Recent Changes in Indian Tax Treaties

*With Mauritius, Singapore and Cyprus*
Introduction to Tax Treaties
Taxation Systems

• Basis of Taxation
  – Residence, Domicile, Citizenship, Sourced Based

• Taxation Systems
  – Worldwide [e.g.. USA, UK, India]
  – Territorial [e.g.. Hong Kong, Macau]
  – Modified territorial taxation [e.g.. Singapore]

• Tax Rates - 0% to 50%+
  – No income tax in - UAE, BVI, Bermuda, Bahamas..
  – Belgium – 50%, UK – 45%, USA – 39.5%, Japan – 55%, China – 45%...
Juridical Double Taxation

- Juridical Double Taxation
  - Same person taxed in two (or more) different countries for the same income
    - Different systems, rules and interpretation of terms
    - Dual Residence
    - Residence in one country and source in another

DTAAs primarily entered into for Elimination of Juridical Double Taxation
- Also aids promotion of mutual economic relations, trade and investment; defining rules for establishing right of country to tax; Exchange of information; etc.
Double Non-Taxation

- Double Non-Taxation could arise due to -
  - Global Non-residents
    - Travellers
  - Difference in Tax systems
    - Territorial taxation in Residence State
  - Differences in definition of residence and source in local laws
  - Shell / Conduit Entities
  - Hybrid mismatches
Base Erosion and Profit Shifting
BEPS

- Digital Economy
- Hybrid Mismatches
- Strengthen CFC Rules
- Interest Deductions
- Harmful Tax Practice
- Preventing Treaty Abuse - Benefits in Inappropriate Circumstances
- Artificial Avoidance of PE
- Transfer Pricing
- Measuring & Monitoring BEPS
- Mandatory Disclosure Standards
- Dispute Resolution Mechanism
- Multilateral Instruments

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6. Preventing Treaty Abuse

- Action Plan 6 - ‘Preventing Granting of Treaty Benefits in Inappropriate Circumstances’

- Treaty Shopping
  - NR attempts to obtain benefits of treaty available to Residents of a State
  - Letterbox companies

- Treaty Abuse
  - Characterization of income – Dividend vs. Capital Gains
  - Interest in entities deriving value from immovable property in State S
  - Artificial Avoidance of profits through creation of PE
  - Splitting up of contracts – Construction PE time threshold
Action 6 – Measures Suggested

• Title and Preamble of Treaty to indicate -
  – Treaty intends to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance

• Combination of LoB and PPT
  – LoB – Specific anti-abuse rule - Objective tests – Detailed / Simplified version
  – PPT – general anti-abuse rule - if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied

• Inclusion of GAAR in Domestic laws

• Policy Considerations for deciding whether or not to enter / continue treaty with no / low tax jurisdictions
Existing Scenario

*India investments from Mauritius, Singapore and Cyprus*
Existing Treaties

- Indian DTAA with Mauritius, Singapore and Cyprus
  - No capital gains tax on sale of shares in domestic laws
  - DTAA provided taxing rights to Residence state only
    - No capital gains in India as source state
    - Double non-taxation
  - No LoB clause in DTAA with Mauritius and Cyprus
    - Misused for round tripping of investments
    - Misused to avoid taxes in India
    - Lead to Treaty Abuse
# Existing CG Taxation

- Taxability in Source State under DTAAs

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>Mauritius</th>
<th>Cyprus</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immovable Property</td>
<td>Taxable</td>
<td>Taxable</td>
<td>Taxable</td>
</tr>
<tr>
<td>Assets of PE / fixed base</td>
<td>Taxable</td>
<td>Taxable</td>
<td>Taxable</td>
</tr>
<tr>
<td>Ship / Aircraft</td>
<td>Not taxable</td>
<td>Not taxable</td>
<td>Not taxable</td>
</tr>
<tr>
<td>Shares of Company</td>
<td>Not taxable</td>
<td>Not taxable</td>
<td>Not taxable</td>
</tr>
<tr>
<td>Other Assets</td>
<td>Not taxable</td>
<td>Not taxable</td>
<td>Not taxable</td>
</tr>
<tr>
<td>LoB Clause</td>
<td>No</td>
<td>No</td>
<td>Yes (For shares)</td>
</tr>
</tbody>
</table>
Country-wise FDI in India

Cumulative FDI in USD Billion
(April 2000 To September 2016)

- Mauritius: 33%
- Singapore: 16%
- UK: 8%
- Japan: 8%
- USA: 6%
- Netherlands: 6%
- Germany: 3%
- Cyprus: 3%
- Others: 17%

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FDI in India and GDP

Cumulative FDI April 2000 to September 2016 (USD Billion)  GDP 2015 (USD Billion)

- Mauritius
- Singapore
- Cyprus

GDP 2015 (USD Billion)
Need for Amendment

• To stop treaty abuse and round tripping of investments
• To gain right to tax capital gains on sale of shares of Indian company
• To comply with BEPS action plans
• To curb revenue loss and prevent double non-taxation
• To stimulate flow of exchange of information
India - Mauritius
DTAA
Capital Gains

