTAA; India-Germany 1996 DTAA; India-Sweden 1997 DTAA and India-UK 1993 DTAA:
  - It showed that triggering event itself (here, mere entering into DTAA with country which was/became OECD member) did not result in grant of any benefit to Netherlands.
  - **It was after bilateral negotiations that the Protocol was entered into, and yet later a notification under Section 90 was issued, bringing it into effect.**

S.90. *(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—*

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory,…..

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

….

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

…

Explanation 3.—For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued thereunder being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

Explanation 4.—For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.

MFN Controversy: Constitution of India Article 73, 253

Article 73. Extent of executive power of the Union

(1) Subject to the provisions of this Constitution, **the executive power of the Union shall extend--**

(a) to the matters with respect to which Parliament has power to make laws; and

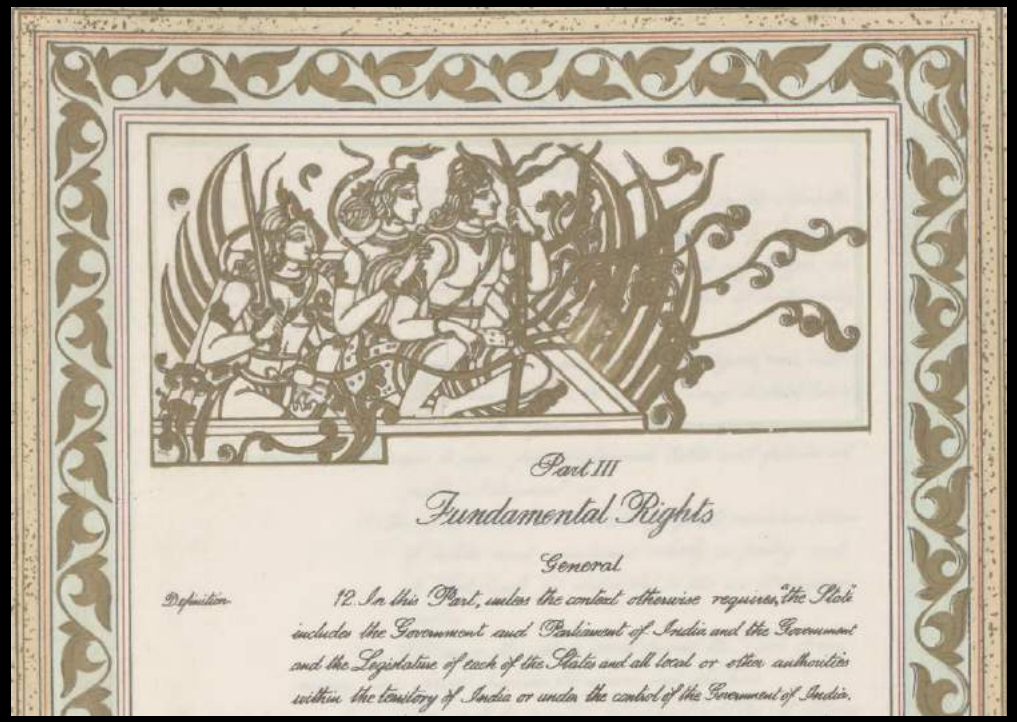
(b) to the exercise of such rights, authority and jurisdiction as are exercisable by the Government of India by virtue of any treaty on agreement:

Provided that the executive power referred to in sub-clause (a) shall not, save as expressly provided in this Constitution or in any law made by Parliament, extend in any State to matters with respect to which the Legislature of the State has also power to make laws.

(2) Until otherwise provided by Parliament, a State, and any officer or authority of a State may, notwithstanding anything in this article, continue to exercise in matters with respect to which Parliament has power to make laws for that State such executive power or functions as the State or officer or authority thereof could exercise immediately before the commencement of this Constitution.

Article 253. Legislation for giving effect to international agreements

Notwithstanding anything in the foregoing provisions of this Chapter, Parliament has power to make any law for the whole or any part of the territory of India for **implementing** any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.



Part III

Fundamental Rights

General

Definition.

12. In this Part, unless the context otherwise requires, "the State" includes the Government and Parliament of India and the Government and the Legislature of each of the States and all local or other authorities within the territory of India or under the control of the Government of India.

MFN Controversy: SC in Nestle SA & Ors
Revenue position: Ram Jethmalani & VCLT Article 31

- Revenue relied on ***Ram Jethmalani v. Union of India***, referring to the General Rule on Interpretation of Vienna Convention on Law of Treaties, 1961 (hereafter "VCLT").Though India is not a party to the VCLT, the convention the principle of interpretation in Article 31 provides a broad guideline as to what should be an appropriate manner of interpreting a treaty in the Indian context as well.
- Broad principle of interpretation **would be that ordinary meaning of words be given effect to, unless context requires otherwise**.
    - That such treaties are drafted by diplomats, and not lawyers [!!], also implies that care has to be taken to not render any word, phrase, or sentence redundant, especially where it would lead to a manifestly absurd situation.
    - This principle of interpretation was applied by the AP HC in *Sanofi Pasteur Holding SA v. Department of Revenue*

MFN Controversy: SC in Nestle & Ors Assessee position

- A plain reading of Section 90 of the Act demonstrates that it does not require each article or paragraph thereof of an already notified agreement to be further notified separately if the amendment is as a consequence of a self-operative MFN clause.
- Undoubtedly if the amendment is as a consequence of a bilateral negotiation, then, a separate notification is required.
- To ascertain if any such requirement exists or otherwise, one will have to refer to the respective clauses itself.
- It is urged that the subject MFN clause in the Protocol to IndiaNetherlands DTAA has no such requirement.

MFN Controversy: SC in Nestle & Ors
Assessee position

- **Different MFN clauses:** India-Finland DTAA requires India to immediately inform the Finland authorities and notify such beneficial provision whenever the MFN clause gets triggered. India-Philippines DTAA, too clearly requires the countries to inform each other and review the provisions. **Why the differences in MFN clauses then?**
- **Article 7(3)** specifically notes that where expense limit is relaxed for computing the profits attributable to PE in any other convention, the CA of one state would notify such CA of the other state, and at request of that CA which is notified, the terms of Treaty shall be amended by Protocol to reflect such beneficial terms. Naturally, once amendment is agreed pursuant to bilateral negotiations, it has to be notified. This language, it was pointed out, was absent in the MFN clause
- **Case laws:** ITAT in *SCA Hygiene Products AB v. DCIT* and Delhi decision in *Mitsubishi Electric India Pvt Ltd v CIT* where Tribunal noted the difference in triggers of the MFN clause.
- Karnataka HC in **Apollo Tyres Ltd.vs CIT (92 Taxmann.com 166 (Karnataka))** had similarly considered the same Protocol to India-Netherlands DTAA which Revenue did not challenge.

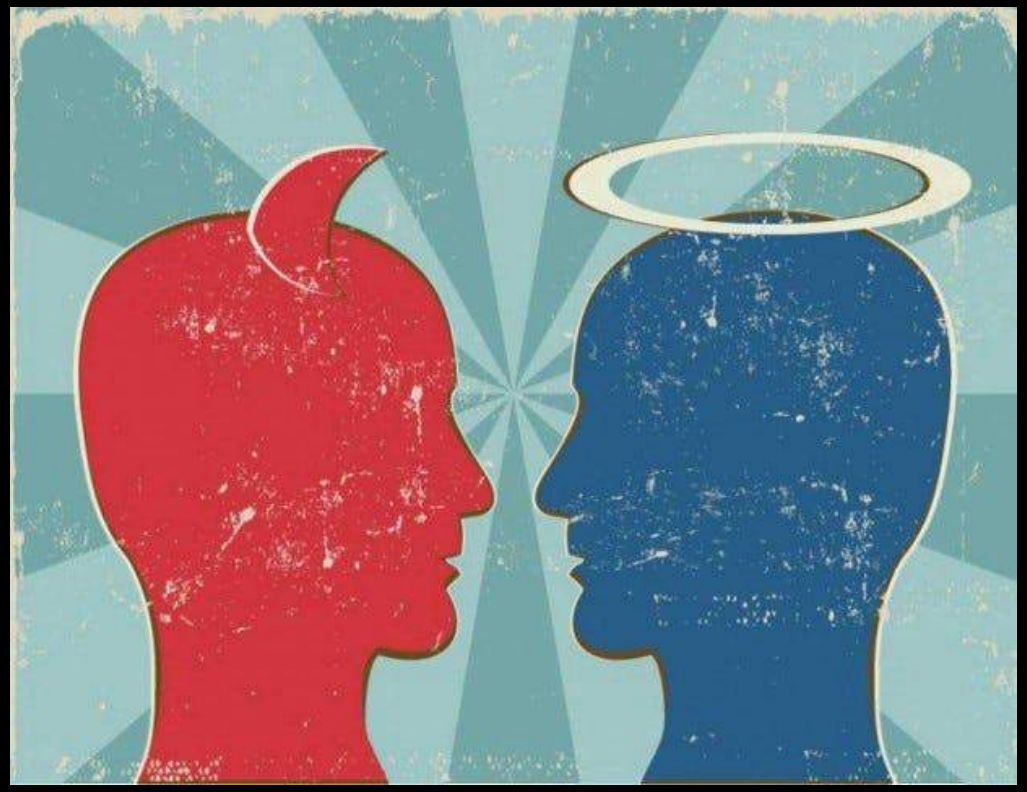
MFN Controversy: SC in Nestle & Ors
Assessee: Unilateral Notifications by Revenue

- Revenue's reference to the **notification dated 30.08.1999**, where the restricted scope of FTS is only given by India w.e.f. 01.04.1997, whereas the limited scope of FTS was agreed in the India-USA DTAA which came into force from 18.12.1990 – Assessee argued this was a **unilateral** notification and not a bilateral amendment by both states
- The assessees highlight, in this regard that the notification nowhere clarifies that both states had agreed to its contents.
- In contrast, Notification No. GSR 382(E)/ Notification No.2/2013 dated 14.1.2013 which notified the Protocol to India-Netherlands dated 10.5.2012 bilaterally amending the DTAA and states

"India and Netherlands... Desiring to conclude a Protocol (hereinafter referred to as "Amending Protocol") to amend the Convention....have agreed as follows"

MFN Controversy: SC in Nestle & Ors Assessee position: Treaty vs Act

- Absence of a unilateral notification which may have in the past been issued as an administrative practice **cannot override the clear language of an MFN clause which provides for automatic application**.
- ***Union of India of India v. Agricas LLP [2020] 14 SCR 372*** held that the State cannot breach a treaty to which it is a party by referring to domestic law-be it legislative, executive, or judicial decision.
- ***Engineering Analysis Centre of Excellence P Ltd vs CIT 432 ITR 471*** applied the principle in ***Director of Income Tax v New Skies Satellite BV 382 ITR 114*** wherein the Delhi High Court held that mere executive position cannot alter the law under the DTAA.



