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Recent Developments in International Taxation

India[1]

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Recent highlights

During the past year, the Union Budget for the financial year (FY) 2020–2021 proposed several amendments to the Income-tax Act, 1961 (the 'ITA') focusing on the expansion of taxing rights in relation to digital transactions, increasing foreign investment in India and aligning provisions of the ITA with the recommendations of the Organisation for Economic Co-operation and Development (OECD) under the Base Erosion and Profit Shifting (BEPS) project. Further, Indian courts discussed and delivered rulings on several important issues, such as availability of tax treaty benefits with respect to indirect transfers, beneficial ownership and interplay of private international law with tax law.

Amendments under the Finance Act, 2020

Dividend distribution tax abolished

In a landmark step, the Finance Act, 2020 (the 'FA, 2020') abolished the dividend distribution tax (DDT) – a 15 per cent additional income tax payable by Indian companies on amounts declared, distributed or paid by them as dividends – and instead moved to the classical system of taxing shareholders on the dividends received at the applicable marginal tax rate. Therefore, dividend payments by an Indian company to a foreign shareholder will now be subject to withholding tax at the rate of 20 per cent or the rate provided under the relevant tax treaty, whichever is more beneficial to the foreign shareholder. The reversion to a classical system for taxation of dividends is a progressive development, and should ensure the availability of foreign tax credit in the state of residence of the recipient against the tax payable on dividends. In addition, given that lower rates under tax treaties are usually restricted to a recipient being the 'beneficial owner' of the income received, the question of beneficial ownership of dividend income becomes much more significant, and issues relating to the beneficial ownership of such income are poised to become flashpoints in the Indian tax litigation landscape potentially for years to come.

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Exemption of sovereign wealth funds from income from infrastructure investments

In order to promote investment by certain sovereign wealth funds (SWFs), the FA, 2020 exempts income of SWFs that is in the nature of dividends, interest or long-term capital gains arising from an investment made by it in India in infrastructure facilities directly or investments by SWFs through an infrastructure investment trust (an 'InvIT') and alternate investment funds (AIF), subject to the fulfilment of certain conditions.

Expanding taxing rights and deferring the implementation of significant economic presence

The FA, 2020 seeks to expand the scope of income attributable to Indian operations that is within India's taxing rights as a source country, primarily in the context of the digital economy and use of data collected from Indian users. The FA, 2020 proposes that the income attributable to operations carried out in India shall include income, inter alia, from the following activities (the 'Attribution Rules'):

- advertisements that target customers who reside in India or customers who access the advertisements through an Internet Protocol (IP) address located in India;
- sale of data from a person who resides in India or from a person who uses an IP address located in India; and
- sale of goods or services using data collected from a person who resides in India or from a person who uses an IP address located in India.

Additionally, the implementation of the significant economic presence (SEP) test that was introduced in the Finance Act, 2018 has now been postponed to April 2021 in light of evolving global discussions at the OECD and global level with respect to taxation of the digital economy. Further, the scope of SEP has been expanded to cover systematic and continuous soliciting of business activities or engaging in interaction with users in India through digital as well as any other means.

The impact of the above is unlikely to be felt with respect to most digital companies in the short run because in the absence of any amendments to treaties, a permanent establishment (PE) is required for any taxes to be levied under the above provisions. However, since the proposed Attribution Rules also apply to non-SEP situations, and also where there is an existence of a PE, businesses should review their current operations and assess potential risks from the implementation of this provision. Further, businesses located in non-treaty jurisdictions that could also be exposed to the impact of this provision will need to re-assess their operations once thresholds are notified. For transactions conducted from a treaty jurisdiction that constitutes a PE, various protections may be explored, including whether attributions as set out in this proposed provision are in line with attributions under Article 7 of the relevant tax treaty, and whether some of the activities qualify as auxiliary or preparatory activities depending on the facts and circumstances.

Withholding tax obligation on e-commerce operators

Section 194-O of the ITA as introduced by FA, 2020 proposes the imposition of new withholding obligations on 'e-commerce operators' from 1 April 2020. Section 194-O provides that where the sale of goods or provision of services of an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such an e-commerce operator shall, at the time of credit of the amount of the sale or services or both to the account of an e-commerce participant or at the time of payment, whichever is earlier, deduct income tax at the rate of one per cent of the gross amount of such sales or services or both.

Section 194-O also sets out a deeming fiction that, even if the money paid to the e-commerce participant did not flow through the e-commerce operator, that is, the purchaser of goods or recipient of services made the payment directly to the e-commerce participant, such an e-commerce operator would be deemed to have paid the e-commerce participant such money and therefore be obligated to withhold income tax at one per cent on such sums as well. However, it is important to note that the obligation exists only in relation to Indian resident suppliers of goods or services through the platform and not with respect to any goods or services facilitated by the platform from non-resident service providers or sellers. Currently, section 194-O does not distinguish between a resident and a non-resident e-commerce operator. Therefore, on the basis of a strict reading, the withholding obligations under section 194-O may also apply to a non-resident e-commerce operator facilitating the sale of goods or provision of services of an e-commerce participant, hence, increasing the compliance burden for non-resident e-commerce operators.

