

The Institute of Chartered Accountants of India  
Western India Regional Council

**ANTI-AVOIDANCE PROVISIONS UNDER  
TAX TREATIES AND DOMESTIC LAWS**

Presentation by  
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## UOI vs. Azadi Bachao Andolan (263 ITR 706)

- ❑ An act which is otherwise valid in law cannot be treated as *non est* merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests.
- ❑ Duke of Westminster principle is very much alive and kicking. A Raman's case is very much relevant even today;
- ❑ Rest of the Judges of the Constitutional Bench in McDowells did not contribute to 'radical' thinking of Chinappa Reddy, J.

# INDIAN APPROACH SO FAR..

## Constitution of India

- Article 51 – The State shall endeavor to:  
(c) Foster respect for international law and treaty obligation in the dealings of organized peoples with one another

## Vienna Convention

- Article 26 – Every treaty in force is binding upon the parties to it and must be performed by them in good faith – “PACTA SUNT SERVANDA”

## Section 90 (2)

- Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him

# SPECIFIC ANTI-AVOIDANCE RULES (“SAAR”) UNDER TAX TREATIES

Beneficial Ownership

Associated Enterprises

Special Relationship

Alienation of shares in real estate entities

Star Companies

Force of Attraction

Place of Effective Management

Limitation of Benefits

Principal Purpose Test



# BENEFICIAL OWNERSHIP

# ARTICLE 10 – DIVIDEND

## OECD Model Convention

1. 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.
2. 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 beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
  - a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
  - b) 15 per cent of the gross amount of the dividends in all other cases.

## UN Model Convention

1. 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.
2. 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 beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
  - a) \_\_\_ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;
  - b) \_\_\_ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases.

# ARTICLE 11 - INTEREST

## OECD Model Convention

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. 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 not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

## UN Model Convention

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. 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 not exceed \_\_\_ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

# ARTICLE 12 - ROYALTIES

## OECD Model Convention

1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

## UN Model Convention

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed \_\_\_ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.



# ANALYSIS

- ❑ “Beneficial Owner” is not defined in the Convention
  - Has to be interpreted as per domestic laws – Article 3(2)
  
- ❑ Not to be interpreted in a narrow technical sense
  - Should be understood in its context and in light of the object and purpose of the Convention
  
- ❑ Klaus Vogel Commentary
  - Benefit of treaty to ‘real’ title and not ‘formal’ title
  - ‘Substance’ has to be given preference over ‘Form’
  - ‘Beneficial Owner’ is he who is free to decide
    - (1) whether or not the capital or other assets should be used or made available for use by others, or
    - (2) on how the yields therefrom should be used, or
    - (3) both
  - ‘Control’ is regarded as the most important factor to determine beneficial ownership

## ANALYSIS (contd...)

- ❑ Agent, Nominee, Conduit Company acting as a fiduciary or administrator cannot be regarded as beneficial owner
  - The recipient's right to use and enjoy the interest is constrained by the contractual or legal obligation to pass the payment received to another person
  
- ❑ Can Collective Investment Vehicle (“CIV”) qualify as beneficial owner of income it receives?
  - If managers of CIV have discretionary power to manage assets generating the income, CIV will be considered as the beneficial owner
  
- ❑ 100% interest of Parent Co. in its subsidiary does not preclude the latter's beneficial ownership in the assets held by it
  - P No. 9 of 1995, In re (1996)(220 ITR 377)(AAR)
  
- ❑ Evidence for beneficial ownership:
  - Tax Residency Certificate
  - Circular 789 dated April 13, 2000

## INDO – UK DTAA

- ❑ Notification No. 10/2014 [F.No.505/3/1986-FTD-I], dated 10-2-2014, w.r.e.f. 27-12-2013 substituted Article 11 – Relevant extract is as under:

*6. No relief shall be available under this Article if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid to take advantage of this Article by means of that creation or assignment.*

- ❑ The “main purposes test” co-existing with the “Beneficial Owner test” ...



# ASSOCIATED ENTERPRISES

# ARTICLE 9 (1)

## OECD Model Convention

1. Where
  - a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
  - b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

## UN Model Convention

1. Where:
  - a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
  - b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

# ARTICLE 9(2) & 9(3)

## OECD Model Convention

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

## UN Model Convention

2. Where a Contracting State includes in the profits of an enterprise of that State—and taxes accordingly—profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of the Convention and the competent authorities of the Contracting States shall, if necessary, consult each other.
3. The provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or wilful default.