MFN Controversy: SC in Nestle & Ors Assessee position

Article 10: Dividends
1. Dividends paid by a company which is a resident of one of the States to a resident of the other State may be taxed in that other State.

If argument, of the revenue that the phrase "is a member of OECD" is ***literally interpreted***, it would mean Slovenia, Lithuania, and Columbia ought to be members of OECD

- at the time of signing of India- Netherlands DTAA [!]
- at the time of execution of their own DTAA, and also
- At the time when the assessee invokes the MFN clause is to be accepted;

then, the consequence would be that while interpreting Article 10(1) of India-Netherlands DTAA which also uses the same word “is” (“is a resident”) the same meaning ought to be given.

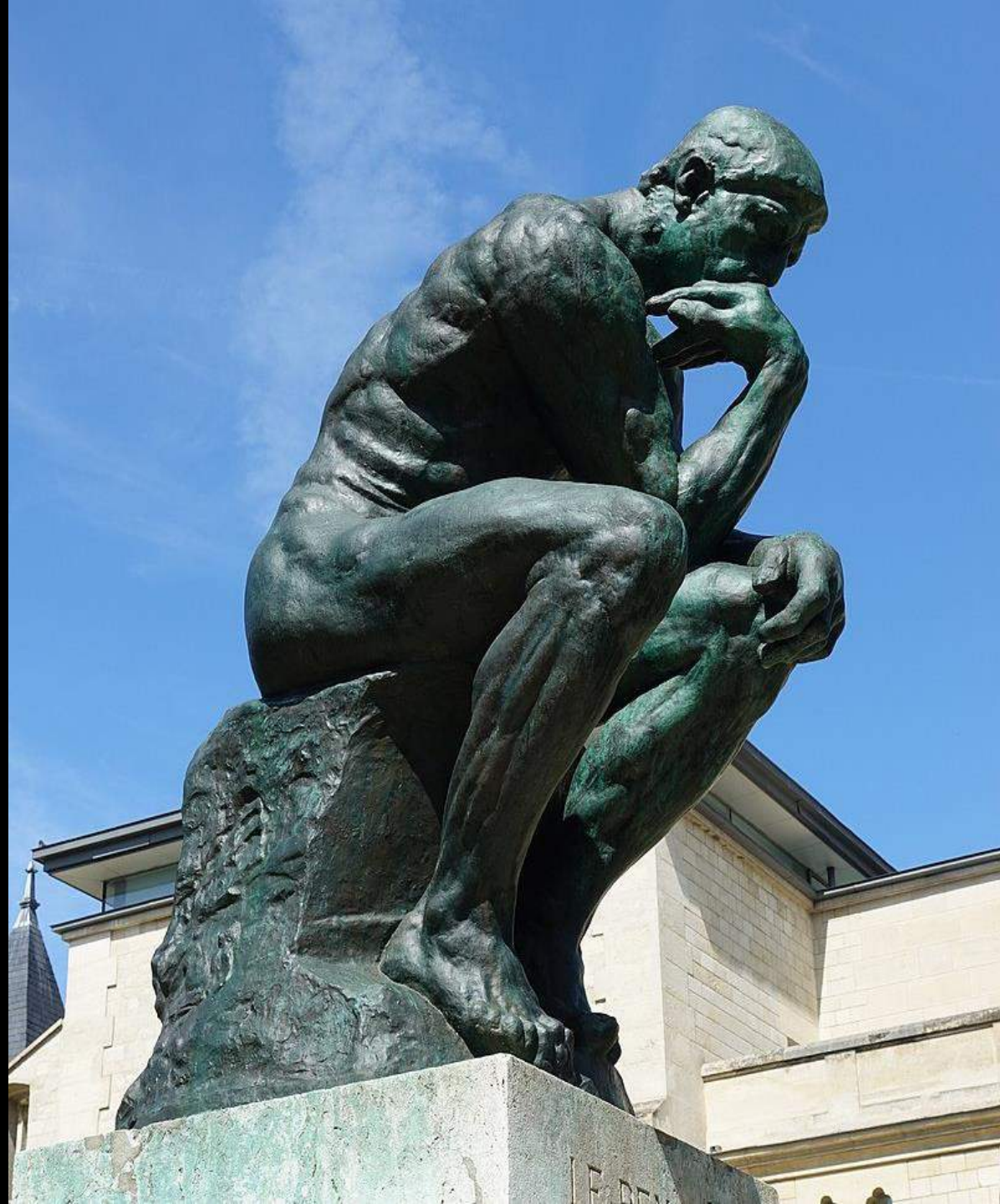
However, undisputed that for Article 10 benefit, assessee needs to be resident of India/NL only for year in which benefit of Article 10 is sought.

Therefore, when for Article 10, *"is"* does not postulate continuous requirement of residence, the same word *"is"* when it appears in the MFN clause can only mean that Slovenia etc. need to be OECD members only when benefit of the MFN clause is invoked.

“35. Learned senior counsel also referred to the opinions of Professor Dr. Robert J Dannon and Prof. Dr. Stef Van Weeghel on the history of treaty provisions and the applicable rules of interpretation, to support the assessees’ arguments.” – that is all??

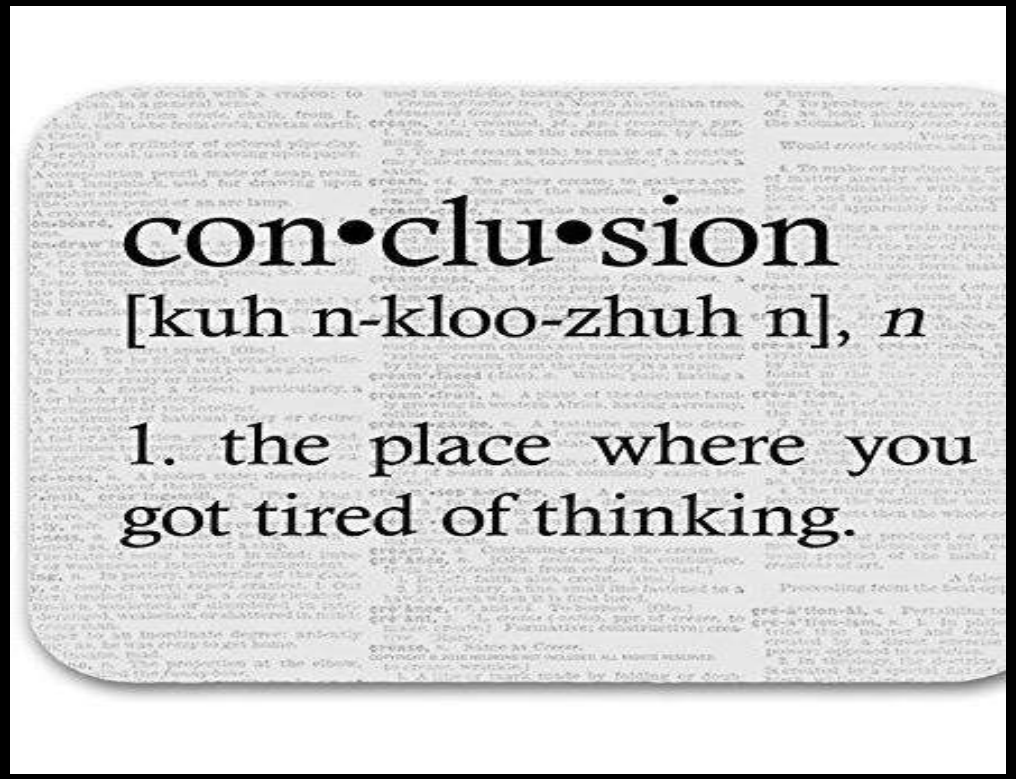
MFN Controversy : Nestle & Ors Judgment SC: Treaty alteration requires legislation

- The structure and phraseology of Article 253 leaves one in no doubt, that it is when a treaty is enacted by law, or enabled through legislation, which assimilates it, that such provisions are enforceable in India.
- Relies on *State of W.B. v. Jugal Kishore More 1969 (1) SCR 320* wherein it was held *executive may make treaties with foreign States for the extradition of criminals, but those treaties can only be carried into effect by Act of Parliament, for the executive has no power, without statutory authority, to seize an alien here and deliver him to a foreign power*
- *State of Gujarat v. Vora Fiddali Badruddin Mithibarwala 1964 (6) SCR 461: "This court observed that in India, unlike some other countries the stipulations of a treaty duly ratified do not by virtue of such event (i.e. signing the treaty alone) have the force of law and Article 253 of the Constitution of India recognises this position.* ***If a treaty either requires alteration of or addition to existing law, or affects the rights of the subjects,*** *or are treaties on the basis of which obligations between the treaty-making state and its subjects have to be made enforceable in municipal courts, or which, involves raising or expending of money or conferring new powers on the government recognizable by the municipal courts,* ***a legislation will be necessary."***



MFN Controversy : Nestle & Ors Judgment
SC conclusion on Need for MFN Notification

1. The terms of a treaty ratified by the Union **do not** ipso facto acquire enforceability;
2. The Union has exclusive executive power to enter into international treaties and conventions under Article 73 [read with corresponding Entries - Nos. 10, 13 and 14 of List I of the VIIth Schedule to the Constitution of India] and Parliament, holds the exclusive power to legislate upon such conventions or treaties.
3. Parliament can refuse to perform or give effect to such treaties. In such event, though such treaties bind the Union, vis a vis the other contracting state(s), leaving the Union in default.
4. The application of such treaties is binding upon the Union. Yet, they "are not by their own force binding upon Indian nationals".
5. **Law making by Parliament in respect of such treaties is required if the treaty or agreement restricts or affects the rights of citizens or others or modifies the law of India.**
6. If citizens' rights or others' rights are not unaffected, or the laws of India are not modified, no legislative measure is necessary to give effect to treaties.
7. In the event of any ambiguity in the provision or law, which brings into force the treaty or obligation, the court is entitled to look into the international instrument, to clear the ambiguity or seek clarity.