Expansion of the Equalisation Levy

The Equalisation Levy was first introduced in India through the Union Budget for 2016, under Chapter VIII of the Finance Act, 2016 (the 'FA, 2016') as a separate, self-contained code, not forming part of the ITA. The equalisation levy (EL) as introduced by the FA, 2016 (the 'Ad EL') was levied at a rate of six per cent on the amount of gross consideration received by non-residents for online advertisements and related services provided to specified persons.

While the OECD is trying to reach a consensus-based solution, governments (including the Indian Government) across the world are not shying away from unilaterally addressing the challenges posed by the digital economy. At the same time, the Office of United States Trade Representative has begun its own investigation into a unilateral digital services tax imposed by various countries, including India. Such an investigation is not expected to deter the Indian Government's stand on taxation of the digital economy.

The Finance Bill, 2020 tabled by the Finance Minister in Parliament did not contain any proposals to expand the scope of the EL. However, at the enactment stage, the scope of the EL was expanded to apply the EL to e-commerce operators (the 'E-com EL') by way of an amendment to the FA, 2016. This came as a surprise to the industry at large, considering the unusual manner of the introduction of the E-com EL directly in the FA, 2020 without any prior discussion/debate during the proposal stage. The E-com EL is applicable at a rate of two per cent on the amount of consideration received or receivable by 'e-commerce operators' from 'e-commerce supply or services' made or provided or facilitated by it to: (1) a person resident in India; (2) a non-resident under certain specified circumstances; (3) a person who buys such goods or services or both using an IP address located in India. The introduction of the E-com EL is likely to have far reaching consequences for players in the e-commerce sector. Unlike the Ad EL, the E-com EL intends to tax business-to-consumer (B2C) transactions and transactions between two non-residents as well. Further, the burden to comply with the provisions of- the E-com EL is on the e-commerce operators. Accordingly, the e-commerce operators will have to check the applicability of these provisions, track transactions with Indian customers, and ensure timely deduction of the E-com EL and filing of statements with Indian tax authorities to avoid any punitive action. Operators intending to comply may also require some local registrations or identification numbers to be compliant with this tax payment obligation.

Further, the provisions of the E-com EL are vague, and several terms have not been defined. In such situations, generally, the intention of the introduction of a statute enables the proper interpretation of the statute. However, in the absence of any indication of legislative intent for expanding the scope of the EL, interpretational issues are likely to arise, creating uncertainties for the implementation of the provisions. Notably, several US companies have refused to pay this tax recently.

Expanding the scope and power of the government to enter into tax treaties to accommodate the MLI

As a result of Action Plan 15 of the BEPS Project, the Multilateral Instrument (MLI) was brought into force on 1 July 2018 and it entered into force for India on 1 October 2019.[2] The MLI is intended to apply alongside tax treaties that each country notifies as a covered tax agreement (CTA). In view of the MLI that comes into effect in FY 2020–2021, the FA, 2020 amended section 90 of the ITA to enable the government to enter into the MLI. Without this amendment, the power of the government to enter into the MLI was potentially questionable based on the current wording of the provision.

Judicial update

Eligibility to claim benefits under a tax treaty

The eligibility to claim benefits under a tax treaty is a much-debated issue in India. Historically, capital gains tax from the transfer of shares in an Indian company was eliminated through the use of structures involving a Mauritian or Singaporean holding company because Indian tax treaties with the aforementioned countries allocated the capital gains taxing rights exclusively to the residence country, subject to certain criteria being fulfilled (eg, absence of a PE in India).[3] However, with the amendments in these tax treaties, this benefit has been restricted to shares acquired prior to 1 April 2017. With the revision of the tax treaties, and introduction of anti-abuse rules, courts and tribunals in India have also been challenging the availability of tax treaty benefits for investments dating prior to 1 April 2017. Recently, the Mumbai bench of the Authority for Advance Rulings (AAR) in Bidvest[4] rejected capital gains tax benefit under Article 13(4) of the India-Mauritius tax treaty to a Mauritian entity on the sale of shares in an Indian joint venture company. The benefit was denied on the basis that the Mauritian entity, on the basis of facts, was shown to be a mere conduit/shell entity and hence was held to not be the beneficial owner of the shares transferred. It is pertinent to note that the AAR gave an adverse order irrespective of

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[2] India signed the MLI on 7 June 2017 and deposited its instrument of ratification on 25 June 2019. See OECD (2020), Signatories and Parties to the Multilateral Convention to Implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf accessed 26 October 2020.