• Capital gains to be taxable in Source Country w.e.f. 1.4.2017
  – On transfer of shares of companies
  – 50% tax in FY 2017-18, FY 2018-19; 100% tax thereafter
    • Subject to Limitation of Benefit (‘LOB’) clause

• Grandfathering for shares acquired before April 1, 2017
  – Continue to be taxed only in country of residence
  – NOT Subject to LOB Clause
LoB Clause

• Introduction of LoB Clause
  – Applicable to Article 13(3B)
  – No benefits available if
    • Arranged primarily to take advantage of 13(3B)
    • No bonfaide business activities
    • Shell / conduit company
      • Negligible or nil business operations or with no real and continuous business activities carried out in that Country
      • Expenditure < Mauritian Rs.1.5 mn or INR 2.7 mn in 12 months prior to gain
      • Not considered Shell if –listed or expense > thresholds
Service Fees and Other Income

- Insertion of article on FTS
  - Tax @ 10% on gross basis in Source State
  - Currently, No separate article for FTS
- Service PE also included in definition of PE
  - Services furnished for > 90 days within any 12 months period
  - Including FTS
- Sourced based taxation of Other Income introduced
Interest

• Tax on interest in Source State capped at 7.5%
  – Currently, interest is taxed in sources state as per domestic laws (5% /20% /40%+ in India)

• Withdrawal of exemption given to Banks
  – Interest arising to banks now taxable @ 7.5%
  – Grandfathering w.r.t. debt claims existing prior to April 1, 2017

• Exemption in Source State continued for Government / local authority, etc.
**Exchange of Information**

- **Scope of Article on EoI enhanced**
  - EoI not restricted to Article 1 and 2
    - Person may necessarily not be resident of India / Mauritius
    - Not restricted to taxes referred to in Article 2
  - Information should be “foreseeably relevant” and may not be “Necessary” for carrying out provisions of DTAA
  - CS not to decline to supply information solely because
    - (a) it has no domestic interest in such information or
    - (b) information is held by a Bank, FI, person acting as agent etc. or it relates to ownership interests in a person.
India - Singapore DTAA

Protocol - December 30, 2016
3rd Protocol

- DTAA – concluded on January 24, 1994
- Protocol 1 – June 2005
  - Residence based capital gains taxation introduced
  - Co-terminus with India-Mauritius DTAA
  - Subject to LoB Clause
- Protocol 2 – June 2011
  - EoI strengthened
    - Similar to India-Mauritius 2016 protocol
- Protocol 3 – Signed on December 30, 2016
  - Required as CG exemption co-existed with IN-MRU DTAA
Capital Gains

• Source based Capital gains tax
  – Similar to India-Mauritius DTAA
  – Investments prior to April 1, 2017 grandfathered
    • Taxable only in residence state, subject to LoB
  – Gains arising during April 2017-March 2019 taxable at 50% of tax rate
    • Subject to LoB
  – Gains subsequent to FY 2018-19, on new investments 100% taxable
LoB

• LoB clause similar to 2005 protocol, expenditure test modified

• Annual expenditure test
  – Average Annual expenditure on operations in residence state $\geq$ SGD 0.2 mn or INR 5 mn
  – For each of 12 months period in 24 months preceding date of gain (for investments prior to April 1, 2017)
  – For 12 months preceding date of gain (for transition relief)

• Other tests
  – Primary purpose (PPT), Bonafide business activities, Not Shell / conduit company
    • Similar to India-Mauritius DTAA
Other Amendments

- Mechanism of corresponding tax adjustments introduced
  - In transfer pricing cases
  - To prevent economic double taxation
Applicability of GAAR?

• “This Agreement shall not prevent a Contracting State from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.”
  – Anti-avoidance rules given preferential treatment in India-Singapore DTAA
Capital Gains

• Capital gains on alienation of shares of company taxable in source state if alienated company
  – is resident in source state or
  – derives value from immovable property in source state

• Shift from residence based to source based taxation
  – Gain on alienation of Shares acquired prior to April 1, 2017 grandfathered

• No LoB Clause in revised DTAA also
Royalty and FTS

• Tax in Source state on Royalty reduced from 15% to 10%

• Article 12 (Royalties and FIS) and Article 13 (FTS) merged

• Revised definition of “Source” – Country of -
  – Residence of Payer
  – PE / fixed base
  – Utilization of property / Performance of service
    • Now added
FTS and Service PE

• FTS to be taxed @ 10%
  – Currently, FIS taxed @ 15%; includes services -
    • (i) in relation to IPR or industrial / commercial / scientific equipment / information or
    • (ii) Made available technical / consultancy services
  – Make-Available Clause removed

• Service PE introduced
  – > 90 days in any 12 months
  – Including FTS
Elimination of Double Tax

