

PLANNING INBOUND AND OUTBOUND TRANSACTIONS INVOLVING INDIA AND OECD/NON OECD COUNTRIES

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Presentation outline

- Overview of India's treaty network with OECD and non OECD countries
- India's treaty regime and key differences in treaties with OECD and non OECD countries
- Structuring transactions - non transfer pricing perspective
- Key takeaways

Overview of India's treaty network

- Indian Income tax law envisages entering into Tax Treaties for:
 - Granting relief in case of double taxation
 - Avoidance of double taxation
 - Exchange of information for prevention of evasion/avoidance of tax
 - Recovery of tax
 - Promotion of mutual economic relations, trade and investment
- India's Treaty network: more than 80 countries, including 26 OECD countries

Key treaty provisions analysed (OECD / Non-OECD)

- PE
 - Agency PE
 - Construction PE
- Royalty
- FTS
 - Existence of 'make available' clause
 - Managerial services - whether included?

Agency PE ... OECD & Non OECD comparison

PARTICULARS	OECD			Non-OECD		
	US	UK	Germ any	Israel	Singa pore	Malay sia*
Whether concept of <i>'activities of the agent devoted <u>wholly or almost wholly</u> on behalf of the foreign enterprise'</i> included?	Yes	Yes	No	No	Yes	Yes
Whether <i>'Arms Length concept'</i> included?	Yes	No	No	No	No	Yes

* New Tax Treaty with Malaysia notified on October 12, 2004

Construction PE ... OECD & Non OECD comparison

PARTICULARS	OECD			Non-OECD		
	US	UK	Germ any	Israel	Singa pore	Malay sia
Whether <i>'supervisory services'</i> included?	Yes	Yes	Yes	Yes	Yes	Yes
Threshold	120 days in any 12 mon	6 mon	6 mon	6 mon	183 days in any fiscal year	9 mon

Royalty ... OECD & non OECD comparison

PARTICULARS	OECD			Non-OECD		
	US	UK	Germ any	Israel	Singa pore	Malay sia
Whether royalty definition includes <i>'payment for use of or right to use industrial, commercial or scientific equipment'</i>	Yes	Yes	Yes	No	Yes	Yes

FTS ... OECD & non OECD comparison

PARTICULARS	OECD			Non-OECD		
	US	UK	Germ any	Israel	Singa pore	Malay sia*
Whether ' <i>make available</i> ' clause exists?	Yes	Yes	No	No	Yes	No
Whether ' <i>Managerial Services</i> ' included?	No	No	Yes	Yes	Yes	Yes

* The earlier Tax Treaty with Malaysia did not contain a separate FTS clause

OECD Model treaty: No FTS clause

Transaction structuring...treaty perspective...overview

- Treaties mainly based on UN model
- No discernible trend in Indian treaties with OECD and non OECD countries
- Accordingly, structuring largely divorced of OECD vis-à-vis non OECD considerations

Transaction structuring...key parameters

- Characterisation of income
- CFC regulations
- Thin Capitalisation
- Participation exemption
- Limitation of Benefits Clause
- Tax Credits

Mitigating the PE risk

- Agency PE
 - Preferable to structure principal - agent relationship from country where 'wholly or almost wholly' concept not included (e.g. Germany, Israel, Korea)
 - If 'wholly or almost wholly' concept included; preferable to structure relationship from country where 'arms length' concept also exists (e.g. USA, Malaysia)
 - Would neutralise what would otherwise have been a dependent agency PE
- Construction PE
 - Situation in case of MNC group where multiple contractor countries possible - preferable to do it through a country with a longer PE threshold, [say, 9 months (e.g. Korea or Mauritius)]

Mitigating PE risk ... BPO units ... CBDT circular

- Taxability of foreign company/head office outsourcing services from India - issues raised by tax department
 - CBDT circular of January 2, 2004 distinguishing between core and incidental activities, former generating taxability in India
- New (overriding) circular of August 9, 2004
 - Payment of arms length price extinguishes tax liability of Head office/foreign entity in India?
 - No reference to core and incidental activity