# ANALYSIS

- ❑ Direct or indirect participation – Klaus Vogel Commentary
  - Direct Participation – Whenever no third party is interposed between the enterprises in their relationship (eg. parent company and subsidiary)
  - Indirect Participation – One or both of the enterprises make use of one or more third parties in order to bring about the interconnection
  
- ❑ Management, control or capital – Klaus Vogel Commentary
  - Covers only cases of interconnection, or exercise of influence, under company law
  - Should be decided with reference to the domestic company laws
  - Para 7 of OECD on Transfer Pricing and Multinational Enterprises expressly indicates – it was thought not necessary to define the expression ‘Associated Enterprises’ and ‘under common control’
  - On the contrary, it was assumed that there was a ‘broad basis of common understanding’ of what was meant

## ANALYSIS (contd...)

- ❑ ‘management, control, capital’ has to be interpreted with reference to ‘Associated Enterprises’ under domestic laws
  - Section 92A(2) provides for instances of deemed participation of management, control, capital
  
- ❑ Special relations – Section 9(1) applies only when:
  - Conditions are made or imposed between two associated enterprises
  - Such conditions are in their commercial or financial relations; and
  - These conditions differ from those that would be made between independent enterprises



## ANALYSIS (contd...)

### □ Article 9(2):

- Provides a relief mechanism to avoid double taxation
- If primary adjustment is made in the hands of the associated enterprise – appropriate downward correlative/corresponding adjustment to be made in the hands of the other enterprise
- Example – A sells goods to B at say 100. The Arm's length price is say 150. In the hands of A the profits would be increased by 50 (Primary Adjustment). Correspondingly, in the Country of residence of B, the profit of B can be reduced by 50, in order to avoid double taxation

## ANALYSIS (contd...)

- ❑ Is the enterprise of the Other Contracting State obligate to make correlative adjustment
  - OECD Commentary

*“...State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment is made in State A is justified both in principle and as regards the amount”*
  - Correlative adjustment necessary only if the other State considers that the primary adjustment is not arbitrary and is justified



# SPECIAL RELATIONSHIP

# PARA 6 OF ARTICLE 11 ON INTEREST

## OECD Model Convention

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

## UN Model Convention

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

# PARA 4/6 OF ARTICLE 12 ON ROYALTIES

## OECD Model Convention

4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

## UN Model Convention

6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

# ANALYSIS

- ❑ Special relationships -Wider than the concept of “AEs”
- ❑ Distinct from the legal relationship giving rise the payment
- ❑ Can cover relationships like –
  - Lender/ borrower ;
  - Supplier/customer relationship ;
  - Donor /Donee ;
  - Friends ;
  - Employer/Employee

## ANALYSIS (contd...)

- ❑ Interplay between the provision of Article 9 and Article 11(6)/12(4)
  - Both can co-exist
  
- ❑ Special relationship must be the cause of the excessive interest/royalties ;
  
- ❑ Tax Treatment of the excess amount :
  - Article 11(6)/12(4) permits adjustment of rate of interest/amount of royalties and not reclassification of loan/royalties
  
  - Such excess amount may be disallowed in the hands of the payer under Article 9/ Transfer Pricing Recommendations

## ANALYSIS (contd...)

- ❑ Recommendation in UN Commentary: Clause on following lines may be added in the treaty –

*“The provisions of this Article shall not apply if it was the main purpose, or one of the main purposes of any person concerned with the creation or assignment of the debt claim/rights in respect of which the interest/royalties is/are paid to take advantage of this Article by means of that creation or assignment.”*





# ALIENATION OF SHARES IN REAL ESTATE ENTITIES

# PARA 4 OF ARTICLE 13 ON CAPITAL GAINS

## OECD Model Convention

4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

## UN Model Convention

4. Gains from the alienation of shares of the capital stock of a company, or of an interest in a partnership, trust or estate, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:
  - (a) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.
  - (b) For the purposes of this paragraph, “principally” in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.

