



Tax implications in relation to remittance of capital gains, salaries, import of goods and services (other than fees for technical services)

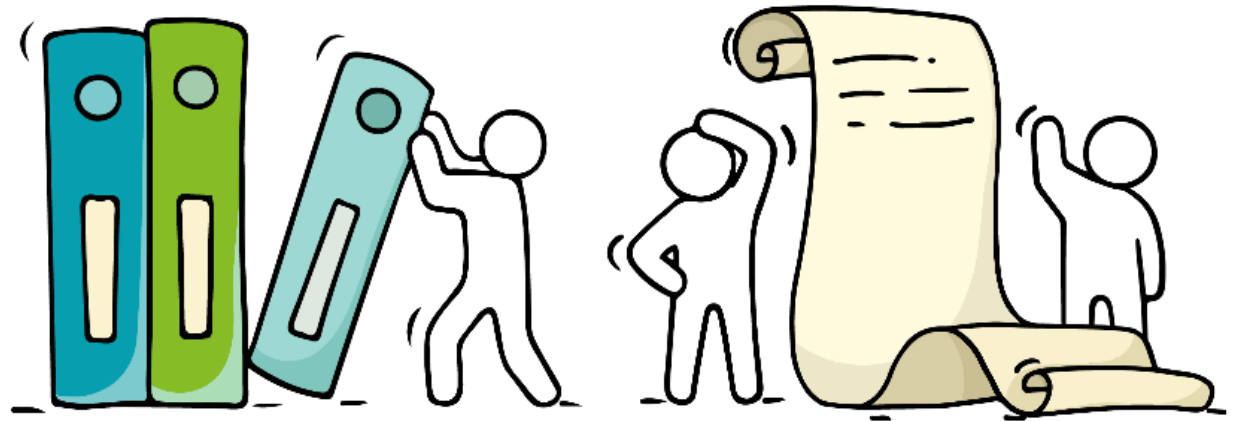
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Western India Regional Council of The Institute of Chartered Accountants of India

7 March 2020

Contents:

- Capital gains
- Salaries
- Import of goods / services



Capital Gains

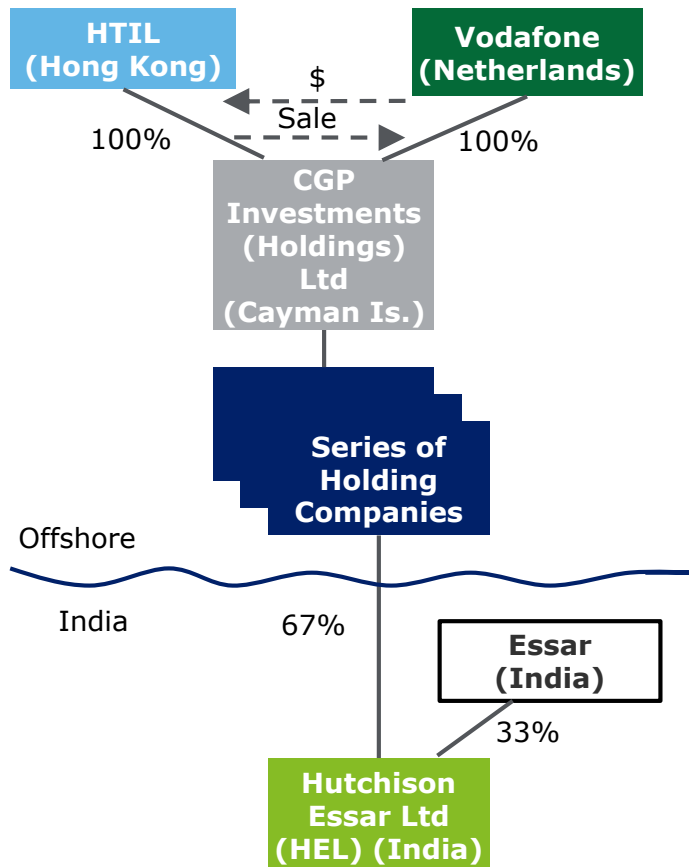
Capital Gains

Overview of key provisions

Sections	Provision
195	Payer responsible for paying to a non-resident is required to deduct income-tax thereon at the rates in force from any sum chargeable to tax under the Act at the time of payment/credit to the account of the payee
9(1)(i)	All income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.
45	Any profits or gains arising from transfer of capital asset shall be chargeable to tax under the head capital gains
115E	In the case of a shareholder being a non-resident Indian, and subscribing to the shares of the company in convertible foreign exchange, in accordance with and subject to the prescribed conditions, LTCG on transfer of the shares of the company will be subject to tax at the rate of 10% (plus applicable surcharge and education cess), without any indexation benefit