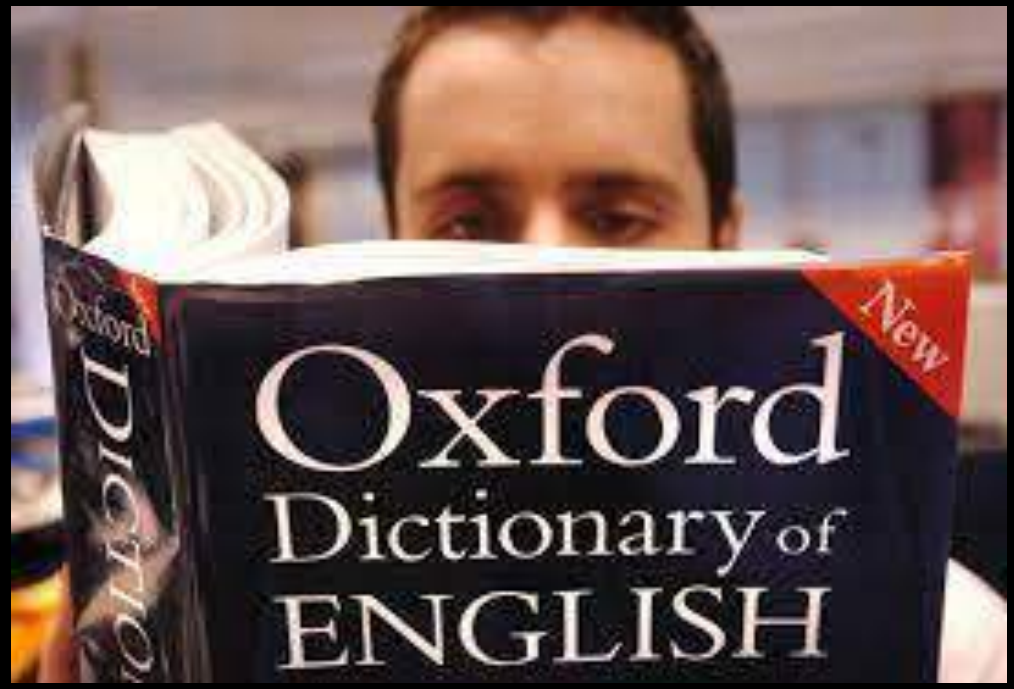


"The legal position discernible from the previous discussion, therefore is that upon India entering into a treaty or protocol does not result in its automatic enforceability in courts and tribunals; the provisions of such treaties and ***protocols do not therefore, confer rights upon parties, till such time, as appropriate notifications are issued, in terms of Section 90(1)****. "*

MFN Controversy : Nestle & Ors Judgment SC on “is”[!!]

- *Jagir Kaur v. Jaswant Singh 8 (1964) 2 SCR 73* "is" was fact dependent and had to be read contextually
- *P. Anand Gajapati Raju v. P.V.G Raju 39 (2000) 4 SCC 539* in the context of the Arbitration and Conciliation Act, 1996, SC explained that “is” normally has present signification
- *Vijay Kumar Prasad v. State of Bihar (2004) 5 SCC 196* relied on

51. From the above discussion, it is clear that the expression “is” has a present signification and it derives meaning from the context. Given this interpretation, the conclusion is that when a third-party country enters into DTAA with India, it should be a member of OECD, for the earlier treaty beneficiary to claim parity.



MFN Controversy : Nestle & Ors Judgment
SC rules on Need for Notification

- SC holds that whilst considering treaty interpretation, **it is vital to take into account practice of the parties**.
    - Issue of treaty interpretation into domestic law is driven by constitutional, political factors subjective to each signatory. So, domestic courts cannot adopt the same approach to treaty interpretation in a black letter manner.
- **SC holds treaty practice of Switzerland, Netherlands and France dictated by conditions peculiar to their constitutional regimes.**
    - *"Could it conceivably be argued that in the event of failure of the Swiss Confederation to secure the requisite majority in a referendum by the Swiss Parliament, or in absence of approval by both houses of States General in Netherlands, a DTAA provision could nevertheless be assimilated into executive decrees? The answer is obviously in the negative."*
    - Likewise, **treaty practice in India points to a consistent pattern of behaviour** when signatory to existing DTAA, points to the event of a third state entering into OECD membership, and a resultant trigger event, the beneficial effect given to the later third-party state has to be notified in earlier DTAA, as a consequential amendment, preceded by exchange of communication (and perhaps, negotiation) and acceptance of that position by India. **Essential requirement of a notification u/S.90 of the consequences of the trigger** event cannot be undermined

Ratio of Nestle Supreme Court Judgment
AO (Intl Tax) vs Nestle SA [2023] 155 taxmann.com 384 (SC)

1. **Mandatory to notify:** SC affirmed that a notification under Section 90(1) is **necessary and mandatory**. It is a condition that must be fulfilled for a Court, Tribunal or Authority to give effect to a DTAA/protocol that alters its terms and conditions, thus affecting the existing provisions of law.
2. **No automatic application:** The Court held merely because a provision in a DTAA or Protocol with one nation requires same treatment in a specific matter, subsequent to its initial signing when another nation receives preferential treatment, this does not automatically lead to integration of such provision to extend same benefit in context of the DTAA of first nation. In such a scenario, the terms of the earlier DTAA need to be amended through a separate notification under Section 90.
3. **Relevant date:** To claim benefit of MFN clause, based on the DTAA between India and the third state that is an OECD member, the relevant date is date when the treaty was entered into with India, not a later date when that country becomes an OECD member.

Will Nestle SC be reviewed? New developments

- SC has been asked to reconsider its judgment of Nestle citing that there is a lot of international material which were not cited.
- Interplay of international law and domestic law on interpretation of treaties including Indian national **Kulbhushan Jadhav's** case
  - Pakistan refused at first to give consular access based on their practice **but international treaty/conventions prevailed.**
- France giving benefit of MFN but India citing **executive practice** not giving.
  - **“Can you pitch executive practice against international law? "** “Dimensions of public international law that have been missed in the judgment... “
- **SC** on review:
  - "Executive practice is not the issue you are arguing, you are arguing that the MFN Clause has actually been notified under Section 90. “
  - While agreeing to hear, SC indicated steep threshold for petitioners to meet as it is not merely about interpretation of a judgment, but rather its reconsideration.
  - **Ordered circulation of review petitions in month of August 2024**

TRC

TRC: BLACKSTONE CAPITAL PARTNERS (SINGAPORE) vs. ACIT

[W.P.(C) 2562/2022, 30.1.2023, Delhi HC]

Taxpayer (a Singapore resident) acquired equity shares of Agile Electric Sub Assembly Private Ltd ("Agile"), a company incorporated in India in two tranches in AY 2014-15.

It subsequently sold all the equity shares of Agile to Igarashi Electric Works Ltd. ("Igarshi") and other parties during the AY 2016-17 ("Transaction").

Claimed that the capital gains arising was not taxable in India in light of Article 13(4) of the India-Singapore Double Tax Avoidance Agreement ("DTAA") **based on the TRC.**

In 2021, S.148 notice for AY 2016-17. Taxpayer objected to reopening, department disposed of such objections. Aggrieved by the disposition, the Taxpayer filed a writ petition before the HC.

"As per filings of Blackstone Group with Securities Exchange Commission, USA, the funds were raised by Blackstone Group Inc., for investing through Blackstone Capital Partner VI (BCP VI), ***therefore, it appears that the source of funds and management of affairs of Blackstone Capital Partners (Singapore) VI FDI Three Pte Ltd., was from USA****. Hence, M/s Black Stone Capital Partners (Singapore) VI FDI Three PTE Ltd., is* ***not entitled for treaty benefit of Singapore.*** *There is an* ***apprehension*** *that M/s Black Stone Capital Partners (Singapore) VI FDI Three PTE Ltd.,* ***is not beneficial owner of this transaction"***

TRC: India-Singapore Article 13

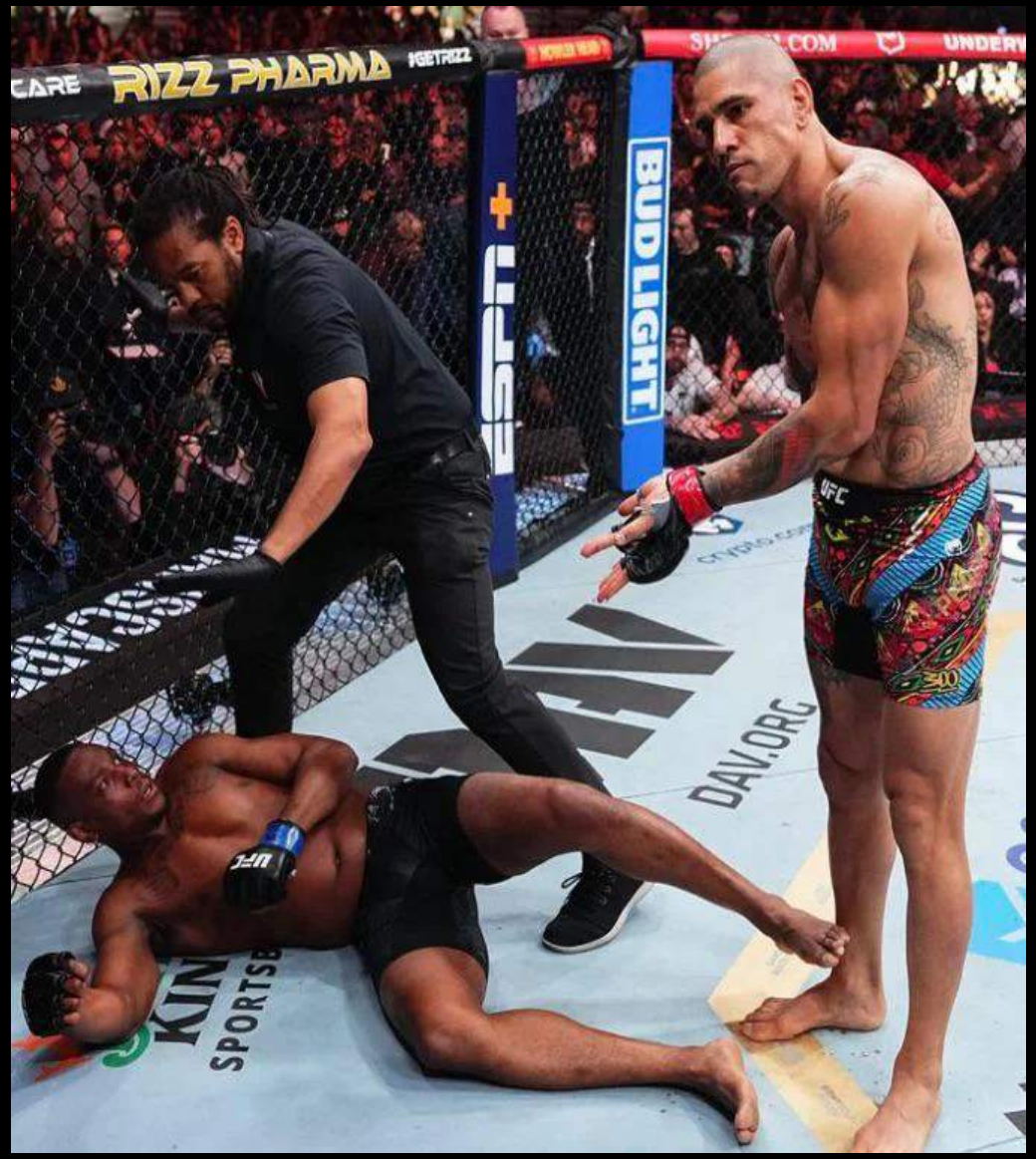
ARTICLE 13 CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.