# ANALYSIS

## ❑ Rationale – UN Commentary:

*“It is designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of a company to hold such property, it is necessary to tax the sale of shares in such a company. This is especially so where ownership of the shares carries the right to occupy the property.”*

## ❑ Directly or Indirectly

- ‘Indirectly’ means ‘through one or more interposed entities’ – UN Commentary
- ‘Directly or indirectly’ have been incorporated to accommodate a ‘see through’
- In the absence of these words, Article 13(4) can be applied only to ‘one-tier’ of the companies rather than a numerous layers

## ANALYSIS (contd...)

- ❑ Wide applicability: Following factors may not have an impact on applicability of Article 13(4) –
  - Nature and type of share and percentage of holding (alienation of even one share will trigger taxation)
  - Alienation of listed/unlisted shares, interest in partnership
  - Mode of alienation (eg. in the course of a reorganization or family settlement);
  - Investor (eg. pension fund) is exempt from tax in country of residence on its investment income;
  - Irrespective of whether the investee is resident of country from which such income is sourced or a resident of third country.

## ANALYSIS (contd...)

- ❑ Exclusions: Article 13(4) may not be applicable under the following circumstances:
  - Where the property which principally consists of immovable properties is used in their business activities (eg, a company which develops, operates and maintains an industrial park)
    - In such a situation, other relevant provision(s) may be applicable;
  - The value of immovable property < 50% of aggregate value of total assets held by such company/ partnership/ trust/ estate.
  - On alienation of debentures, bonds, intangible assets, etc. – since only shares are covered



# STAR COMPANIES

# PARA 2 OF ARTICLE 17 – ARTISTES AND SPORTSPERSON

## OECD Model Convention

2. Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised.

## UN Model Convention

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

# ANALYSIS

- ❑ Article 17(1) – Income derived by individual entertainers and sportsperson of State R from personal activities exercised in State S, may be taxed in State S
  - OECD Model Convention – Notwithstanding Article 7 and 15
  - UN Model Convention – Notwithstanding Article 14 and 15
  
- ❑ Article 17(2)
  - Income from the activities of the performers accrues to another person (say, star company);
  - State S does not ordinarily have the right to ‘look-through’ the person receiving income and tax such income of performer
  - Para 2 provides that such income may be taxed in State S
  - OECD Model Convention – Notwithstanding Article 7 and 15
  - UN Model Convention – Notwithstanding Article 7, 14 and 15



# ANALYSIS

- ❑ Treaty Abuse if Article 17(2) is absent
  - No taxability in the hands of the performer – due of absence of ‘look through’ approach in State S
  - No taxability in the hands of the star company – In the absence of Permanent Establishment in State S, business profits would not be taxed in State S – Article 7
  
- ❑ Article 17(2) not triggered where income is not derived from personal activities of performer for example :-
  - Income derived by independent promoter from sale of concert tickets and advertisement space
  - Prize money derived by a horse owner or team to which a race car belongs from the results of a horse race or car race

# CASE STUDY - TRIANGLULAR SITUATION

## A - Performer

- Resident of State R

## Star Company

- Resident of State B
- A is at the disposal of such company

## Event

- Event takes Place in State S
- Event manager makes payment to Star Company

- If State S follows 'look-through' approach
  - Interposed star company would be ignored
  - Article 17(2) of S – R DTAA  
A will be taxed



# FORCE OF ATTRACTION (“FOA”)

# PARA 1 OF ARTICLE 7 ON BUSINESS PROFITS

## OECD Model Convention

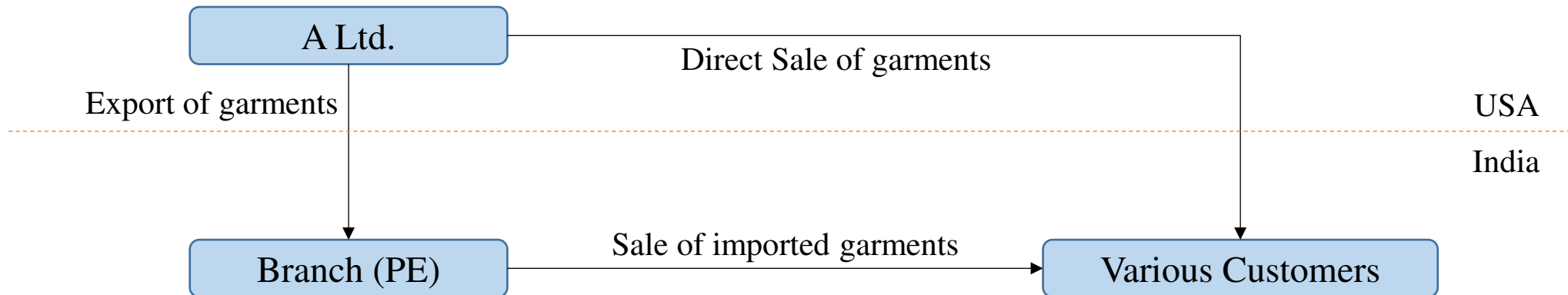
1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

## UN Model Convention

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.