Indirect transfer of shares

Section 9(1)(i)



Post SC's decision in Vodafone's case, clarificatory amendment was introduced vide Finance Act, 2012 (retrospective effect from April 1, 1962). As a result of which:

- Shares of foreign company deemed to be situated in India if it derives, directly or indirectly, its value substantially from assets located in India
- 'Capital asset' definition amended to include rights in or in relation to an Indian company including management rights, control or any other rights
- 'Transfer' definition widened to include disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (entered in India or outside India) or otherwise

Indirect transfer of shares

Construct of indirect transfer provisions

Sections	Provision
Explanation 5 to Section 9(1)(i)	An asset or capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India , if the share or interest derives, directly or indirectly , its value substantially from the assets located in India Exception – Investment by non-resident in Category-I FPI under the SEBI (FPI) Regulations, 2019
Explanation 6 to Section 9(1)(i)	Share or interest shall be deemed to derive its value substantially from Indian assets, as on specified date if: <ul style="list-style-type: none">• Value exceeds ten crore rupees; and• Value represents at least fifty per cent of the value of all the assets owned by the company or entity
Explanation 7 to Section 9(1)(i)	Exception to taxation of indirect transfer shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, in the immediately preceding 12 months from the date of transfer: <ul style="list-style-type: none">• Neither holds the right of control or management• Nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital in the foreign company or entity directly holding the Indian assets (direct holding company)
47(viab) / (vicc)	Transactions not regarded as transfer – Intergroup restructuring – Any capital gain arising in the amalgamation or demerger of the group companies will not be liable to capital gain on fulfillment of specified conditions

Rules on Indirect transfer of shares

Notification 55/2016 dated 28 June 2016

Rule 11UB

Manner of Computation of FMV of tangible and intangible assets

Rule 11UC

Determination of Income attributable to assets in India =

Income from transfer as per the Act x FMV of assets located in India on specified date
FMV of all assets of the company/ entity as on specified date

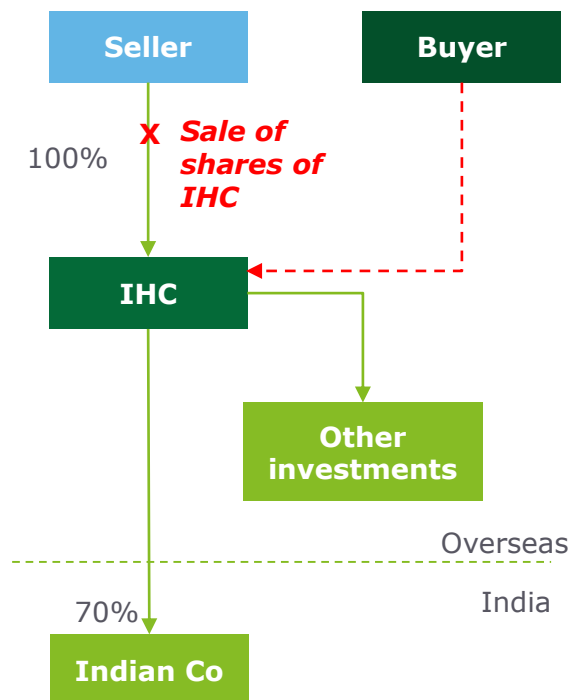
Rule 114DB

Documents to be furnished as per Section 285A by an Indian concern:

- **Form No, 3CT** – Certifying that the income attributable to assets in India has been correctly computed
 - **Form 49D** – To be furnished within a period of 90 days from end of FY in which transfer of share or interest in an Indian company / entity or foreign company / entity took place
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Indirect transfer of shares

Case Study



Particulars	Amount ₹ in million
Value of all assets of IHC	500
Value of all assets of Indian Co	300
Underlying value of indirect transfer	210
% of value of IHC derived from Indian assets	42%