Importance of structuring transaction on an arm's length basis

Foreign Institutional Investors ... Recent advance ruling

- Fidelity advance ruling investment fund organised as a trust, registered as sub account of an FII
 - Trading in equity shares of listed companies
- Key issue - character of income - business income or capital gains
- AAR ruling
 - Trading motive leads to business income
 - Not taxable in India in absence of PE

Importance of structuring transaction - characterisation issue and avoidance of PE

Inbound investment ... liaison office ... PE mitigation

- AAR ruling in UAE LLC
 - UAE exchange centre having India LO
 - Providing remittance to customer in India
 - Indian LO downloading and printing of cheques
- AAR ruling
 - Printing, dispatching of cheques by LO in India is significant and creates PE

Nomenclature of India presence not determinative - importance of structuring for PE mitigation or recognising liability

Royalties - equipment ... charter hire

- Equipment hire clause - present in some treaties and absent in others
- Ongoing controversy vis-à-vis charter hire paid by shipping companies
- Time charter and voyage charter not royalty (not for “use of equipment”)
- Bareboat charter use of equipment?

Transaction structuring: avoid equipment royalty country

Fees for technical services ... structuring possibilities

- Absence of Article on FTS
 - Mauritius, UAE, Sri Lanka, etc. (New Malaysian Treaty introduces FTS clause)
- Need to consider benefit of narrower definition i.e. “make available” clause
 - Make available clause present in US, UK, Singapore and Australia treaties
 - Generally in such cases, service PE clause for non-covered services
- Absence of ‘managerial services’ in FTS definition
 - UK, US, Australia, etc.

**Choice of service providing country
could determine tax liability**

MFN Clause...structuring

- Limitation on rates of tax or scope of income
- Indian Treaties with OECD countries having MFN clause
 - UK, France, Norway, Netherlands, Switzerland, Spain, Belgium, Sweden
- Indian Treaties with Non-OECD countries having MFN clause – Israel, Kazakhstan, Philippines

Favourable MFN Clause could impact tax liability

Underlying Tax Credit ...choice of investment vehicle

- A few Indian Tax Treaties provide for Underlying Tax Credit ('UTC')

UK / Malaysia	Singapore / Mauritius
UTC available only in respect of Indian taxes (and not vice versa)	UTC available in respect of taxes in other jurisdiction (i.e. both ways)

- India Singapore Tax Treaty also provide for Tax Sparing benefit in respect of the UTC

UTC minimises the overall tax cost while structuring transactions

Inbound investments - Dividend Distribution Tax

- Indian investee company liable to DDT at 13.06%
- If investment made through Indian holding company: two level DDT
- Structuring thoughts:
 - Preferable to avoid Indian holding company
 - Investment through country where underlying tax credit available

Sale of shares of Listed Companies ... LTCG Exemption

- Some Treaties (primarily Mauritius): provide for Capital Gain exemption
 - Most Treaties: Capital Gain taxable as per domestic law
- New provision: such gain exempt under Indian tax laws, if transacted through Stock Exchange (subject to payment of Securities Transaction Tax)
- Transfer of shares through negotiated deal – within the group or otherwise: need to go through Stock Exchange mechanism for Capital Gain exemption

Outbound investments ... Intermediate holding company?

- Dividend received from foreign subsidiary fully exposed to Indian tax
- Exchange control regime now facilitates overseas holding company (Level 1)
- Advisable to interpolate overseas holding company where dividend can be 'vessel'
 - Extraction of dividend at Level 1 without payment of Indian tax possible

Key Takeaways

- No significant differences between India's OECD & Non OECD Country Treaties
 - However critical to leverage treaty differences for transaction structuring
- Important to recognise persuasive value of judicial precedents
- Commercial justification: foundation for transaction structuring



Thank You

