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Recent Changes in Indian Tax Treaties

With Mauritius, Singapore and Cyprus

January 2017

Introduction to Tax Treaties

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Taxation Systems

- Basis of Taxation
  - Residence, Domicile, Citizenship, Sourced Based
- Taxation Systems
  - Worldwide [e.g.. USA, UK, India]
  - Territorial [e.g.. Hong Kong, Macau]
  - Modified territorial taxation [e.g.. Singapore]
- Tax Rates - 0% to 50%+
  - No income tax in - UAE, BVI, Bermuda, Bahamas..
  - Belgium – 50%, UK – 45%, USA – 39.5%, Japan – 55%, China – 45%...

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Juridical Double Taxation

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

DTAAs primarily entered into for Elimination of Juridical Double Taxation

- **Also aids promotion of mutual economic relations, trade and investment; defining rules for establishing right of country to tax; Exchange of information; etc.**

Double Non-Taxation

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

Base Erosion and Profit Shifting

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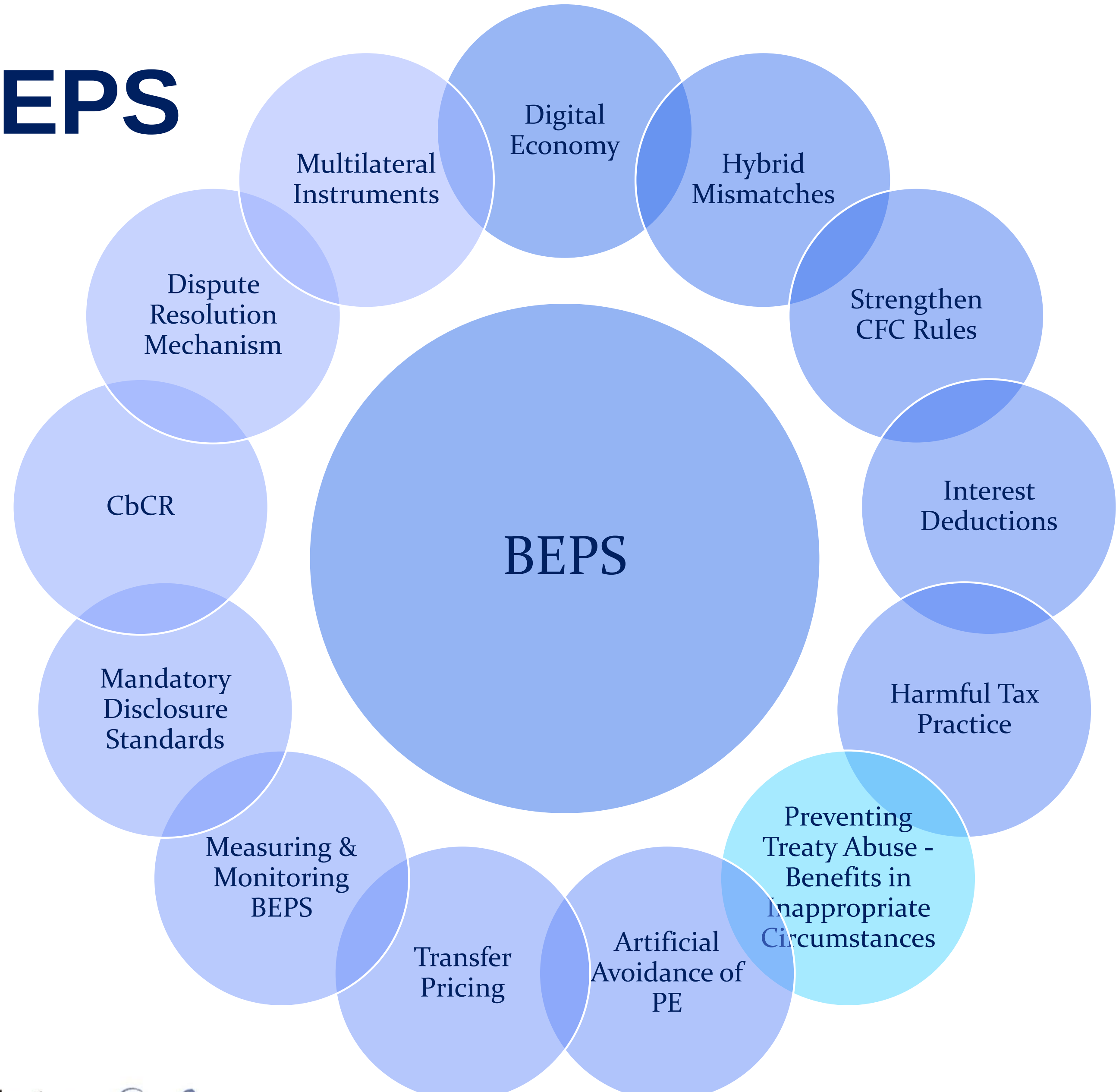
BEPS



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6. Preventing Treaty Abuse

- Action Plan 6 - ‘Preventing Granting of Treaty Benefits in Inappropriate Circumstances’
- Treaty Shopping
  - NR attempts to obtain benefits of treaty available to Residents of a State
  - Letterbox companies
- Treaty Abuse
  - Characterization of income – Dividend vs. Capital Gains
  - Interest in entities deriving value from immovable property in State S
  - Artificial Avoidance of profits through creation of PE
  - Splitting up of contracts – Construction PE time threshold