Condition I :

Satisfied as value is more than ₹10 crores

Condition II:

Not satisfied as less than 50% of value of IHC is derived from Indian assets

Therefore, sale of shares of IHC shall not be taxable in India

Indirect transfer exemption under tax treaty

Some of the tax treaties entered into by India with foreign countries is tabulated below including whether the Indirect Transfer would be taxable in India or not:

Sr No	India's tax treaty with	Remarks
1	Australia	Not Taxable
2	Cyprus	Not taxable
3	Luxembourg	Not taxable
4	Mauritius	Not taxable
5	New Zealand	Not taxable
6	Netherlands	Not taxable
7	Singapore	Not taxable
8	UAE	Not taxable
9	UK	Taxable
10	USA	Taxable
11	Cayman Islands/ BVI	No tax treaty. Hence, taxable in India

Purchase of immovable property from NRI

- TDS is to be deducted by the buyer as per provisions of Section 195.
- In case the property is held for more than two years, then there would be 'Long Term Capital Gain' and TDS would be deducted at the rate of 20%.
- There would be a Short Term Capital Gain in case the property is held for less than two years. In the case of Short Term Capital Gain, TDS would be deducted at 30%.
- The facility of lower TDS rate is also available in case of TDS deduction on the purchase of property from NRI. (Section 197)
- The amount on which TDS is to be deducted in case of purchase of property from NRI depends on the following two situations –
 - When the certificate of computation of Capital Gain has been obtained from the Income Tax Officer – As computed by the Income Tax Officer
 - When the certificate of computation of Capital Gain has not been obtained from the Income Tax Officer
 - on the Capital Gain amount
 - If not available, on the entire transaction value
- The buyer is obligatory to deduct the TDS within earlier of date of payment or date of credit of income.

- **Basic exemption limit**
- **CA certificate in Form 15CB**
- **Property purchased prior to 1 April 2000**

Beneficial Ownership

Whether TRC is sufficient or beneficial owner test to be satisfied?

Circular 789 dated 13 April 2000, issued in the context of India-Mauritius DTAA.

Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

ADIT v. Universal International Music B.V. (2013) 214 Taxman 19 (Bom.) Bombay High Court

Aditya Birla Nuvo Ltd. [2011] 12 taxmann.com 141 (Bombay HC)

AB Holdings, Mauritius-II, In re [2018] 90 taxmann.com 177 (AAR - New Delhi)

MLI

Article 7: Prevention of treaty abuse

- As a minimum standard, jurisdictions should implement either
 - PPT (default rule – minimum standard)
 - PPT *plus* Simplified LOB

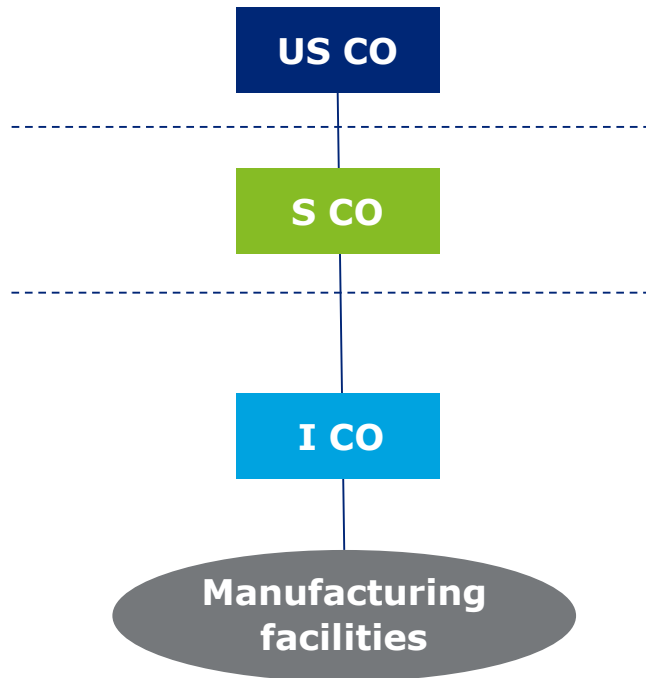
PPT being minimum standard, it will apply to all its CTAs