[3] In certain scenarios, eligibility to claim relief under a tax treaty may be conditional upon the satisfactions of certain 'substance' requirements. For example, the India-Singapore tax treaty incorporates a Limitation of Benefit clause, which requires a Singapore resident company to demonstrate the following, before it can claim benefits under the tax treaty:

1. the primary purpose of its incorporation in Singapore should not be to take advantage of the treaty benefits;
2. it should not be a shell/conduit company and it must have bona fide business activities; and
3. it will be deemed not to be a conduit company if:
   (i) its total annual expenditure on operations in Singapore is at least S$200,000 during two years prior to share transfer; or
   (ii) it is listed on a stock exchange in Singapore.

Under the Mauritius law, there are substance requirements that a Mauritius entity needs to fulfil in order to receive a tax residency certificate (TRC) from Mauritian authorities. The TRC in turn allows the entity to avail tax treaty benefits.

[4] *In Re: Bid Services Division (Mauritius) Ltd* 2020 (2) TMI 1183.

the fact that the investment of the Mauritian entity was grandfathered under the India-Mauritius tax treaty (ie, the investment pre-dated 1 April 2017).

Applicability of indirect transfer provisions

Indirect transfer provisions were introduced in the ITA as a knee-jerk reaction to the Supreme Court's decision in the *Vodafone International Holdings*[5] case. The retrospective amendments introduced by the Finance Act, 2012 effectively negated the decision of the Supreme Court, wherein the Supreme Court had held that the offshore transfer of shares was not liable to tax in India. Despite several clarifications issued under the ITA, the indirect transfer provisions continue to remain one of the most litigated issues in India. Recently, the AAR has held that amendments made to the indirect transfer provisions by Finance Act, 2015 are clarificatory and hence, retroactive in nature.[6] One heavily litigated issue is the availability of tax treaty benefits for indirect transfers.

MUMBAI INCOME-TAX APPELLATE TRIBUNAL

The Mumbai Income-tax Appellate Tribunal (ITAT) in *Sofina SA*[7] noted that, while the indirect transfer provisions contained in Explanation 5 to section 9(1)(1) of the ITA may contemplate a 'see-through' approach, Article 13(5) of the India-Belgium tax treaty does not permit a 'see-through' approach. The Mumbai ITAT noted that, in the absence of a deeming fiction in the India-Belgium tax treaty like the deeming fiction in Explanation 5, the said deeming fiction cannot be read into the provisions of the tax treaty. Accordingly, it was held that a transfer of shares of a Singapore company that derived value from India was not taxable in India under the India-Belgium tax treaty. The Mumbai ITAT placed reliance on the ruling of the Andhra Pradesh High Court in *Sanofi Pasteur Holding SA.*[8] While in these rulings the courts have taken a view that an indirect transfer may be protected under the relevant tax treaty, the recent decision of the AAR in *Tiger Global* (discussed below) is contrary and does not address these decisions.

AAR

The AAR rejected applications made by Tiger Global International seeking a ruling on the taxability of capital gains arising from the sale of shares of a Singapore entity (which derived substantial value from an Indian company) on the ground that the arrangement was a pre-ordained transaction created for the purpose of tax avoidance in India.[9] While rejecting the applications at the admission stage, the AAR interestingly, with respect to the India-Mauritius tax treaty, observed that exemption from capital gains tax on the sale of shares of a company not resident in India was never intended to be provided under the original as well as the revised India-Mauritius tax treaty. This case once again raises a plethora of questions with respect to the availability of tax treaty benefits for indirect transfer provisions.

Intersection of private international law and taxation

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[5] *Vodafone International Holdings BV v Union of India (2012)* 6 SCC 613.
[6] *In Re: A and Others*, decision dated 18 March 2020, AAR Nos 1555 to 1564 of 2013.
[7] *Sofina SA v ACIT*, decision dated 5 March 2020, ITA No7241/Mum/2018.
[8] *Sanofi Pasteur Holding SA v DoR* [2013] 257 CTR 401 (AP).
[9] *In Re: Tiger Global International II Holdings, Mauritius*, decision dated 26 March 2020, AAR Nos 4, 5 and 7 of 2019.

In a significant recent decision,[10] the Bombay High Court allowed the taxpayers of three sub-funds of Aberdeen Institutional Commingled Funds, LLC ('AICFL'), a Delaware (US)-based limited liability company (LLC), to carry forward losses following a change in the legal identity of AICFL from a trust to a LLC. While allowing the carry forward of losses, the Bombay High Court applied the *lex domicilli* principle to hold that the LLC in its trust form is the same entity post conversion and therefore eligible to the carried forward losses. The Bombay High Court recognised that, under conflict of laws principles, matters relating to the legal status of an entity will be determined by the law of the state of incorporation, that is, *lex domicilii* and not Indian law. In this regard, the Bombay High Court placed reliance on the Supreme Court's decision in *Technip SA*,[11] which dealt with the status of a French company, and the applicability of the Indian Takeover Code to it. This ruling is significant as it is the first ever judgment in the international tax space that explicitly gives effect to private international law principles in tax matters on the question of legal status.