4. Gains derived by resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of this Article shall be taxable only in that State



TRC: FinMin Press Release

“FINANCE MINISTRY'S CLARIFICATION ON TAX RESIDENCY CERTIFICATE (TRC)

PRESS RELEASE, DATED 1-3-2013

Concern has been expressed regarding the clause in the Finance Bill that amends Section 90 of the Income-tax Act …… Sub-section (4) of Section 90 was introduced last year by Finance Act, 2012. …..

However, it has been pointed out that the language of the proposed sub-section (5) of Section 90 could mean that the Tax Residency Certificate produced by a resident of a contracting state could be questioned by the Income Tax Authorities in India. The government wishes to make it clear that that is not the intention of the proposed subsection (5) of Section 90. **The Tax Residency Certificate produced by a resident of a contracting state will be accepted as evidence that he is a resident of that contracting state and the Income Tax Authorities in India will not go behind the TRC and question his resident status. ….”**

TRC: Delhi HC findings

1. **Beneficial ownership** under DTAA was not required for capital gains: HC held that satisfaction of beneficial ownership was required only qua dividend, interest and royalty.

ARTICLE 10 DIVIDENDS

- Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
- However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the **beneficial owner** of the dividends, the tax so charged shall not exceed: xx…….xx

ARTICLE 11 INTEREST

- Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
- However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the **beneficial owner** of the interest is a resident of the other Contracting State, the tax so charged shall be exceed: xx……..xx

ARTICLE 12 ROYALTIES AND FEES FOR TECHNICAL SERVICES

- Royalties and fees for technical services arising in a Contracting State and paid to resident of the other Contracting State may be taxed in that other State.
- [However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that Contracting State, but if the recipient is the **beneficial owner** of the royalties and fees for technical services, the tax so charged shall not exceed 10 per cent.] xx……xx

ARTICLE 13 CAPITAL GAINS

- Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.
- Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.

TRC: Delhi HC findings

2. Requirements of Limitation of Benefit ("LOB") clause stood satisfied: Audited financial statement of Taxpayer and an independent CA certificate, HC held that the Taxpayer was satisfying the **LOB condition provided in the DTAA.**

- Amended Protocol to the India-Singapore DTAA vide Notification No.1022 (E) dated 18th July, 2005 provides for an objective and not a subjective test, namely, the LOB clause.
- Protocol limits the application of the DTAA to entities that are not shell/conduit companies in Singapore with negligible or nil business operations or with no real and continuous business activities carried out in Singapore.

Article 3

1. A resident of a Contracting State shall not be entitled to the benefits of article 1 of this protocol if its affairs were arranged with the primary purpose to take advantage of the benefits in article 1 of this protocol.

2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of article 1 of this protocol. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

3. A resident of a Contracting State is deemed to be a shell/conduit company if its total annual expenditure on operations in that Contracting State is less than S$200,000 or Indian Rs. 50,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 24 months from the date the gains arise.

4. A resident of a Contracting State is deemed not to be a shell/conduit company if:

(a) it is listed on a recognised stock exchange of the Contracting State; or

(b) its total annual expenditure on operations in that Contracting State is equal to or more than S$200,000 or Indian Rs. 50,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 24 months from the date the gains arise.

TRC: **Respondent-revenue cannot go behind the TRC of another jurisdiction**

3. ***"it is a fundamental rule of international taxation that every nation has a sovereign right to impose tax on the global income of its residents and on income that accrues or arises within its territorial limits"*** **and** ***"Respondent's attempt in seeking to question the TRC is wholly contrary to the Government of India's repeated assurances to foreign investors."***

HC referred to:

- **Union of India vs. Azadi Bachao Andolan, [2003] 132 Taxman 373 (SC)** which upheld validity of CBDT Circulars No.682, 789 dated 30th March, 1994 and 13th April, 2000
- **Vodafone International Holdings B.V. vs. Union of India and** Anr., (2012) 6 SCC 613 which held ***Azadi Bachao Andolan (supra)*** is correct and TRC is sufficient evidence to show residence of the contracting state
- **CIT (International Taxation)-3, Mumbai vs. JSH (Mauritius) Ltd**., [2017] 297 CTR 275 (Bom)
- **Sanofi Pasteur Holding SA V. Department of Revenue, Ministry of Finance,** [2013] 354 ITR 316 (AP)
- **Serco BPO (P.) Ltd vs Authority for Advance Rulings, New Delhi,** (2015) 60 taxmann.com 433 (Punjab & Haryana)

- **HC noted that TRC is statutorily only evidence required to be eligible for the benefit under the DTAA. Ruled that the tax authorities cannot go behind the TRC issued by the other tax jurisdiction and such an attempt is not tenable in law.**
- **Stayed by SC!**

PE

DTAA Articles: Article 5 - PE - Example from OECD MC

Article	What it covers	Type of PE
Article 5(1)	Basic Rule	Fixed base PE
Article 5(2)	Illustrative list	Fixed base PE
Article 5(3)	PE in relation to projects	Construction & Service PE
Article 5(4)	List of exclusions	Exclusions from Fixed base PE
Article 5(5)/5(6)	Dependent & Independent Agent	Agency PE
Article 5(7)	Associated Enterprise	Subsidiary PE

CIT v. Vishakapatnam Port Trust (44 ITR 146 AP)

"The words Permanent Establishment postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a ***virtual projection of the foreign enterprise of one country onto the soil of another country****.*

- Circular No. 14 of 2001 ([2001] 252 ITR (St.) 65, 107) clarified that term PE not been defined in Act but its meaning understood from DTAA.
- However, vide Finance Act, 2002, the definition of PE was inserted in the Act under **S.92F(iiia)** which states that the PE *includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.*
- Morgan Stanley [2007] 292 ITR 416 (SC) observed that the PE is an **inclusive** definition - service PE, agency PE, construction PE, etc.

Fixed base PE

- Income generating activities?
- Preparatory & Auxiliary activities?

Agency PE

- Dependent Agent?
- Independent Agent?

Installation/ Construction PE

- Building site, construction, installation project > 6/12* months?

Service PE

- Services by employees or others if last beyond period aggregating to 90* days in a year

Article 5(1) - Fixed Base PE

In OECD, UN and US Models:

"For the purpose of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on"

- ✓ Existence of 'place of business'
- ✓ Place of business is at disposal
- ✓ Place of business must be 'fixed'
- ✓ Business is carried on wholly or partly through fixed place of business

"Place of business"?

- Reasonable degree of permanence and continuity
- Geographical and Commercial Coherence

"Place of business at disposal"?

- Certain space should be available at the disposal
- Ownership test – immaterial
- Some domain / control / right to use is required
- Test of place of business at disposal (para 4.2 – 4.6 of OECD MC)

Article 5(2) - Fixed base PE Inclusive List - MC

- A place of management
- A branch
- An office
- A factory
- A workshop
- A mine, an oil or gas well, a quary or any other place of extraction of natural resources

Article 5(3) - Construction/Installation PE

"A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months"

"a) A building site, a construction,assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than six months;"

"(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned."

Article 5(4): PE Exclusions

Auxiliary/Preparatory Activities

- Use of facilities for storage or display of goods
- Maintenance of stock of goods for storage or display
- Maintenance of stock for processing of goods
- Purchasing goods or merchandise or for collecting information for the enterprise
- Carrying on, for the enterprise, any other **activity of a preparatory or auxiliary character**
- **Crux: What is a core vs preparatory/auxiliary activity?**
    - Can we split up activities into separate entities? Anti-"Fragmentation" rule
- **Does an Indian liaison office constitute a PE?**

Mere downloading info, issuing cheques not PE: **UOI vs UAE Exchange Centre (CA 9775/2011 dated 24-7-20)**

Project Office setup to act as a "communication channel" between Samsung and ONGC does not constitute a PE: **DIT vs. Samsung Heavy Industries (CA 12183 of 2016, 22-7-20 SC)**

Crux: What is a core vs preparatory/auxiliary activity?

- Can we split up activities into separate entities? Anti-"Fragmentation" rule

Article 5(5) - Agency PE - DAPE - OECD & UN Model

"5(5). …where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, ***habitually concludes contracts****, or habitually plays the principal role leading to the conclusion of contracts that are* ***routinely concluded without material modification*** *by the enterprise, and these contracts are*

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment…"

Person said to have authority to conclude contracts if, he/she:

Sufficient authority to bind foreign enterprise, decide final terms.

Can act independently, without control from the principal

Is authorized to negotiate all elements, details of a contract

Approval of contract by foreign enterprise is mere formality

Article 5(6)– Agency PE – Independent Agent

Paragraph 5….shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an ***independent agent and acts for the enterprise in the ordinary course of that business****. Where,* ***however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related****, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*

Article 5(7) - Subsidiary PE

"The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other"

- Identical under OECD, UN and US MC

- **Existence of a subsidiary by itself does not constitute PE**
  - Legal independence of the subsidiary respected
  - Test of fixed base PE / service PE / agency PE need to be satisfied
  - ***Daimler Chrysler AG (39 SOT 418) case***

PE: Mastercard case

Mastercard Asia Pacific Pte Ltd., Singapore – (2018) 406 ITR 43 AAR

How you lose your money in 5 easy steps

- ***Mr. VV presents the credit card*** *(MasterCard) at vendor outlet (Fruit Shop on Graemes Road!).*
- ***Vendor swipes the card*** *using the Pos Device forwarding transaction to its bank (**the acquirer bank**) for authorization. This is now forwarded to the cardholder's bank (the **issuer bank**) through the **MasterCard Interface Processor (MIP),** a small PC-like device at acquirer and issuer banks.*
- *Once the **transaction is authorised**, the vendor is paid by acquirer and the transaction is complete in so far as the vendor/consumer. The vendor is required to pay a "merchant service fee" to its bank (acquirer).*
- *MasterCard facilitates authorization, clearing and settlement of transaction between the cardholder and the merchant via the issuer and acquirer. Settlement **between the issuer bank and the acquirer bank occurs through a settlement bank (Bank of India)** appointed by MCI which owns the settlement bank account. If the settlement is successful between acquirer and issuer, the settlement bank account would end-up with a nil bank balance. Credit - Debit!*
- *Issuer bank pays the acquirer bank the value of the transaction less interchange fees and the transaction is posted to the cardholder's account. Issuer issues the cardholder with a bill to collect the amount of the purchase ☹*

PE: Mastercard case

- Remember, Mastercard's customers are the banks! The banks and financial institutions are required to pay

(i) transaction processing fee

- relating to authorization, clearing and settlement of transaction;

(ii) assessment fees for building and maintaining a processing network

- that serves the needs of customers globally and also for setting up rules that govern authorization, clearance and settlement process for every payment authorization, so as to maintain integrity and reputation of network and also to guarantee settlement.

