

Deloitte Haskins & Sells

DTC and DTAA

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Introduction

DTC and DTAA

- On 30 August 2010, Direct Taxes Code Bill, 2010 ('DTC 2010') was placed before the lower house of the Parliament
- DTC 2010 would become a law upon being passed by both houses of Parliament and receiving the assent of the President of India
- Once enacted, DTC 2010 is proposed to be effective from 1 April 2012
- Income Tax Act (ITA) has specific provisions which would enable the tax payer to avail the benefits of the double tax avoidance agreements (DTAA) entered into by India with different countries if the conditions provided in the DTAA are fulfilled
- DTC while retains the above provision of DTAA receiving a preferential status over the DTC, specifically provides for certain exceptions wherein the provisions of the DTC would prevail whether or not they are more beneficial to the tax payer

Limited treaty override by DTC

Existing provision in the Income-tax Act, 1961	Provisions as per the DTC Bill
<p>The provisions of the Act or the relevant tax treaty whichever is more beneficial to the taxpayer, to be applied.</p>	<p>The provisions of the DTC or relevant Tax Treaty, whichever is more beneficial to the tax payer, to be applied. However the Tax Treaty will not have preferential status over domestic law in the following circumstances (limited treaty override):</p> <ul style="list-style-type: none"> •When the General Anti Avoidance Rule (“GAAR”) is invoked, or •When Controlled Foreign Corporation (“CFC”) provisions are invoked, or •When Branch Profit Tax (“BPT”) is levied <p>Tax payers are entitled to claim relief under the provisions of the Tax Treaty on production of a certificate in the prescribed form, from the tax authorities of the resident country, to the effect that, such person is a resident of the country</p>

Some treaty related issues – GAAR

- Suo – moto override of treaty whether permissible? *Pacta Sunt Servanda* principle?
- Whether treaty override that does not explicitly target artificial arrangements is and will always be an illegal breach of a treaty

Status on existing transactions/arrangements ?

Whether the override would refer to entire treaty or only the respective clauses ?

- Reclassification of characteristics of income for e.g. dividend income as interest income
 - Whether DDT paid would be refunded to the company or be considered as a credit against the tax payable on the interest income by the NR.
- Benefits under the treaty whether could continue to apply for other aspects
 - Where interest income classified as dividend- rate of tax on dividend under treaty whether available; or whether the WHT on interest to be considered as DDT
 - MAP proceedings – whether could be initiated
- Investments through low tax jurisdiction countries may go through detailed scrutiny

Some treaty related issues - CFC rules

- Whether CFC rules could be considered as being discriminatory
- No DTAA relief or no credit for taxes paid by CFC in foreign jurisdiction
- Presumably applies to multiple layers – what happens if a dividend is paid between two CFCs
- Considered as ‘other income’ - under treaty “other income’ normally taxed in the resident country.
- Treaty Override - Entire DTAA provisions may be made ineffective?
- Interplay between GAAR and CFC – which would be applicable?

Some treaty related issues - Branch Profits Tax

- Only foreign companies liable to pay BPT
 - BPT not payable by other non-residents like firms, AOPs, etc.
- BPT not payable if no PE in India
 - If business connection but no PE, BPT should not be payable
 - Definition of PE as per DTC or as per relevant treaty?
 - Definition of PE under DTC is very wide
- Interplay between income-tax and BPT unclear
 - Can additional income-tax (TDS / advance tax) be adjusted against BPT or does it need to be paid separately
- Branch Profits Tax - Credit for BPT in home country
 - Income-tax payable at the rates specified in the First Schedule; BPT specified in the Second Schedule
 - BPT is a tax, but is not income-tax
 - Taxes covered under treaties typically include only income-tax

Transfer of shares outside India – Treaty related issues

- Basic definition of "income deemed to accrue or arise in India" remains the same as in ITA - no specific inclusion of *indirect transfer* of shares
 - Presumption that the transfer of share of a foreign company is covered under indirect transfer of a capital asset situated in India
 - Unlike circular issued by China in December 2009 specifically stating that sale of an offshore intermediary holding company owning a Chinese resident enterprise may be taxed in certain cases
- Intention does not seem to be met – reference point is in connection with the assets of the shareholder and not the Indian company
- Treaty benefits available – classification as capital gains or other income under treaty
- Internal group restructuring may be hit by the provisions

Residential Status – POEM

POEM is defined to mean

- The place where the Board of Directors of the Company or its executive directors make their decisions; or

 - In a case where the Board of Directors routinely approve the commercial and strategic decisions made by executive directors or officers of the company the place where such executive directors or officers of the perform their functions
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- Different from definition in OECD commentary
 - Arguably, one meeting of the Board of Directors of a foreign company in India where decisions are made could make it tax resident in India
 - Does not elaborate on the nature of decisions made by BOD or commercial and strategic decisions
 - May result in a foreign company being a resident of multiple territories by virtue of different tests followed by various jurisdictions
 - Double tax avoidance agreement may provide relief
 - In some tax treaties, POEM may be determined under the tie-breaker clause by making an application under the Mutual Agreement Procedure
 - Difficulties/Issues in obtaining the tax residency certificate as required under the DTC

Thank you

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