India has opted not to grant treaty benefits when PPT invoked

India has accepted to apply PPT as an interim measure and intends where possible to adopt LOB provision, in addition or replacement of PPT, through bilateral negotiations

PPT – Case Studies

Case study 1: Impact on India - Singapore treaty



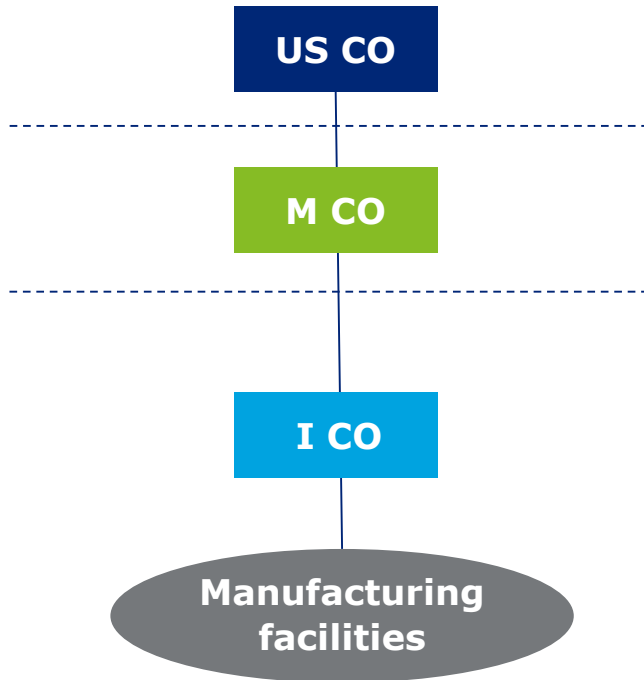
Article 13(4A) & (4C) Grandfathering of gains arising for investment in shares prior to 1 April 2017 and gain arising between 1 April 2017 to 31 March 2019 for investment in shares after 1 April 2017

Article 24A of India-Singapore tax treaty – limitation of relief

1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(4A) or (4C) if its affairs were arranged with **the primary purpose to take advantage of the benefits** in the said paragraphs.
2. Shell or conduit resident company is not entitled to tax treaty benefit
 - Primary purpose v. One of the principal purposes
 - PPT on gain arising for investment made prior to 1 April 2017
 - No exclusion in LOB

PPT – Case Studies

Case study 2: Impact on India - Mauritius treaty



Article 13(3B) Grandfathering of gain arising between 1 April 2017 to 31 March 2019 for investment in shares after 1 April 2017

Article 27A of India-Mauritius tax treaty – limitation of benefits

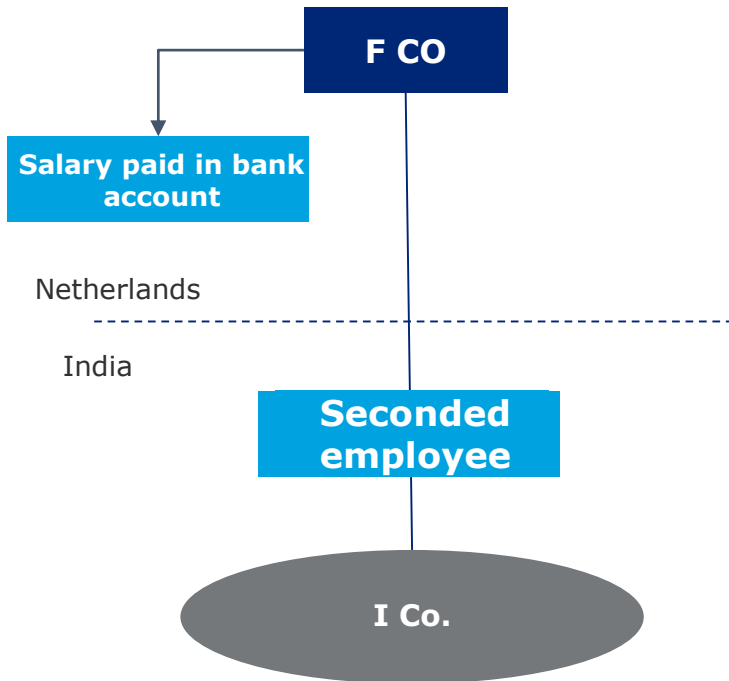
1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.
2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention.
3. Mauritius has not included India as covered tax agreement.
4. No impact on India-Mauritius treaty.