(iii) miscellaneous fees for ancillary activities

- warning bulletin fees for listing invalid or fraudulent account, cardholders service fee, programme management service, account and transaction enhancement services, holograms and publications.

PE: Mastercard case
Questions to the AAR

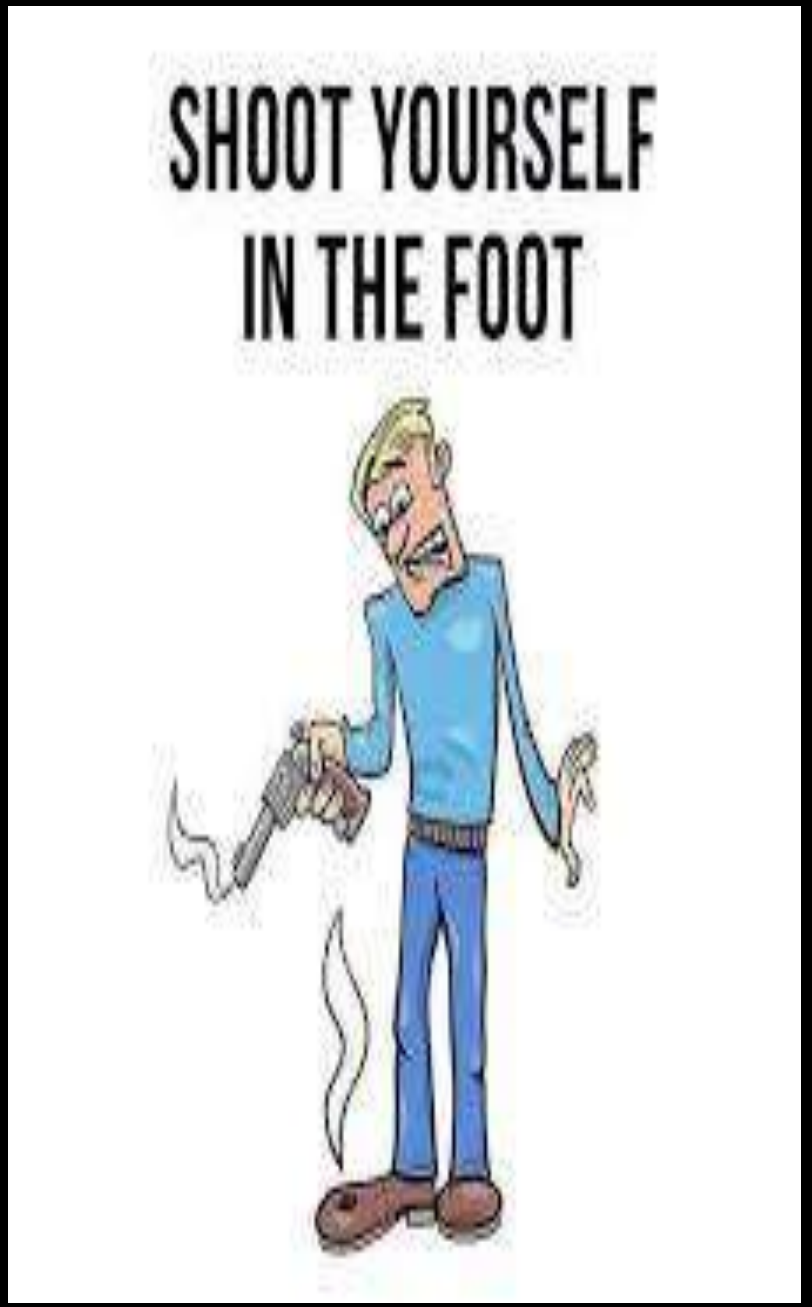
Master Card Asia Pacific Pte (Mastercard Singapore) went to AAR on **taxability of fees of services for use of a global network, infrastructure to process card payment s for Indian customers:**

(i) Whether Mastercard Singapore (MAPPL) has a **permanent establishment in India under Article 5** of the Indo Singapore DTAA…..?

(ii) ……**whether provision of arm's length remuneration** to such PE…**would absolve any further attribution** of the global profits of the applicant in India?

(iii) …. fees received by Singapore from Indian customers…..chargeable to tax in India?

(iv) …whether any tax withholding at source would be required.



PE: Mastercard case AAR decision

(i) **Yes, Mastercard Singapore has a permanent establishment in India under Article 5** of the India-Singapore DTAA. Further, there is a **fixed place** PE, **service PE** and **dependent agent PE**!

(ii) **No, Arm's length remuneration to the PE will not absolve Master Card Singapore** from any further attribution since FAR of Indian sub. does not reflect functions / risks of Singapore.

(iii) **Yes, part of fees to be received by Singapore** from India **would be classified as 'royalty'** However it would be taxed under Article 7.

(iv) Yes, **required to withhold tax at source** on amount attributed to Indian PE at rate at which NR is subjected to tax in India.

PE: Mastercard case
AAR: **Why** fixed place PE?

MIP is fixed place PE

- MIP Automatic equipment can also create a PE.
- MIP owned by Indian subsidiary (MIPL) not relevant.
  - Space at disposal of foreign entity used for business
- MIP does primary validation, PIN checking. Significant role and not preparatory/auxiliary!
- Indian subsidiary MIPL's FAR profile shows it does only support and not transaction processing.
- MIP upgrade, maintenance by third party, AE of MasterCard Singapore who is thus real owner
- All risk decisions taken by Mastercard Singapore not MIPL

Mastercard Network is fixed place PE!

- MasterCard network in India made up of *MIP, transmission tower, leased line, fibre optic cable, nodes, internet* owned by third party providers *and application software* owned by Singapore.
- Network passes the test of permanency and fixed place. Passes test of disposal
- Application software owned by Singapore, controlled by them and at their disposal.
- Network provided by third-party service provider in India also at disposal of MasterCard Singapore.

PE: Mastercard case
AAR: **Why** dependent agent PE?

Bank of India premises constitutes fixed place PE

- 90+% of settlement done by BOI in India on behalf of MasterCard Singapore through a dedicated team.
- Employees of BOI carrying out this work are under the control and supervision of Singapore and space occupied in BOI is at disposal of Mastercard Singapore.

Indian subsidiary (MISPL) is Dependent Agent PE

- Orders routed through MISPL though finalization of contract by Singapore. **May not satisfy 'concluding contract' but certainly satisfies 'securing order'.**
- The term **'habitually'** interpreted in context of business. Only 2-3 contracts in a year, 'habitually' would be satisfied.
- MISPL is dependent agent PE on account of **habitually securing orders wholly for applicant.**

PE: Mastercard case
AAR: **Why** Royalty? Why **service PE**?

Royalty

1. Licensing of trademark / logo, etc. is dominant purpose. Royalty paid by Singapore to MCI, US (in INR) is for use of IP in India for and in connection with the promotion and sale of goods or services.

2. Whether MCI US is rendering transaction processing services or not does not matter. What matter is these IPs for which Singapore applicant further sub-licenses it to various banks in India.

Royalty

3. It is consumer who is using IPs and hence the payment made by it to merchant as a part which represents payment for use of MasterCard IP.

4. The use of software inside MIP and cards in application software are essential part without which no transaction can be completed. Use of software is royalty and is effectively connected to the permanent establishment.

Service PE : Visit of employees of Singapore for introducing new products to the existing customers constitute service PE, if their stay exceeded 90 days.

PE: Mastercard case
AAR: **Why** service PE and **why** further attribution?

Further attribution necessary:

(i) Where a subsidiary has a fixed place PE, the **Morgan Stanley** ruling would not apply.

(ii) FAR profile of MISPL does not fully capture its role. **AO may consider further attribution** to PE.

Further attribution necessary….

(iii) Even in DAPE, there is need for **further attribution** since functions not reflected in FAR.

(iv) All revenues received by applicant from India not be attributed to Indian PE, significant activities carried outside India.

PE: Mastercard case (Delhi HC)

- MasterCard Delhi HC hearings – completed. Order reserved
- AAR judgment assailed on every front….
- Delhi HC in another Mastercard held *Equalization levy* won't apply
- Illustrative of potential PE litigation
  - **Example: Durr Gmbh Contract Risk – Storage PE**

Morgan Stanley: PE attribution

Facts:

- **MS & Co. USA** group - Morgan Stanley; **MSAS** India supports the group front office and infrastructure unit functions globally operations.
- **MS & Co. outsourced activities to MSAS via service agreement.**
- MS & Co. personnel for **stewardship** and for **deputation on lien**.

SC and AAR ruling:

- **PE:**
  - MSAS operations results in neither fixed place or service PE of MS &Co. But deputation is service PE while stewardship is not.
- **Attribution to PE:**
  - **SC held once ALP has been paid to PE, nothing further can be attributed to the PE.**
  - AAR had held no portion of profits of MS & Co. taxable in India **if PE compensated at ALP**. Relied on Circular 23 of 1969, 5 of 2004 . **SC held AAR is correct** that once proper TP analysis is undertaken, no further attribution of profits to a PE.

SET Satellite:

SET Satellite Singapore Pte vs DDIT (218 CTR 452 Delhi HC)

- Singapore appellant through dependent agent SET India (P) Ltd., is carrying on marketing activities in India for advertisement slots.
- Only income attributable to appellant's Indian operations viz *marketing time slots* taxable in India.
  - Ad revenue earned were not attributable to PE as contracts made outside India (CBDT Circular 23 r.w. Article 7(1))
- Delhi HC: **Appellant remunerated SET India DAPE on arm's-length basis, no further attribution to DAPE required.**
  - Only requirement per Article 7(2) to ascertain ALP if instead of SET India similar activities were carried out through an independent enterprise, then what would be the amount that would have been charged by such enterprise and the difference would be regarded as the profit attributable to the PE.
- Followed ***Morgan Stanley*** SC decision.
- SLP before SC:
  - Dept says Morgan Stanley does not apply for DAPE! Is MS being revisited?