General anti-avoidance rules

India introduced domestic general anti-avoidance rules (GAAR) under the ITA in 2012, although it was applicable with effect from 1 April 2017. The introduction of the GAAR in Indian domestic law has brought in a shift towards a 'substance over form' approach in India, an approach that is also reflected in other actions of the Indian Government – in actively participating in the OECD's BEPS project, recent policy changes, and so on. The GAAR provisions[12] enable Indian tax authorities to declare an arrangement to be an impermissible avoidance arrangement (IAA) and to determine the tax consequences by disregarding any structure, reallocating or recharacterising income, denying treaty relief and so on. Thus, the Indian GAAR permits Indian tax authorities to deny relief under tax treaties. Since the introduction of the GAAR and other anti-abuse provisions under domestic and international tax laws, concerns regarding aggressive actions by revenue authorities have been on the rise.

Interestingly, the Mumbai bench of the National Company Law Tribunal (NCLT) had rejected a scheme of amalgamation between Ajanta Pharma Limited and Gabs Investment Private Limited on the ground that the scheme was designed purely for the avoidance of tax and was not in the public interest – an order seen as an indirect invocation of the GAAR.[13] Contrary to the aforesaid ruling, the Delhi bench of the NCLT sanctioned a scheme of amalgamation between investment holding companies (PIPL Business Advisors and Investment Private Limited, and GSPL Advisory Services and Investment Private Limited) with a listed entity, NIIT Technologies Limited, while rejecting the objections raised by tax authorities and holding that every transaction or arrangement that is permissible under law and has the effect of reducing the tax burden cannot be looked upon with disfavour.[14] The National Company Law Appellate Tribunal (NCLAT) vide a December 2019 order upheld the NCLT's order approving a scheme of demerger among Reliance group companies, rejecting the revenue's plea that the scheme had been devised as a tool to evade taxes.[15] Recently, the Kolkata ITAT upheld the sanctity of a scheme of amalgamation approved by the Punjab and Haryana High Court and the Delhi High Court, and categorically rejected the

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[10] *Aberdeen Asia Pacific Including Japan Equity Fund v DCIT*, decision dated 12 June 2020, WP No 2796 of 2019 (Bombay High Court).
[11] *Technip SA v SMS Holding Private Limited* (2005) 5 SCC 464.
[12] Ch X-A read with s 144BA of the ITA; read with Rules 10U to 10UC of the Income-tax Rules, 1962.
[13] *In Re: Gabs Investments Pvt Limited and Ors*, decision dated 30 August 2018, CSP Nos 995 and 996 of 2017 in CSA Nos 791 and 792 of 2017.
[14] *In Re: PIPL Management Consultancy and Investment Private Limited and Ors*, decision dated 12 November 2018, Company Petition CAA – 284/ND/2017 with CA (CAA) – 85(ND) of 2017.
[15] *JCIT v Reliance Jio Infocomm Ltd*, decision dated 20 December 2019, Company Appeal (AT) Nos 113 and 114 of 2019.

revenue's attempt at invoking the GAAR provisions retrospectively on the contention that the amalgamation was a colourable device, being illegal and without any factual base.[16]

Article 7 of the MLI corresponds to the recommendations in Action Plan 6 mentioned above. The Action Plan 6 recommends the inclusion of certain minimum standards in tax treaties, inter alia, the inclusion of a principal purpose test (PPT) or limitation of benefit (LoB) test. The PPT essentially states that if it can be reasonably concluded that obtaining benefits under tax treaties was one of the principal purposes of any arrangement or transaction, benefits under the tax treaty would be denied unless it is established that granting of such benefits is in accordance with the object and purpose of the provisions of such a tax treaty. Accordingly, going forward, the demonstration of commercial rationale and substance will play an integral role in obtaining benefits under tax treaties.

Therefore, aside from the GAAR, a PPT has also been incorporated in several of India's tax treaties by the operation of the MLI. The default anti-avoidance standard under the MLI is the PPT, which is expected to apply to most double taxation avoidance agreements (DTAAs) notified as CTAs going forward. While the scope of the GAAR and PPT are similar, there are several significant differences as well. Having said this, it will be important to examine the interplay between the provisions of the GAAR and PPT under the tax treaty with respect to the facts of each transaction.

[16] *DCIT v JCT Limited*, decision dated 8 July 2020, ITA Nos 84/Kol/2019 and 2389/Kol/2018.