# CONCEPT

- ❑ FOA rule implies that when foreign enterprise sets up a Permanent Establishment (“PE”) in State S, it brings itself within the fiscal jurisdiction of that State to such a degree that all profits that the enterprise derives from State S, whether directly through the PE or not, can be taxed by it (State S)



Profits of the Indian Branch =  
Profits earned through own sales + Profits earned by A Ltd. From direct sales to customers



# LIMITATION OF BENEFIT (“LOB”)

# ACTION PLAN – 6 - AN OVERVIEW

- ❑ Action Plan 6 provides safeguard against ‘**Treaty Abuse**’ and in particular ‘**Treaty Shopping**’
- ❑ Three-pronged approach recommended to address treaty shopping arrangements:

**Clear statement of intent** in tax treaties to avoid creation of opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements

Introduction of specific anti-abuse rule, for instance, the **Limitation-of-Benefits (“LOB”)** rule, that limits availability of treaty benefits to entities meeting certain conditions

Conditions based on legal nature, ownership in, and general activities of entity to ensure sufficient link between entity and State of residence

Introduction of a more general anti-abuse rule based on the **principal purposes test (“PPT”)**

## ACTION PLAN – 6 (contd...)

- ❑ **Minimum Standard** – to include in the tax treaties an express statement that common intention is to eliminate double taxation without creating opportunities for non-taxation, tax evasion or avoidance
  
- ❑ In order to implement the minimum standard the treaties should include
  - LOB
  - PPT
  - Simplified LOB supplemented by PPT



# WHAT IS LOB?

- ❑ It is a SAAR aimed at treaty shopping
- ❑ Treaty benefits to be denied to a resident of a Contracting State who is not a ‘Qualified Person’
- ❑ ‘Qualified Person’ to include
  - An individual
  - The State, its political subdivision, entities owned by the State
  - Certain charities and pension funds
  - Certain publically held entities and their affiliates
  - Certain entities that meet certain ownership requirements and/or turnover requirements
  - Certain collective investment vehicles
  - Entities permitted by competent authorities

# CBDT CLARIFICATION

- ❑ Central Board of Direct Taxes (“CBDT”) has issued the said circular providing clarification on implementation of GAAR

- Question no. 2: Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?

Answer: *Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.*

# VARIATIONS IN DTAAs (contd...)

## Indo – Mauritius Treaty

- **Article 27A – “Limitation of Benefits” – Inserted by Notification No. SO 2680(E) {NO.68/2016 (F.No.500/3/2012-FTD-II)} dated August 10, 2016; Applicable from April 1, 2017**

1. *A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention*
2. *A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. 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 expenditure on operations in that Contracting State is less than Mauritian Rs.1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 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 recognized stock exchange of the Contracting State; or*
  - b) *its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs.1,500,000 or Indian Rs.2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.*

*Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention.*

# VARIATIONS IN DTAAAs (contd...)

## Indo – Singapore Treaty

### ▪ Article 24A – “Limitation of Benefits”\*

1. *A resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement if its affairs were arranged with the primary purpose to take advantage of the benefits in the said paragraph 4A or paragraph 4C of Article 13 of this Agreement, as the case may be.*
2. *A shell or conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement. A shell or 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 or conduit company if its annual expenditure on operations in that Contracting State is less than S\$200,000 in Singapore or Indian Rs.5,000,000 in India, as the case may be:*
  - (a) *in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;*
  - (b) *in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.*

**\* Listed in Third Protocol signed by the Contracting Jurisdictions on December 30, 2016 – Yet to be notified by CBDT**