Virtual PE – SEP - S.9(1)(i) Explanation 2A, 3A

"significant economic presence"—

(a) transaction in respect of any goods, services or property carried out by NR with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions (OR)

INR 2 crores

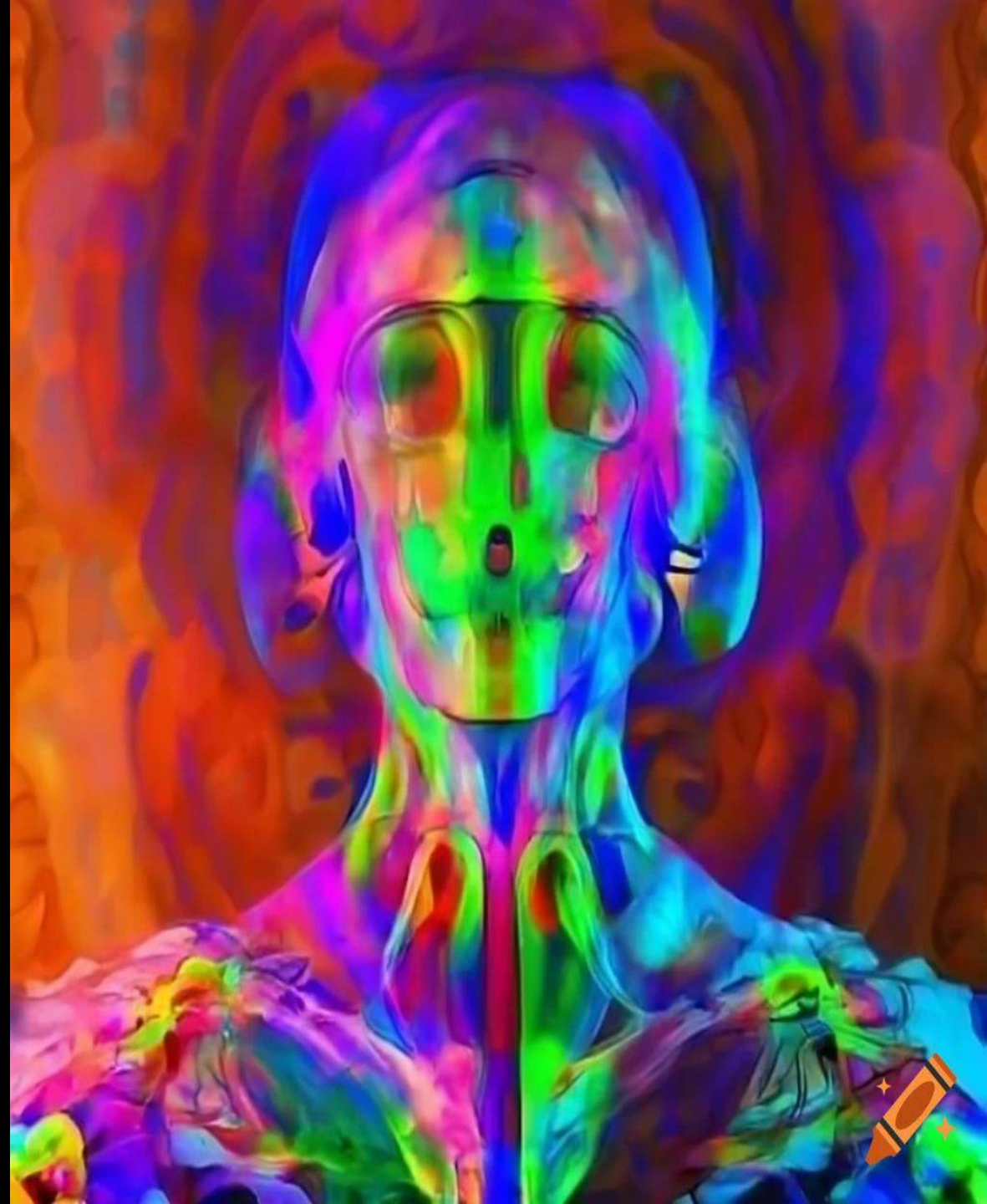
(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India

300,000 users

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Whether or not:
(i) agreement for such activities is entered in India; or
(ii) NR has a residence or place of business in India; or
(iii) NR non-resident renders services in India:

W-e-f 1-4-2022



Virtual PE – SEP - S.9(1)(i) Explanation 2A, 3A

- Can it override Article 5 r.w Article 7 of DTAA?
- IP address defined in the IT Act?!!

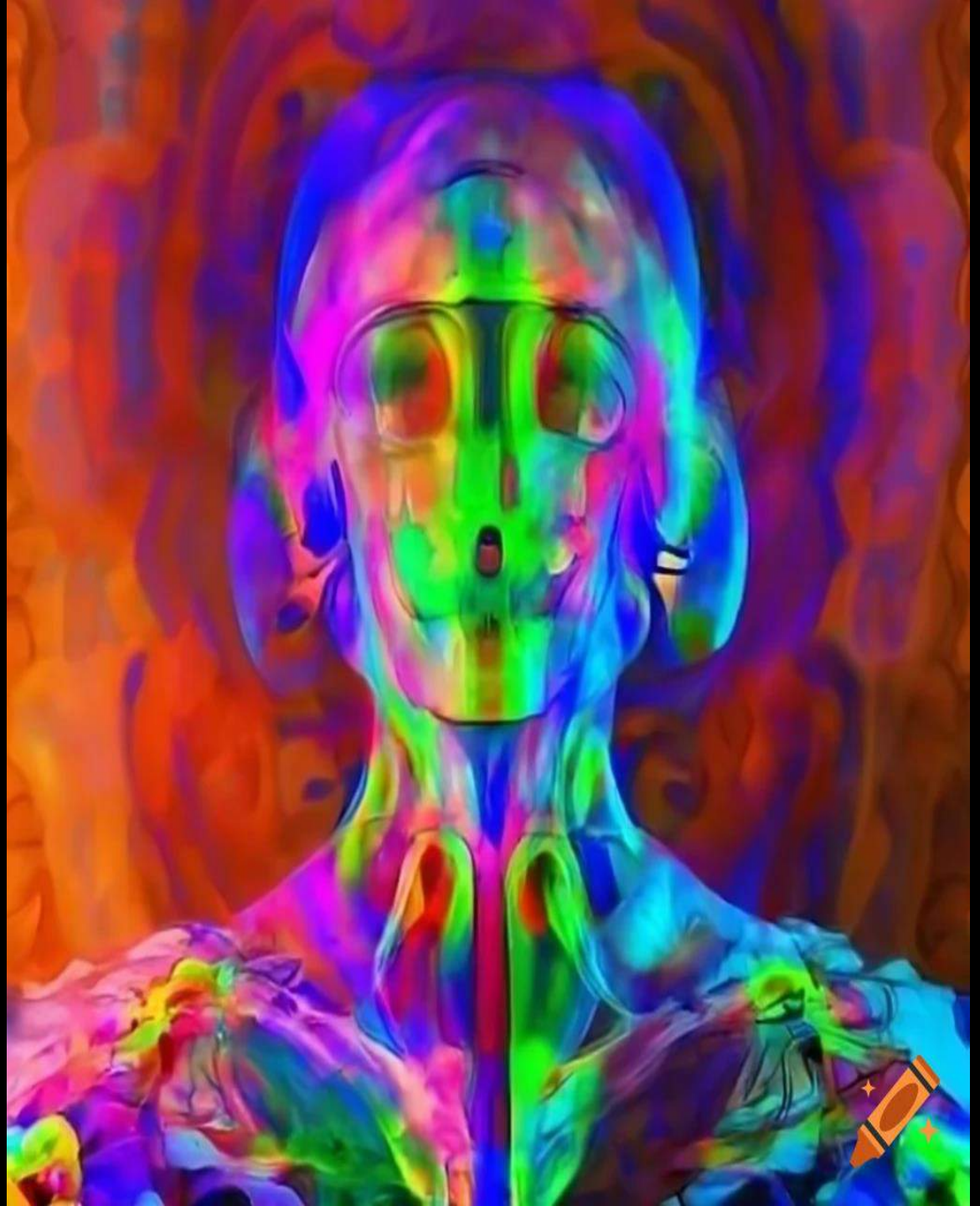
Explanation 3A - …income attributable to the operations carried out in India…shall include income from

*(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through **internet protocol address** located in India;*

*(ii) sale of data collected from a person who resides in India or from a person who uses **internet protocol address** located in India; and*

*(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses **internet protocol address** located in India:*

Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A.



Equalization Levy

- **EL1.0:** FA 2016 introduced EL on payments for online advertisements ("specified service")
  - Received by NR not having Indian PE
  - S.10(50) to exempt under IT Act, S.40(a)(ib) for disallowing payment without EL.
  - S.166(1)-(3) calls for deduction by payer on specified services at 6% on gross amounts
- **EL 2.0:** FA 2020 – EL is widely expanded!
  - On consideration receivable from **specified payers** by NR **e-commerce operator** engaged in **e-commerce supply or services** made or provided or facilitated by it
  - E-commerce operator, e-commerce supply and services, specified players all widely defined
  - 2% of consideration of e-commerce operator
- Many precedents prior to EL that online ad payments not taxable in India –no PE! Ex: Pinstorm, Right Florists, eBay

E-commerce operator –NR who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both

E-commerce supply or services – S.164(cb) –

- Online sale of goods owned by e-commerce operator
- Online provision of services by e-commerce operator
- Both *facilitated* by e-commerce operator

Specified payers – S.165A(1)

- A person resident in India; or
- An NR in 'specified circumstances'
- A person who buys goods, services using Indian IP

Specified circumstances – S. 165A(3)

- Sale of advertisement targeting a customer, who is resident in India or accesses the advertisement through an IP address located in India
- Sale of data collected from customer, who is resident in India or from a person using Indian IP

EL 2.0 - Finance Act, 2021 – Adding salt to wound?