• Tax Sparing clause removed

• Until now, tax rates mentioned in Article 10, 11, 12 and 13 were deemed as tax paid in source state
  – The clause is now removed
  – Eg. Cyprus resident receiving dividend from Indian Company
    • No WHT under domestic laws of India
    • Rate as per Article 10 = 10% (assuming ownership criteria met)
    • Deemed tax paid, available as Credit in Cyprus = 10%
Other Key Amendments

- Uniform rate of tax on dividends at 10%
  - Ownership criteria removed
- Business Income
  - Removal of Force of Attraction rule
  - Transactions between PE and HO to be ignored
    - Royalties/ FTS / commission / interest
    - Interest to be considered if bank
    - Other than reimbursement of expenses
Other Key Amendments

- Definition of PE expanded
  - Sales outlet, warehouse, farm / plantation included in PE
  - Threshold for Construction / Installation PE
    • ‘Continues for a period of 12 months’ replaced with ‘lasts for 6 months’
  - Insurance PE introduced
  - Use of facilities for / maintenance of stock for delivery of goods removed from Exceptions to PE
  - Definition of Agency PE expanded
Other Key Amendments

• Source State may now tax Specified Other Income
  – Income from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting.

• Insertion of new Articles on assistance in the collection of taxes

• Article on Exchange of Information and Non-discrimination amended

• Rolling period concept in IPS & DPS
Summary
## Revised DTAAs

<table>
<thead>
<tr>
<th>Transactions</th>
<th>Source Taxation in India under DTAA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Singapore</td>
</tr>
<tr>
<td>CG from alienation of shares of Co. acquired after 1-4-2017</td>
<td>√</td>
</tr>
<tr>
<td>Grandfathering for shares acquired till 31-3-2017</td>
<td>√</td>
</tr>
<tr>
<td>Lower taxation for transitory period of 2 years</td>
<td>√</td>
</tr>
<tr>
<td>LOB provisions (for CG exemption on alienation of shares)</td>
<td>√</td>
</tr>
<tr>
<td>(Applicable for grandfathered and transitory relief)</td>
<td>(Applicable only for transitory relief)</td>
</tr>
</tbody>
</table>
## Revised DTAA's

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<tr>
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</thead>
<tbody>
<tr>
<td></td>
<td>Singapore</td>
</tr>
<tr>
<td>Gains from alienation of shares of foreign Co. deriving value from assets in Source State</td>
<td>✗</td>
</tr>
<tr>
<td>Gains from alienation of immovable property</td>
<td>✓</td>
</tr>
<tr>
<td>Gains from alienation of assets of OE / fixed base</td>
<td>✓</td>
</tr>
<tr>
<td>CG from alienation of debt instruments including convertible debts, derivatives</td>
<td>✗</td>
</tr>
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## Revised DTAAAs

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<tr>
<td></td>
<td>Singapore</td>
</tr>
<tr>
<td>Interest</td>
<td>10/15%</td>
</tr>
<tr>
<td>FTS</td>
<td>10%</td>
</tr>
<tr>
<td>Service PE</td>
<td>90 days in fiscal year (30 days in case of related enterprises) (Other than FTS as per Article 12)</td>
</tr>
<tr>
<td>Other Income</td>
<td>√</td>
</tr>
<tr>
<td></td>
<td>(If arises in source state)</td>
</tr>
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</table>
Consequential Effects
Consequential Effects

- Grandfathering of existing investments from Indian tax net
- Other securities continue to be taxed in Residence State
- Shares held by FIIs as stock in trade, not having PE, not taxable in Source State
- Underlying tax credits under Mauritius and Singapore treaties continue
  - Relevant for outbound investments
Consequential Effects

• Inter-play with GAAR provisions
  – Overriding effect on DTAA with Mauritius and Cyprus?

• Impact on volume of investments

• Rescindment of notification considering Cyprus as an NJA
  – Quick de-notification of Cyprus as an NJA
    • Encourage fresh investments
    • Through Cyprus prior to 1-4-2017
Case Studies
Case Study 1

- Issue of bonus shares
  - Singapore Co. holds 20% equity shares in Indian Co. since 2004
  - Indian Co. issues 1:1 bonus on May 30, 2017
  - Singapore Co. transfers shares on June 30, 2020
  - Tax liability in India?

- Shares issued on conversion of CCD?
Case Study 2

- Anti-avoidance rules given preferential treatment in India-Singapore DTAA
  - Which of the following provisions in domestic laws of India would override DTAA benefits?
    - GAAR?
    - Indirect transfer (Substance over form)?
    - Transfer Pricing regulations?
Case Study 3

- Indirect transfers
  - German Co. selling shares of Mauritius Co. which derives value substantially from shares of Indian Co.
  - Tax under Income tax Act?
  - Taxable in India as per DTAA?
  - What if POEM of Mauritius Co. in India?
  - Impact of GAAR?
Milin Mehta
Partner
K C Mehta & Co.
Vadodara, India

Phone: + 91 265 2440 401
E-mail: milin.mehta@kcmehta.com