Salaries

Employees deputed in India

Employees of foreign company deputed in India

Withholding tax on salary



Facts

I Co. obtained expatriate-employees from a foreign company and the said employees, continuing to be employees of the foreign company, received salary and allowance in their home country in foreign currency

Issue

Whether a foreign employer is required to deduct taxes on salary paid outside India to expat employees seconded to India for services rendered in India?

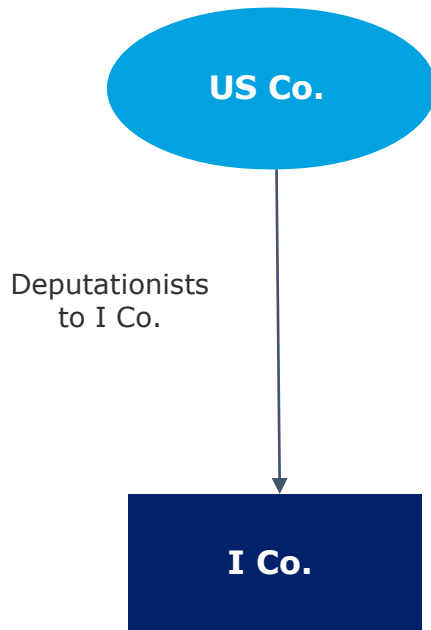
Held

Though the payment of salary to the expatriate was made by the foreign company outside India, the TDS provisions did apply as the Act had extra-territorial operation as there was a nexus between the said salary and the rendering of services in India

Eli Lilly & Co. (India) (P) Ltd. [2009] (312 ITR 225) (SC)

Employees of foreign company deputed in India

Service PE



Issue

Whether employees of foreign company deputed to Indian company working under the supervision and control of Indian company constitute a service PE for the foreign company in India?

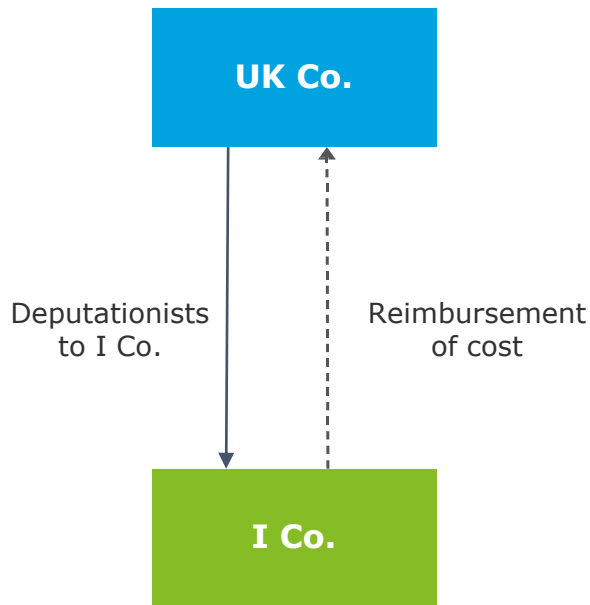
Held

- Where the activities of the foreign company entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service P.E. can emerge.
- Two tests to be analysed viz. responsibility for the work of assigned employee; and control over the assigned employee

Morgan Stanley and Co. Inc. [2007] (292 ITR 416) (SC)

Employees of foreign company deputed in India

Reimbursement of salary (1/2)



Facts

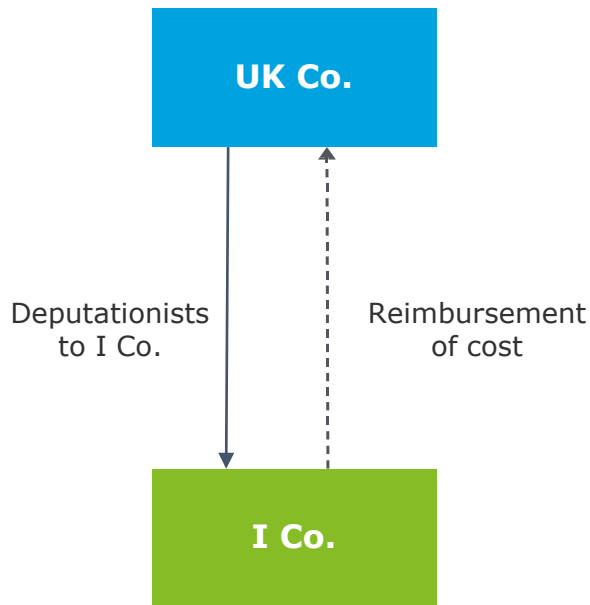
I Co. entered into an agreement with overseas entities in which the overseas entities seconded some employees for fixed tenure for providing "business support services". The salary to seconded employees was paid by overseas entities. The salary so paid was reimbursed by I Co. to overseas entities on cost basis. I Co. withheld taxes on the salary paid to seconded employees