S.163(3) Proviso - the consideration received for specified services shall not include the consideration which is taxable as royalty/FTS under Act/DTAA

Explanation to S.164(cb) that "online sale of goods" & online provision of services" shall include:
(a) acceptance of offer for sale; or
(b) placing of purchase order; or
(c) acceptance of purchase order; or
(d) payment of consideration; or
(e) supply of goods, provision of services, partly or wholly

S.165A(3)(b) providing that consideration received from e-commerce supply or services shall include:

- Consideration for sale of goods **irrespective of whether the e-commerce operator owns the goods**
- Consideration for provision of services **irrespective of whether service** facilitated by e-commerce operator

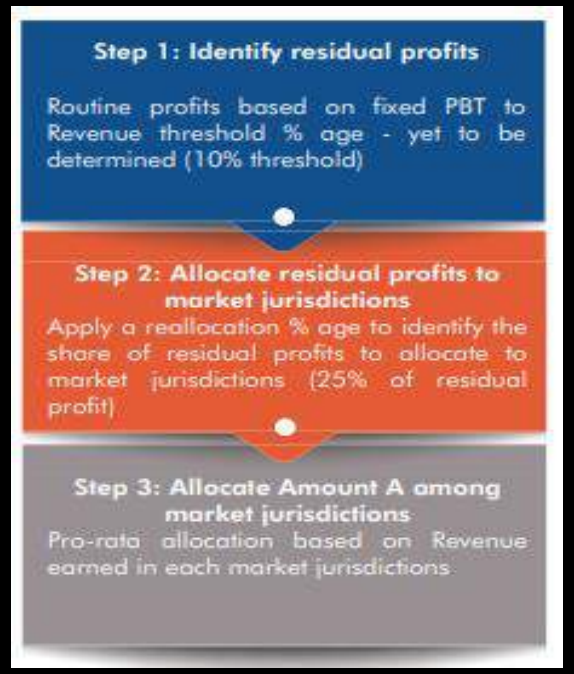
Coursera Inc vs ITO (WP 13678/2023, 9.1.2024) : *Dept said 15% TDS in addition to 2% EL.*
Delhi HC reduced rate of tax to be deducted giving effect to the EL being paid (i.e., 13%)

OECD Two Pillar Approach

- While BEPS was going on, countries took unilateral measures to address the gaps in the global tax architecture.
  - UK's Digital Services Tax, India introduced Equalization Levy etc.
  - USA retaliated with trade measures.
- So, OECD was forced to come up with its radical Two-Pillar approach and has now been formalized with 137 (out of 141) world’s largest economies agreeing to be a part of the Inclusive Framework and implement this approach.

PILLAR ONE

Large MNES (turnover > Euro 20billion) and profitability > 10% would allocate 25% of excess profits ("residual profits") to countries where they sell their products irrespective of the physical presence.



PILLAR TWO

Global Anti-Base Erosion (GlOBE) Rules provides that all countries will impose a **minimum tax of 15%** on corporates.

While countries may still choose to not impose a 15% tax, P2 provides where profits are in places where tax < 15%, source country can tax those profits by way of application of following rules:

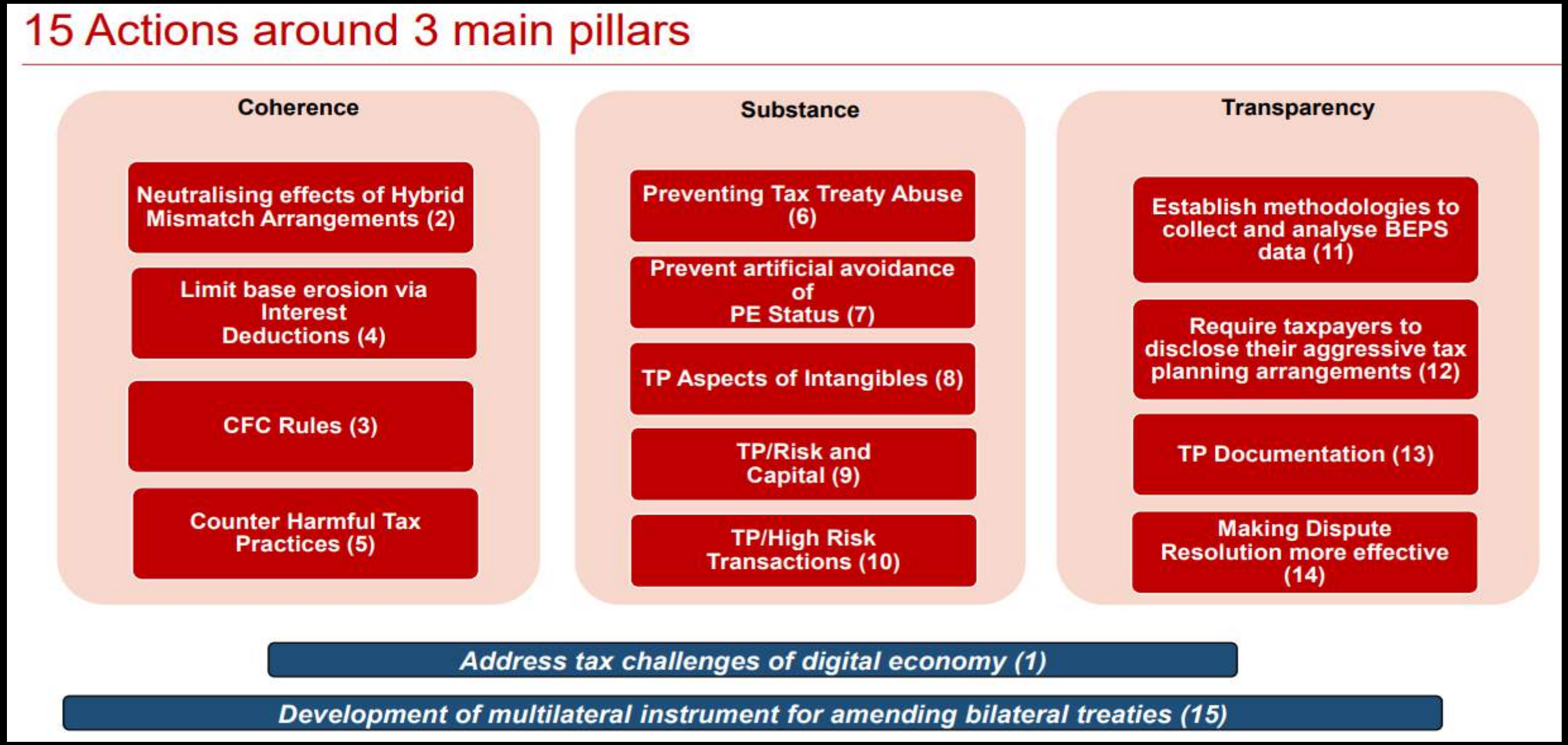
Income Inclusion Rule ('IIR')	Parent company pays **top-up tax**[2] on its proportionate share of income of its group entity located in low-tax jurisdiction
Switch-Over Rule ('SOR')	Compliments the IIR by providing an enabling mechanism to overturn tax treaty obligations.
Undertaxed Payments Rule ('UTPR')	This rule kicks in especially in cases where IIR is inapplicable. As per UTPR, the MNE Group will allocate top-up tax to group entities in the ratio of deductible payments made by such companies to the entity located in low-tax jurisdiction. IIR has priority over UTPR.
Subject to tax Rule ('STTR')	This Rule triggers when the covered payment is subject to nominal rate of tax in payee jurisdiction. For example, if the payment is taxable at 5% in payee jurisdiction, as per STTR, additional withholding tax of 4% will apply in the payer jurisdiction (irrespective of the tax treaty rate).

OECD Two Pillar Approach

- The Multilateral Convention (‘MLC’) will require all parties to withdraw all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future.
- No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.
- **India would withdraw its Equalisation levy provisions** in sync with the commitment agreed to by the members of the Inclusive Framework.
    - Expected to increase tax collection via Two Pillar!

PPT

OECD Base Erosion Profit Shifting (BEPS) Actions



BEPS: India's rapid response

Action Plan 1	Equalization Levy, Significant Economic Presence (SEP)
Action Plan 4	S.94B - Interest claimed by entity to AE restricted to 30% of EBITDA (or) interest payable to AE whichever is lesser
Action Plan 5	S.115BBF - Royalty income from patent developed and registered in India @ 10%. No deduction allowed against it.
Action Plan 8-10	India committed to implementing the BEPS reports on TP recos. Receipt of low-value intra-group services added in Safe Harbour rules
Action 13	Rule 10DB - CbCr in IT Act

MLI: A primer

What is it?	A single instrument that modifies multiple tax treaties in one stroke (OECD/G20)
Applicability	Not automatic. Have to be signatory to MLI. And both Contracting jurisdictions need to notify their tax treaties as Covered Tax Agreements (CTA)
CTA?	A Tax Treaty that is in force between two or more Parties with respect to which each such Party has notified to the Depository as a listed agreement under the MLI
Impact on DTAA	Will not replace the existing treaty, but operate alongside it– supplement, compliment and modify application of DTAA!
Is DTAA frozen, is MLI frozen?	No and No.
Rule of interpretation	MLI to be interpreted in accordance with ordinary principles of treaty interpretation

MLI: Flexible Framework

Minimum Standards	All countries to meet Minimum Standards (BEPS AP 6 - Treaty Abuse, AP 14 - Dispute Res.)
“Reservations”	Flexibility to opt out of a provision if not MS
Optional Provisions	Choose among alternate provisions intended to address the same issue
Notification clauses	Notify choice of optional provision and existing provisions of CTA to be modified/replaced
Compatibility clauses	MLI provisions applies “in place of”, “applies to”, “modifies”, “in the absence of”

Hierarchy to check whether a DTA is affected by MLI:

i) Is the DTA notified by both the countries under article 2(1)(a)(ii) i.e., CTA of MLI? If yes, then MLI applies to the DTA prima facie. If any of the countries has not notified the DTA, MLI will not apply.

ii) **Reservation:** Has any country made a reservation for any provision of MLI? If yes, then that MLI provision does not apply. DTA is not affected. This is the position, even if the other county has not made a reservation. Thus, if no country makes reservation for the MLI provision, the MLI provision will apply.

iii) **Optional provision:** Have the countries selected the optional / alternative provision of MLI?

- i) If yes, have they selected the same option? If yes, the MLI will modify the DTA.
- ii) If any one country does not select an option, or both countries select different options, that MLI provision (the options) does not apply.

Indian CTAs

MLI to enter into effect from 1 April 2020

List of jurisdictions that have notified tax treaty with India as CTA and have deposited their ratification instruments with OECD Secretariat by 30 June 2019

Austria	Australia	**Belgium**
Finland	**France**	Georgia
Ireland	Israel	**Japan**
Lithuania	**Luxembourg**	Malta
Netherlands	New Zealand	Poland
Russia	Serbia	**Singapore**
Slovak Republic	Slovenia	Sweden
United Kingdom	**UAE**	

Article 7 – Prevention of Treaty Abuse – Minimum Standard

- Provides safeguard against “treaty abuse”
- **Statement of intent in clear terms** to avoid creation of opportunities for non-taxation or reduced taxation through tax evasion including treaty shopping arrangements
- Introduction of **Principal Purpose Test** (compare it with GAAR). **This is a Minimum standard!**
- Optional Provisions:
  - **India has chosen to apply SLOB. <u>So, India position = PPT+SLOB</u>**
  - The SLOB will apply if all countries to the DTA have chosen to apply the SLOB. If one country applies SLOB and the other does not, then SLOB will not apply. Only PPT will apply.
  - E.g. U.K. has not opted SLOB. Hence SLOB will not apply to India-UK DTA.