# VARIATIONS IN DTAAs (contd...)

## Indo – Singapore Treaty

### ▪ **Article 24A – “Limitation of Benefits”** (contd...)

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

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

*(b) its annual expenditure on operations in that Contracting State is equal to or more than S\$200,000 in Singapore or Indian Rs.5,000,000 in India, as the case may be:*

*(i) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;*

*(ii) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.*

5. *For the purpose of paragraph 4(a) of this Article, a recognised stock exchange means:*

*(a) in the case of Singapore, the securities market operated by the Singapore Exchange Limited, Singapore Exchange Securities Trading Limited and The Central Depository (Pte) Limited; and*

*(b) in the case of India, a stock exchange recognised by the Securities and Exchange Board of India.*

*Explanation: The cases of legal entities not having bona fide business activities shall be covered by paragraph 1 of this Article.*

## VARIATIONS IN DTAA's (contd...)

### Indo – UAE Treaty

- **Article 29 – “Limitation of Benefits” - Inserted by Notification No. SO 2001(E) dated November 28, 2007**

*An entity which is a resident of a Contracting State shall not be entitled to the benefits of this Agreement if the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits of this Agreement that would not be otherwise available. The cases of legal entities not having bona fide business activities shall be covered by this Article.*

### Indo – Kuwait Treaty

- **Article 27 – “Limitation of Benefits”**

*A resident of a Contracting State shall not be entitled to the benefits of this Agreement if its affairs were arranged with the primary purpose to take benefits of this Agreement. The case of legal entities not having bona fide business activities shall be covered by the provisions of this Article.*

# VARIATIONS IN DTAAs (contd...)

## Indo – USA Treaty

### ▪ **Article 24 – “Limitation of Benefits”**

1. *A person (other than an individual) which is a resident of a Contracting State and derives income from the other Contracting State shall be entitled under this Convention to relief from taxation in that other Contracting State only if :*
  - a) *more than 50 per cent of the beneficial interest in such person (or in the case of a company, more than 50 per cent of the number of shares of each class of the company's shares) is owned, directly or indirectly, by one or more individual residents of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or other individuals subject to tax in either Contracting State on their worldwide incomes, or citizens of the United States ; and*
  - b) *the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not resident of one of the Contracting States, one of the Contracting States or its political sub-divisions or local authorities, or citizens of the United States.*
2. *The provisions of paragraph 1 shall not apply if the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct by such person of a trade or business in the first-mentioned State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company).*

## VARIATIONS IN DTAA's (contd...)

### Indo – USA Treaty

#### ▪ **Article 24 – “Limitation of Benefits”** (contd...)

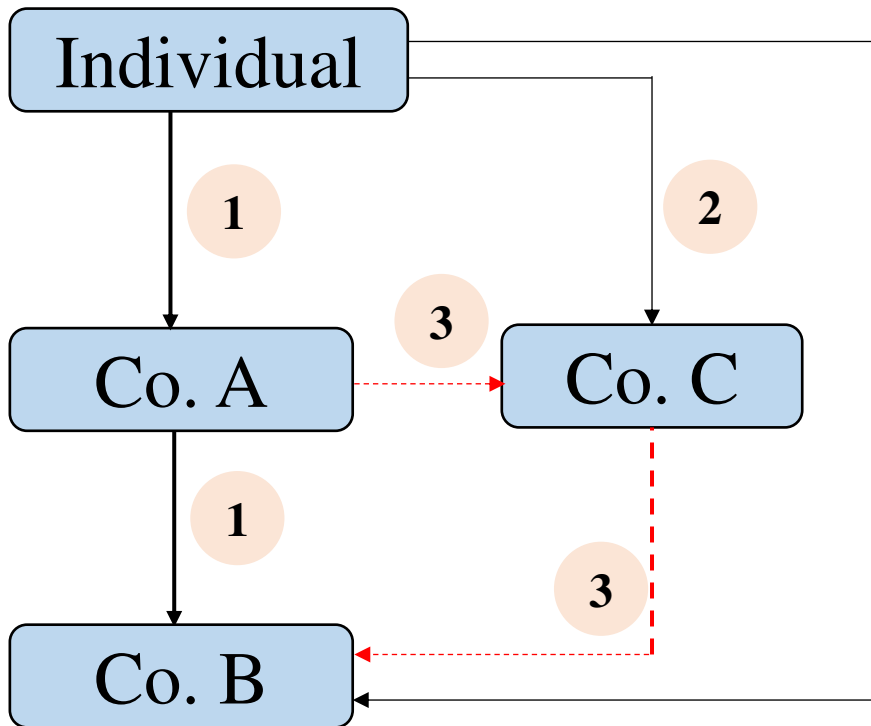
3. *The provisions of paragraph 1 shall not apply if the person deriving the income is a company which is a resident of a Contracting State in whose principal class of shares there is substantial and regular trading on a recognized stock exchange. For purposes of the preceding sentence, the term "recognized stock exchange" means :*
  - a) *in the case of United States, the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Act of 1934 ;*
  - b) *the case of India, any stock exchange which is recognized by the Central Government under the Securities Contracts Regulation Act, 1956 ; and*
  - c) *any other stock exchange agreed upon by the competent authorities of the Contracting States.*
4. *A person that is not entitled to the benefits of this Convention pursuant to the provisions of the preceding paragraphs of this Article may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income in question arises so determines.*