Issue

Whether I Co. is required to deduct taxes reimbursements to UK Co.

Employees of foreign company deputed in India

Reimbursement of salary (2/2)



Held

- Overseas entities constitute Service PE in India under the relevant tax treaty. The argument that there is no “service PE” is not acceptable because though CIOP has operational control over the persons in terms of the daily work, and is responsible (in terms of the agreement) for their failures, these are limited and sparse factors which cannot displace the larger and established context that the persons continue to be employees of the foreign parties.
- The argument that the payment is a “reimbursement” on the ground that it is described as such in the secondment agreement and that there is no mark-up is not acceptable.
- Reimbursement of salary is in the nature of income accrued to the overseas entities which may or may not apply it for payment to the secondees, based on its contractual relationship with them.
- I Co. is liable to deduct tax on payments to overseas entities

Centrica India Offshore Pvt. Ltd. [2014] 364 ITR 336 (Delhi HC). SC has dismissed Special Leave Petition filed by Centrica

Employees of foreign company deputed in India

Reimbursement of salary – Against the taxpayer

Key findings

- Personnel seconded, have to work under the control, direction and supervision of the assessee, as all are senior technical/managerial position employees
- Deputed employees are rendering highly technical services
- Technology was made available to the subsidiary company in India and there is no need for the employees to come again
- Reimbursement of salary cost of employees deputed to India, constitutes FTS under the Act and under the India-Japan Tax Treaty

Panasonic Corporation [2018] ITA No. 1483/Chny/2017 (Chennai Tribunal)

- Reimbursements of salaries of seconded employees were taxable because the seconded employees temporarily exchange experience and skill, and do not lose the employer-employee relationship of the parent organization even after the secondment has ended.

Nippon Paint (India) Pvt. Ltd. I.T.A. No. 2562/Chny/2018 dated 29 March 2019

Employees of foreign company deputed in India

Reimbursement of salary – Decisions in favour of the taxpayer

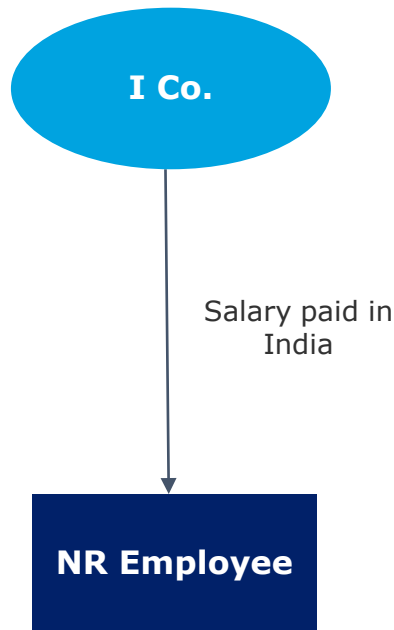
Key findings

- Merely supplying employees or assisting the Indian entity in the business did not constitute making available technical or consultancy services. Once the Indian entity has withheld tax on the salaries of seconded employees, that same salary income cannot be subject to withholding tax a second time when the income is remitted by the Indian entity to the foreign entity. **Marks & Spencer Reliance India Pvt. Ltd. (ITA No. 893 of 2014) Bombay High Court**
- The receipt is in the nature of reimbursement of cost and not FTS. No profit element involved. Entire salary has been subjected to tax in India in the hands of employee. **Morgan Stanley Asia (Singapore) Pte. Ltd. [2018] 95 taxmann.com 165 (Mumbai Tribunal)**
- Reimbursements of salaries of seconded employees were not FTS as they were working under the control and supervision of the Indian entity and were not furthering the business of the overseas entity. **AT & T Communication Services (India) P. Ltd. [2019] 111 taxmann.com 201 (Delhi Trib.)**
- Payments received by a foreign company from an Indian associated entity as a partial reimbursement of salary costs for a seconded employee were not FTS and, hence, were not taxable in India in the hands of the foreign company. **M/s. Faurecia Automotive Holding ITA No.784/PUN/2015 (Pune ITAT) dated 8 July 2019**