Article 7 – Principal Purpose Test

"Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, ***that obtaining that benefit was one of the principal purposes of any arrangement or transaction*** *that resulted directly or indirectly in that benefit,* ***unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.****"*

- "One of the principal purposes" – Tougher than GAAR?!
- Onus on Department.

Transfer Pricing

TP: Intra-group Management fees

- **Intra-group Management fees paid to AE** typically for centralized services around HR, IT, Payroll etc.
  - Being subject to TP adjustment: How the tide has turned!

- Number of Tribunals have recently held:
  - Agreements with description of services and benefits,
  - Mere Email correspondences for proof of rendering service,
  - Certificates of AE to show allocation basis

  are NOT enough to show proof of service.

  Crux is showing proof of rendering of service

- Legal Questions persist around:
  - Role of TPO to arrive at ALP instead of averring genuineness?
  - Can benefit test be applied by TPO?
  - Can single transaction be carved out of TNMM entity level ?
  - Can CUP be applied without comparables to arrive at ALP NIL?
  - Are the OECD IGS Guidelines being interpreted correctly?

TP: Interest on outstanding receivables

- TP adjustment on charging notional interest on outstanding receivables after 31st March
- **Department: Separate transaction after insertion of S.92B Explanation in Finance Act 2012.**
- Number of Tribunal rulings taking different view than in Delhi HC upholding charging of LIBOR rates on outstanding receivables

Assessee's arguments	Cases in favour
Cannot be separate international transaction; early/late realization is incidental to business	Valuelabs vs ACIT (ITA hyd 1910/Hyd/2017)
Working capital adjustment subsumes any need for this separate adjustment	**Kusum Healthcare vs. ACIT (ITA 765 of 2016, Delhi HC)**
Debt free company	**PCIT vs Bechtel India (ITA 379/2016, 21.7.2016 Delhi (SLP CC4956/2017)**
No contractual right to receive interest on delayed receivables either.	Indo American Jewellery Ltd (ITA 1053 of 2012)
PLR is not appropriate	Cotton Naturals I Pvt Ltd (ITA 233 of 2014)

TP: Is Forex loss operating or not?

- Is it linked to running of business?
- Who is to bear forex risk? India co or AE?
- What about Safe Harbour rules?
  - Rule 10TA(j)(iv) of IT Rules, 1962 and Safe Harbor Rules defines operating expenditure and operating income and as per said Rules forex loss/gains has been specifically excluded from operating expenses or operating income.
- SC decision in *Shah Originals vs CIT in CA No. 2664/2011*
  - Nature of forex loss/gains from EEFC account u/s. 80HHC does not fall within the meaning of 'derived from' export .
- Differing decisions by Tribunals!
- **Economic adjustments:** Highly litigated **-** *Customs duty, Cash-PLI, Capacity utilization.* Mixture of facts & law

Secondment + Salary

Secondment

- **Deputed employees (secondees) from Foreign Co. to Indian Subsidiary Co.**
- Work for Indian Co. for few years. Lien with Foreign Co. to return after that time.
- Salary paid directly overseas by Foreign Co to deputed employees' foreign bank accounts and claimed as reimbursement from Indian Sub Co
- Such **salaries offered to tax in India** by the secondees after withholding tax obligations for employee taxes.
- **Whether reimbursement of salary cost of secondees by India to Foreign co was income of Foreign.Co liable to TDS u/s 195?**

Centrica Delhi HC (SLP dismissed by SC)

FTS applicable with secondees "making available" their technical expertise!

Service PE – applicable!

Payment is not reimbursement, rather payment for services

Payment is not diversion of income by overriding title

In Northern Operating Systems SC recently said Indian Co Liable To **Service Tax** On Secondment From Overseas Group as *Recipient Of Manpower Supply*

Morgan Stanley Mumbai ITAT

Service PE created

Not FTS.

Once Service PE created, FTS will not apply. Centrica did not consider the exclusion clause

Service PE revenue offset by deductions of salary costs.

Flipkart, Boeing, AT&T

Control and supervision with Indian Sub. Co.

Not FTS

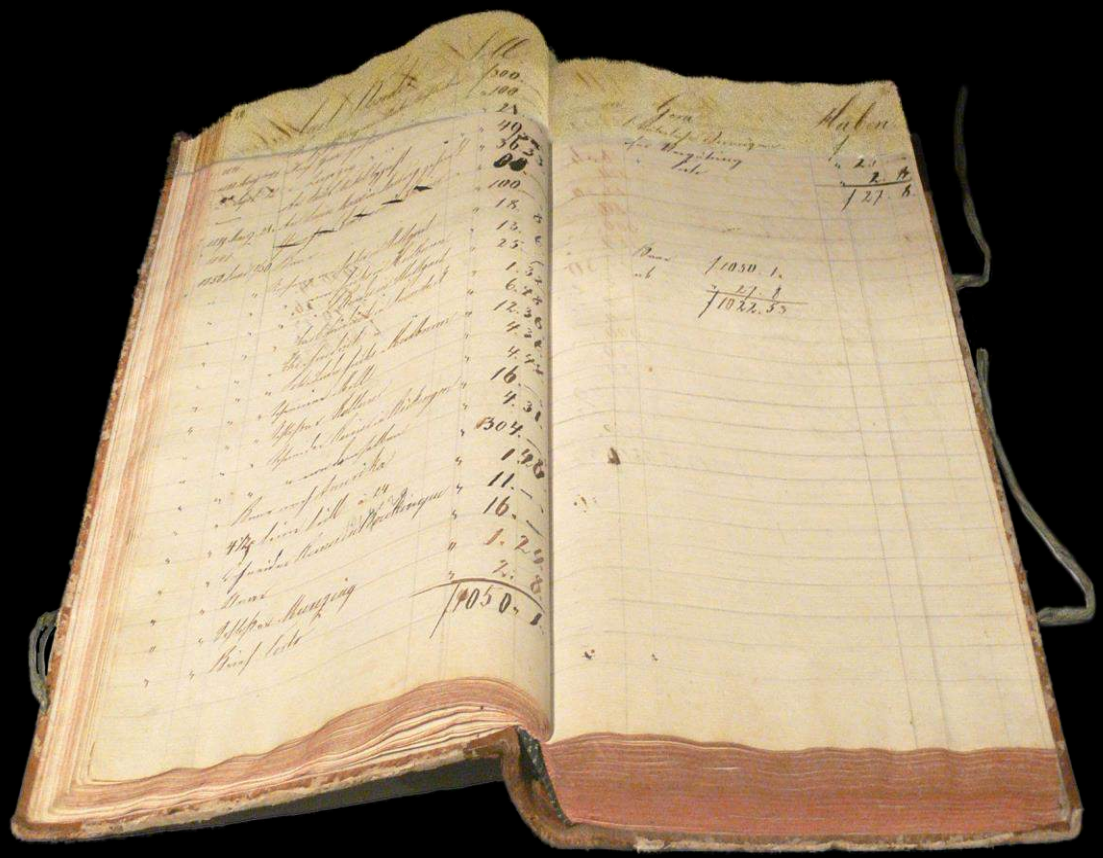
Considered Centrica, NOS

Salary

- Deeming fiction on salary – S9(1)(ii)

income which falls under the head "Salaries", if it is earned in India.
Explanation.—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—
(a) service rendered in India; and....
shall be regarded as income earned in India ;

- What about salary of non-resident seafarer services rendered for non-resident shipping line outside India but money received in Indian NRE account - *DIT vs Prahlada Vijendra Rao (198 taxmann 551), CBDT Circular 13/2017*
- Indian employee was in India for 63 days only in fiscal. Rest worked in UK for the company and earned salary there. Not taxable - *Kanagaraj Shanmugam vs ITO (2936/Chny/2018)*
- *Capt. A.L. Fernandez vs ITO [81ITD203 (Mum)(TM)]* where assessee was on board an Indian vessel. It was employed by the Indian Government and as salary was received in India - Same was held to be taxable in India.
- WFH – Point to ponder – Permanent Establishment created by fixed place of employee WFH in India? Covid PE relaxations – Circular 11 of 2020, 3 of 2021



DDT

Dividend Distribution Tax – Treaty vs. 115-O

“Whether protection granted by the tax treaties under S.90 in respect of taxation of dividend in source jurisdiction, can be extended, even in the absence of a specific treaty provision to that effect, to DDT under S.115-O in the hands of a domestic company?”

- Assessee paid dividend in AY 2016-17 to French NR shareholder.
- S.115-O domestic company is required to pay additional income tax on any amount declared, distributed or paid by way of dividend.
- Assessee took the plea that rate at which tax u/s.115-O has to be paid cannot be more than the rate at which dividend can be taxed in the hands of the NR shareholder under India-France DTAA.
- Giesecke & Devrient ITAT Delhi said yes, **Total Oil Special Bench** said NO

Dividend Distribution Tax: S.115-O vs Treaty

DDT tax on company not shareholder (refers to Godrej & Boyce HC, SC, SIDB Mumbai HC)

Unlike provisions of TCS/TDS that specifically provide such payments are on behalf of payee, DDT provisions do not mention the same.

Since DDT is not tax on shareholder but on income of domestic co, there is no double taxation of same income. Domestic co does not enter the domain of tax treaty at all.

No specific extension of tax treaty rate to DDT under India-France, unlike India-Hungary.

> *"When the company paying the dividends is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend"*

DDT payable on S.115-O rate not Treaty.

A plain reading of the provisions of Sec.115O shows that it creates a charge to additional income tax on any amount declared, distributed or paid by domestic company by way of dividend for any assessment year. The tax so charged is "in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year". The additional income tax is referred to as "tax on distributed profits" commonly referred to as "Dividend Distribution Tax". It is a tax on "distributed profits" and not a tax on "dividend distributed“

Foreign Tax Credit

- S.139 r.w. Rule 128: Is **Form 67 mandatory** to file with ITR to get FTC?
- ***Directory not mandatory.*** No Section in the Act specifically saying it must be filed with ITR, only Rules.
- Benefits given under DTAA can't be overruled by Rules.
- *Wipro Finance* SC does not apply!
- **WP: Muthukumaraswamy**
- **Ration of GE Knitting**

In Summary

- **Leeway for interpretation:** Every clause in Treaty will be litigated?
- **Lifting the corporate veil: E**ven in international tax transactions!
- **PE**: New wave of litigation understanding its various contours
- **One-handed clapping:** Getting over treaty restrictions unilaterally
- **Source-based approach:** Are Indians your consumers; is income generated in India – has India got its fair share of tax?
- **Powerful tool of PPT and MLI litigation:** Will soon see light of day.
- **Procedural minutiae:** Strict interpretation for benefits

Thanks!

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