# PRINCIPLE PURPOSE TEST (“PPT”)

# Gregory V/S. Helvery (1935) (US Supreme Court)



## Steps:

1. Individual owns Co. A; Co. A owns Co. B
2. Individual floats a new company – Co. C
3. Co. A transfers shares of Co. B to Co. C
4. Co. C is liquidated; Individual holds Co. B
5. Individual sells shares of Co. B and receives cash

Corporate  
Reorganisation

Origins of Anti-tax Avoidance Doctrine

# Gregory vs. Helvery (1935) (US Supreme Court) (contd...)

## ❑ US – Court of Appeals

### ▪ Purpose of the Legislation:

- readjustment shall be undertaken for reasons germane to the conduct of the venture in hand
- To dodge the shareholders taxes is not one of the transactions contemplated as Corporate ‘Reorganisation’

## ❑ US – Supreme Court

### ▪ Intention of the taxpayer:

- Simply an operation having no business or corporate purpose
- A mere device which put on the form of corporate reorganisation as a disguise for concealing real character

And

- Purpose of legislation: Approved Court of Appeals observations

## ARTICLE – X(7) UNDER ACTION PLAN – 6

*“Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 this Convention**”*

# ANALYSIS

Benefits of a tax convention should not be available

where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty

and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention

## PPT – BURDEN OF PROOF

- ❑ Obtaining tax benefit is one of the principal purposes – Onus on the tax department
- ❑ Arrangement is in accordance with the object and purpose of the treaty – Defence available with the tax payer

# PPT V/S. INDIAN GAAR

## Action Plan 6

- “arrangement or transaction” to include any:
  - Agreement
  - Understanding
  - Scheme
  - Transaction
  - Series of transactions
- Whether or not they are legally enforceable [explained in Article X.7(9)]
- X.7(9) gives an example of “arrangement”
  - *“Where steps are taken to ensure that meetings of the Board of Directors of a company are held in a different country in order to claim that the company has changed its residence”*

## Section 102(1) of the Act

- “arrangement” means:
  - Any step in, or a part or whole of any:
    - Transaction
    - Operation
    - Scheme
    - Agreement
    - Understanding
  - Whether enforceable or not
  - And includes:
    - Alienation of any property in such transaction/operation/scheme/agreement/understanding

# HOW TO DETERMINE WHETHER THE PRINCIPAL PURPOSE IS TO OBTAIN TREATY BENEFITS?

- ❑ Undertake an objective analysis of aims and objects of **all persons involved** in putting arrangement / transaction in place
- ❑ Why are all of them a party to it?
- ❑ Conclusive proof – not required
- ❑ “reasonable to conclude” after objective analysis
- ❑ Looking merely at the “effect” not sufficient
- ❑ What is a reasonable explanation of:
  - *“Why you have done what you have done?”*
- ❑ Mere denial not sufficient



# HOW TO DETERMINE OBJECT AND PURPOSE OF RELEVANT PROVISION OF TREATY?

## ❑ Title of the Treaty

- *Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and tax avoidance*

## ❑ Preamble of a Treaty

- *“Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),”*

## ❑ Reading the Treaty as a whole

## ❑ Commentary on Model Convention (if no reservations)

# INTERPLAY BETWEEN LOB AND PPT

- ❑ LOB is SAAR, PPT is GAAR
- ❑ PPT supplements LOB
- ❑ PPT does not restrict LOB
- ❑ Even if LOB Test is passed, PPT can apply (commentary to Article X.7 – Para 4)
  - Example – Public listed company – Passes LOB Test but if involves in Treaty Shopping – PPT will deny benefit