**Indian company employees
deputed outside India**

Indian company employees deputed outside India

Withholding on salary



Issue

Whether salary income received in India by non-resident employee from the Indian company for rendering services outside India is taxable in India?

Whether withholding is applicable on such salary income?

Held

If salary is subject to tax only outside India as per treaty, Indian employer need not deduct tax.

British Gas India (P.) Ltd., In re [2006] 285 ITR 218 (AAR)

Subsequent decision on similar basis - Hewlett Packard India Software Operation (P.) Ltd. [2018] 91 taxmann.com 473 (AAR – New Delhi)

Indian company employees deputed outside India

Foreign Tax Credit

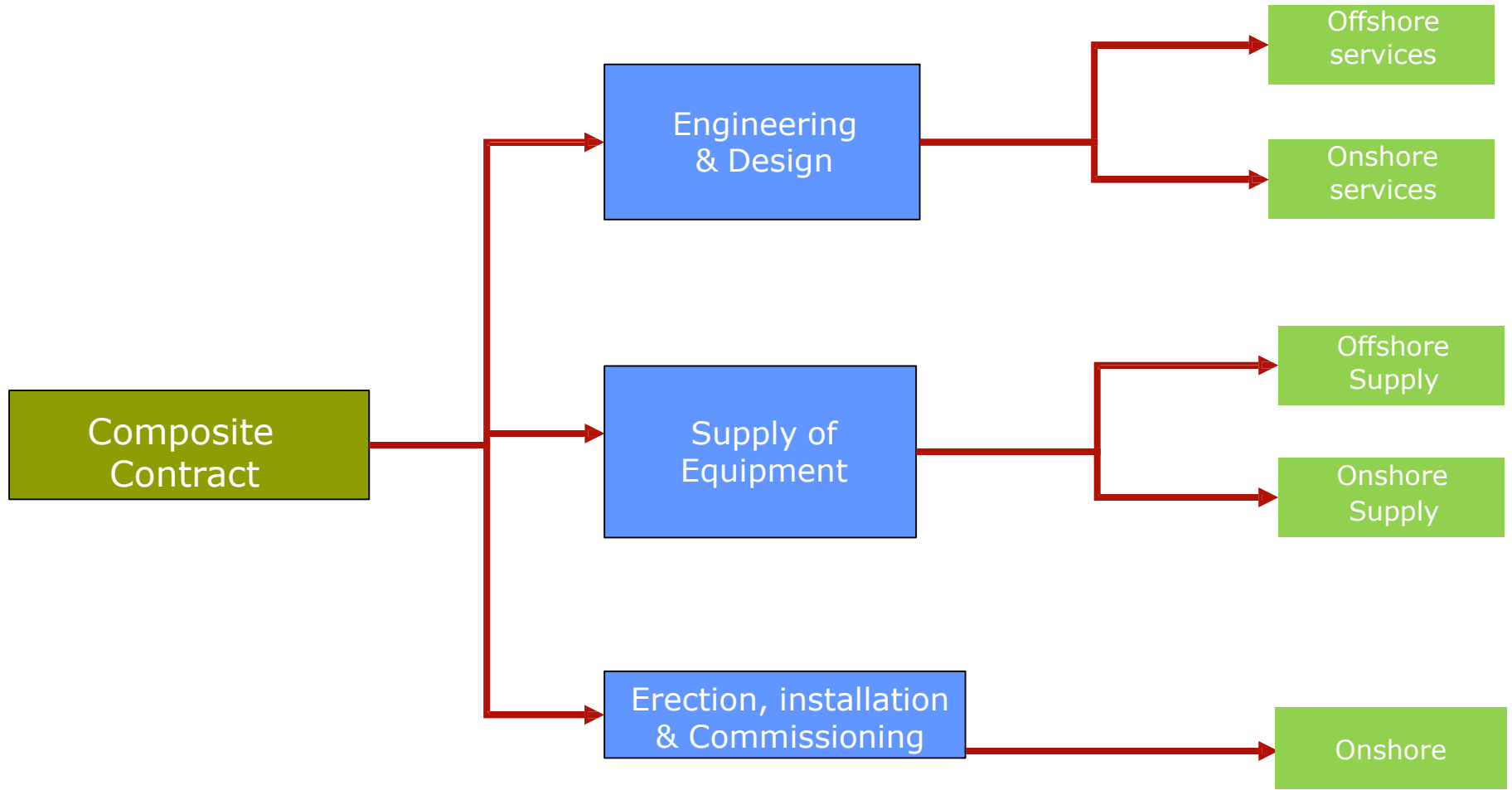
Whether foreign tax credit can be considered while computing TDS under section 192?

