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Recent Developments in International Taxation

India

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INTRODUCTION

The taxation regime in India is governed by the Indian Income-tax Act, 1961 ("**ITA**") and the Indian Income-tax Rules, 1962 (the "**Rules**"). Since India has been gearing towards towards the General Elections 2019 during the course of the previous year, there have been a few but crucial amendments to the its tax regime in the past year.

The key amendments to the Indian tax regime, from an international taxation standpoint, have been highlighted in brief below:

A. Budget 2019 and Amendments to the ITA

On February 01, 2019, the Finance Minister presented the Budget before the Lok Sabha pursuant to which the Finance Act, 2019 was passed. Since the General Elections 2020 were slated to take place from March 2019 onwards, the budget was only an interim one, so as to enable the functioning of the government for the next couple of months. The new government that shall be elected on May 23, 2019 shall present the main budget in July, 2019. Since this budget was a pre-elections one, the focus of the present government was majorly on the agrarian and rural sectors. While the Finance Act, 2019 does not provide for major tax policy amendments, technological development, creation of digital infrastructure and digitalization of governance was the primary focus in the Budget.

The Finance Minister in the course of his Budget Speech proposed to create a taxpayer friendly, technology-driven, tax assessment platform, whereby tax scrutiny can be performed in an anonymous and time efficient manner. It is expected that tax returns will be processed digitally within 24 hours under this project. It would be interesting to see how this is implemented and whether this can minimize challenges around unreasonable and high-pitched assessments by the tax authorities.

Similarly, the Indian income tax department's "project insight" intends to use data analytics to message, call and email individuals that pose as a high risk for tax evasion to voluntarily inform them to comply with the taxation laws. Since the government possesses vast data in relation to taxpayers pursuant to the enactment of goods and services tax in 2017, the government now intends to ensure improvement of tax compliance by profiling assessees and reminding them to comply with taxation laws.

B. Permanent Establishment: Public Consultation Paper

In order to harmonise the mechanism for determination of profit attribution to a PE, a Committee was formed to examine and provide proposals for such PE profit attribution. On April 18, 2019, the Committee released a proposal seeking inputs for Amendment of Rules for Profit Attribution to Permanent Establishment ("**PE**") ("**Proposal**").

The Committee recognized that business profits depend on two variables, namely sales revenue (demand side factor) and cost (supply side factor) and sales revenue is further based on to variables, i.e. price per unit and number of units sold. Therefore, upon on a comparative jurisdiction analysis, the Committee recommended taking into account both demand side factors and supply side factors for profit attribution. In order to determine the demand side factors, attribution would be determined upon the 'sales' and for supply side, factors such as employees, wages and assets would be taken into account. Accordingly, the Committee recommended a formula pursuant to which profits attributed to India would be obtained by apportioning the profits derived in India by assigning prescribed weights to both supply and demand side factors of employees, payroll, assets and sales (and additionally 'users' in case of digital businesses).

While demand side factors have been assigned 30% of the weightage, 'users' (in case of digital business businesses) have been assigned 10% weightage in case of low and medium user intensity and 20% (with corresponding reduction of weightage to employees) in case of high user intensity. For the purposes of the abovementioned formula, profits derived from India has been recommended to be higher of global operational percentage profit percentage on India sales, *OR* 2% of the revenue or turnover derived from India.

It is pertinent to note that the public consultation paper is still at a preliminary stage and pursuant to the receipt of comments from stakeholders, shall be further amended in order to plug loopholes.

C. Tax Treaties

a. India-Kuwait DTAA

On May 04, 2018, a Protocol amending the existing Double Taxation Avoidance Agreement ("**DTAA**") between India and Kuwait signed on July 15, 2006 was notified. The Protocol

updates the provisions in the DTAA with exchange of information provisions as per international standards. Further, the Protocol enables sharing of the information received from Kuwait for tax purposes with other law enforcement agencies with authorisation of the competent authority of Kuwait and vice versa.

b. India-China DTAA

Further, India and China also amended their DTAA on November 26, 2018. Similar to the India-Kuwait DTAA, the Protocol between India and China amended the existing provisions of the DTAA to provide for exchange of information in line with the latest international standards. Further, the Protocol incorporated changes required to implement treaty related minimum standards under the Action reports of Base Erosion & Profit shifting ("**BEPS**") Project, in which India had participated on an equal footing. In addition to minimum standards, the Protocol was updated in line with BEPS Action reports as agreed upon by the two countries.

c. Implications of the India-Singapore DTAA and India-Mauritius DTAA

In addition to the above amendments, the sunset clause contained under the Article 13 (Capital Gains) pursuant to the third Protocal amending the India-Singapore DTAA dated December 30, 2016 and the Protocol amending the India-Mauritius DTAA dated May 10, 2016 has expired on March 31, 2019 ("**Protocols**"). The respective Protocols introduced amendments that made a shift from residence-based taxation to source-based taxation and therefore, capital gains arising on or after April 01, 2017 from alienation of shares of a company resident in India would be subject to tax in India.

However, the Protocol also provided for a relaxation in respect of capital gains arising to Singapore and Mauritius residents from alienation of shares acquired after April 1, 2017 but alienated before March 31, 2019. The tax rate on any such gains would not exceed 50% of the domestic tax rate in India subject to the limitation of benefits clause under the respective Protocols. This timeframe has now ended and therefore, capital gains earned from the sale of shares shall now be subject to the full rate of domestic tax in India under the respective Protocols.

D. Country-by-Country ("CbC") Reporting

Recently, India and USA finalised a Bilateral Agreement for Exchange of CbC Reports. India notified the same on March 25, 2019. Earlier, the absence of an agreement between India and USA required Indian subsidiary companies of US multinationals to comply with local filing requirements of CbC Reports in India. However, this agreement will now enable both countries to exchange CbC Reports filed by the ultimate parent entities of multinational enterprises (MNEs) in the respective jurisdictions without requiring the subsidiary company to also comply with local filings of their international groups.

India has previously signed the Multilateral Competent Authority Agreement ("**MCAA**") for Exchange of CbC Reports, which enables exchange of CbC Reports with 62 jurisdictions. This process stems from minimum standards required under the Action 13 Report of OECD/G20 BEPS Project whereby the CbC Reports are filed by the parent entity of multinationals with the applicable jurisdictional authority and such reports are thereafter, exchanged between the competent authorities of the said jurisdiction and the jurisdiction in which the group has one or more of its constituent entities.

E. Proposed Customs Duty on Electronic Transfers

The Government of India introduced the Draft National E-commerce Policy ("**Draft Policy**") with a view to regulate the use and processing of "data" and to address the concerns related to privacy and security. The objective was to centralise and regulate data in the context of cross-border situations.

From a taxation perspective, the Draft Policy touched upon the requirement of imposition of customs duty on electronic transmission of data. The reasoning behind the aforesaid proposal was that customs duties provides a tool for governments to monitor and control foreign access to domestic markets. However, the same cannot be done for digital transmissions which travel into the country online. In order to facilitate the said introduction of customs duty, the Draft Policy has recommended the formulation of an integrated system connecting the Customs, Reserve Bank of India and India Post to be developed to better track imports. It has also recommended that all e-commerce websites and applications available for downloading in India establish a registered business entity in India to function as an importer on record or the entity through which all the sales in India are executed.

It is pertinent to note that currently, the Indian goods and services tax ("**GST**") law already provides for the imposition of GST on the impost of goods and services. Therefore, the

proposed imposition of customs duty on digital imports should take into consideration the existing levy of GST on such imports to prevent additional tax on foreign service providers providing digital goods and services to Indian recipients.