## ILLUSTRATIONS

- ❑ India – Ireland DTAA definition of royalty includes use of CIS equipment (excluding aircraft). Major hub for aircraft leasing business across the globe. Whether GAAR applies?
- ❑ India – Philippines DTAA no separate article of FTS. Philippines is a major hub for repairs and maintenance of plant and machinery for various equipment manufactures across the globe. Whether GAAR applies?
- ❑ India – UK DTAA restricts the scope of FTS. It excludes managerial services. Whether using UK for providing managerial services could be hit by GAAR.

## ILLUSTRATIONS (contd...)

- ❑ R. Co. for expanding its business globally has identified three different countries with similar economic and political environments. It selects State S for setting up its business on account of favourable treaty with State R. Will PPT apply? Expansion of business in the principal purpose.
- ❑ R. Co is a collective investment vehicle managing diversified portfolios of investment globally. It has significant investments in State S on account favourable treaty on dividend taxation. Whether PPT applies? The intent of treaties is to provide benefit to encourage cross border investments

# CHANGING INIDAN APPROACH

- ❑ Section 90(2A) and 90A(2A) of the Act contain overriding provisions
- ❑ Section 100 states that GAAR would apply in addition to or in lieu of any other basis of taxation
- ❑ Mere tax benefit under a tax treaty would not automatically lead to application of GAAR unless other conditions prescribed u/s 96(1) are also fulfilled;
- ❑ GAAR provisions are in addition to LOB or other anti-abuse provisions in DTAA



# SAAR UNDER DOMESTIC LAW

# SAAR UNDER DOMESTIC LAW

Sections	Provisions
2(22)	Deeming certain transactions with shareholders/their related parties as dividend
9	Explanation 5 – Indirect Transfer
14A	Disallowance of expense in relation to exempt income
40A(2) & 92	Expenses or payments not deductible in certain circumstances involving related parties
50C, 50CA, 50D	Deeming sales consideration in case of transfer of land, building, unquoted shares or where such consideration is not ascertainable or determinable
56(2)	Treating any receipt of property at NIL or inadequate consideration as income of recipient
60	Transfer of income without transfer of assets
61 & 62	Taxation of revocable and irrevocable trust

Sections	Provisions
64	Transfer of income by husband to wife vice versa
72A	Carry forward and set off of losses in case of amalgamation/demerger
79	Carry forward and set off of losses in case of change of shareholding
80IA, 80IB, 80IC	Tax Holiday – Inter company/Intra company transfers
93	Avoidance of income-tax by transfer of income to non-residents through transfer of assets, rights, interest
94	Dividend Stripping/ Bonus Stripping
94B	Thin Capitalisation
94CE	Secondary Adjustments, etc.

*Note: The above tables are only illustrative in nature - the Income-tax Act covers other SAAR provisions as well*

# DRAFT GUIDELINES FOR GAAR IMPLEMENTATION UNDER DIRECT TAX CODE BILL, 2010 (“DTC”)

- ❑ Concerns have been raised that there could be interplay between the SAAR and GAAR. The committee examined this issue and gave the below recommendation:

*“While SAARs are promulgated to counter a specific abusive behavior, GAARs are used to support SAARs and to cover transactions that are not covered by SAARs. Under normal circumstances, where specific SAAR is applicable, GAAR will not be invoked. However, in an exceptional case of abusive behavior on the part of a taxpayer that might defeat a SAAR....., GAAR could also be invoked.”*

(Underlined for emphasis)



# SHOME COMMITTEE REPORT

- The report observed that the statement made by the earlier committee in the draft guidelines for DTC came under criticism. The committee stated as under

*“It is a settled principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes. For instance, transfer pricing regulation in respect of transactions between associated enterprises ensures determination of taxable income based on arm’s length price of such transactions. Here GAAR cannot be applied if such transactions between associated enterprises are not at arm's length even though one of the tainted elements of GAAR refers to dealings not at arm’s length.....”*

*In view of the above, the Committee recommends that that where SAAR is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/element.”*