Once employee becomes resident on return to India and salary is paid, provisions of section 192(2) will apply, however, company can give credit to the employee for taxes deducted during his deputation outside India in view of article 25 of India-USA DTAA.

Texas Instruments (India) (P.) Ltd., In re [2018] 401 ITR 289 (AAR - New Delhi)

Import of goods / services

Different Components of Composite Contract



EPC Contracts

Key Parameters

- Composite contract vs. Separate contract
- Identification of consideration for off shore – on shore activities in composite contracts
- Existence of payee's PE in India
- Whether it is advisable to have certificate from AO/AAR before making payment?

▪ Landmark ruling

- Ishikawajima-Harima Heavy Industries [2007] 288 ITR 408 (SC)
- Hyundai Heavy Industries Co [2007] 291 ITR 482 (SC)
- Linde AG [2014] 44 taxmann.com 244 (Delhi HC). Department SLP dismissed in [2016] 73 taxmann.com 212 (SC)

Controversies around taxability

- Controversies around taxability of offshore supply in case of composite contracts
- Controversy was settled by the Supreme Court, in the case of Ishikawajima Harima Heavy Industries Company Limited [2007] 288 ITR 408 (SC).
 - Decision was passed in the context of a composite contract
 - If all the legs of a transaction such as transfer of property in goods, payments, etc., are performed outside India, then such offshore supplies would not be taxed in India
- Controversy revived by series of AAR rulings after Vodafone case [2012] 341 ITR 1 (SC)
 - Dissecting approach cannot be accepted and complete transaction is to be looked at
 - Composite works contract – entire income shall accrue and arise in India
- Contrary rulings which disregarded the reliance placed on 'look at' approach and held in favour of the tax payer
 - Linde AG (supra); Nokia Networks OY [2018] 94 taxmann.com 111 (Delhi Trib.) (SB.), etc.

Taxability of designs, drawings, engineering services, etc.

- **Pure sale of designs - whether royalty?**

- *Davy Ashmore 190 ITR 626 (Kol); Creative Infocity Ltd. – Guj HC – 2017; Outotec (Finland) Oy – Kolkata AT – May 2019 (India-Finland DTAA)*

- **Incidental to supply of equipment / machinery – whether treatment similar to supply?**

- *Neyveli Lignite 243 ITR 459 (Mad) , Mitsui Engg 259 ITR 248 (Del), Pro-Quip 255 ITR 354 (AAR)*

- **Separate from supply - In case primary objective is 'right to use designs and drawings' – taxable as Royalty / FTS**

Factual analysis of transaction and wordings of the contract required to be examined

Summing Up

Offshore supplies

- Generally not taxable (appropriate safeguards to be maintained)

Offshore services

- If services effectively connected with PE in India – 'Net' income taxable @ 43.68 percent
- If services not effectively connected with PE in India – Generally 'Gross' receipts taxable as Royalty @ 10 percent
- If integral part of supply, possible to contend – not taxable

Onshore supply

- Generally, taxable in India in the hands of supplier

Onshore services

- If services provided by overseas entity
 - If services effectively connected with PE – 'Net' income taxable @ 43.68 percent
 - If services not effectively connected with PE in India – 'Gross' receipts taxable @ 10 percent
- If services provided by Indian entity– its 'Net' income taxable @ 34.94 percent

Questions



Thank you!

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