## CIRCULAR NO. 7 of 2017 dated 27/01/2017

- ❑ Central Board of Direct Taxes (“CBDT”) has issued the said circular providing clarification on implementation of GAAR

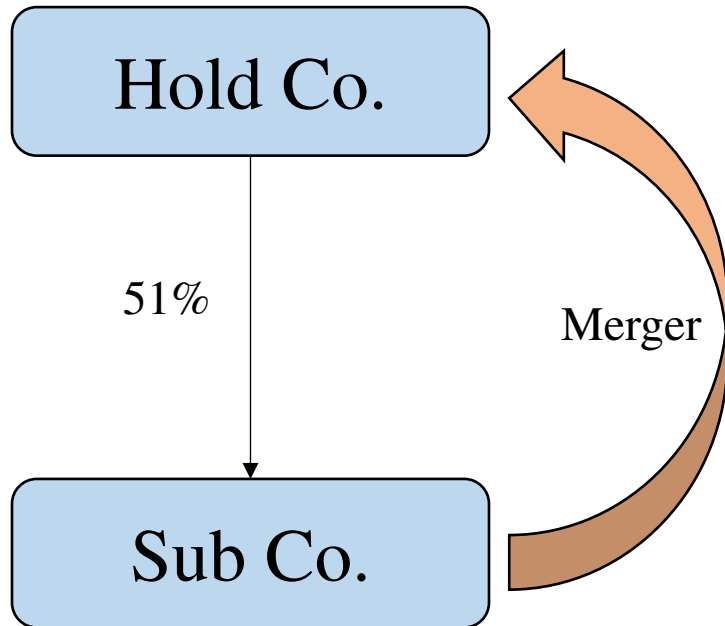
*“Question no. 1: Will GAAR be invoked if SAAR applies?”*

*Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislations. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.”*

Co-existence of GAAR & SAAR depends on necessity, facts and circumstances of the case

Circular creates AMBIGUITY

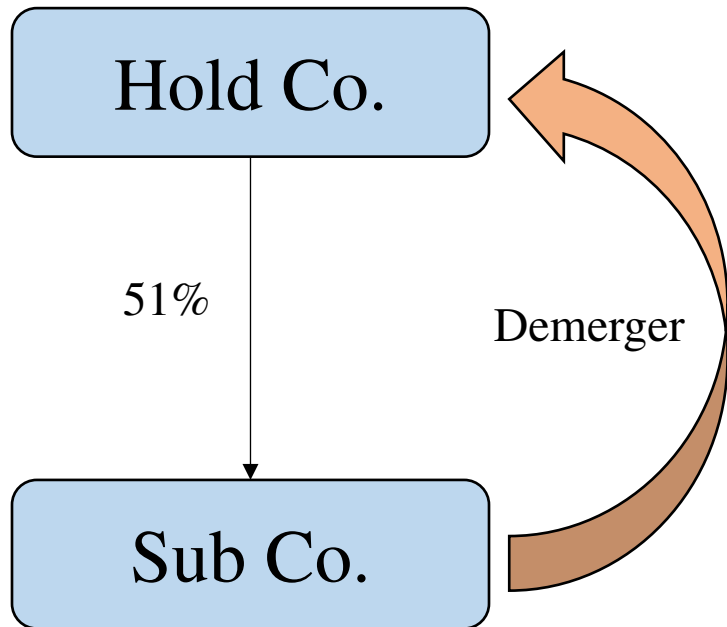
## ILLUSTRATION (1/2)



- ❑ Sub Co. has substantial carried forward losses where as Hold Co. is a profit making company
- ❑ The scheme is a qualifying amalgamation u/s 2(1B)
- ❑ Transfer exempt u/s 47(vi)
- ❑ Hold Co. will be allowed to set – off the losses u/s 72A
- ❑ Predominant intention behind the arrangement is set off of losses

**Can GAAR provisions be invoked?**

## ILLUSTRATION (2/2)



- Sub Co. is a trading company
- It has substantial carried forward losses whereas Hold Co. is a profit making company
- Sub Co. starts a new consultancy business
- Sub Co. demerges trading division to Hold Co.
- The scheme is a qualifying demerger u/s 2(19AA)
- Transfer exempt u/s 47(vib)
- Hold Co. will be allowed to set – off the losses u/s 72A(4)

**Can GAAR provisions be invoked?**



THANK YOU!!!