Action 6 – Measures Suggested

- Title and Preamble of Treaty to indicate -
  - Treaty intends to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
- Combination of LoB and PPT
  - LoB – Specific anti-abuse rule - Objective tests – Detailed / Simplified version
  - PPT – general anti-abuse rule - if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied
- Inclusion of GAAR in Domestic laws
- Policy Considerations for deciding whether or not to enter / continue treaty with no / low tax jurisdictions

Existing Scenario

India investments from Mauritius, Singapore and Cyprus

Existing Treaties

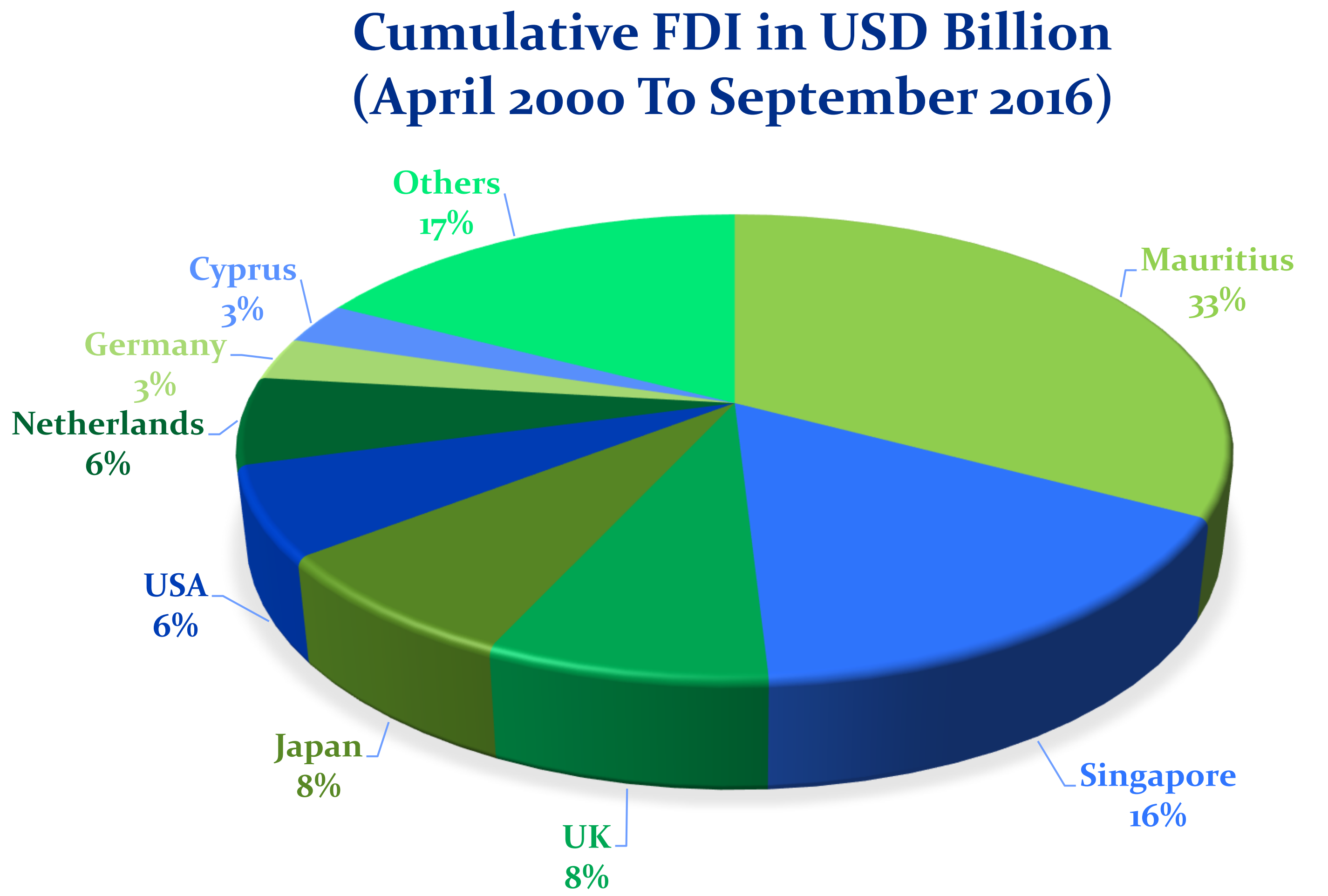
- Indian DTAA with Mauritius, Singapore and Cyprus
  - No capital gains tax on sale of shares in domestic laws
  - DTAA provided taxing rights to Residence state only
    - No capital gains in India as source state
    - Double non-taxation
  - No LoB clause in DTAA with Mauritius and Cyprus
    - Misused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

Existing CG Taxation

- Taxability in Source State under DTAAs

Type of Asset	Mauritius	Cyprus	Singapore
Immovable Property	Taxable	Taxable	Taxable
Assets of PE / fixed base	Taxable	Taxable	Taxable
Ship / Aircraft	Not taxable	Not taxable	Not taxable
Shares of Company	Not taxable	Not taxable	Not taxable
Other Assets	Not taxable	Not taxable	Not taxable
LoB Clause	No	No	Yes (For shares)

Country-wise FDI in India



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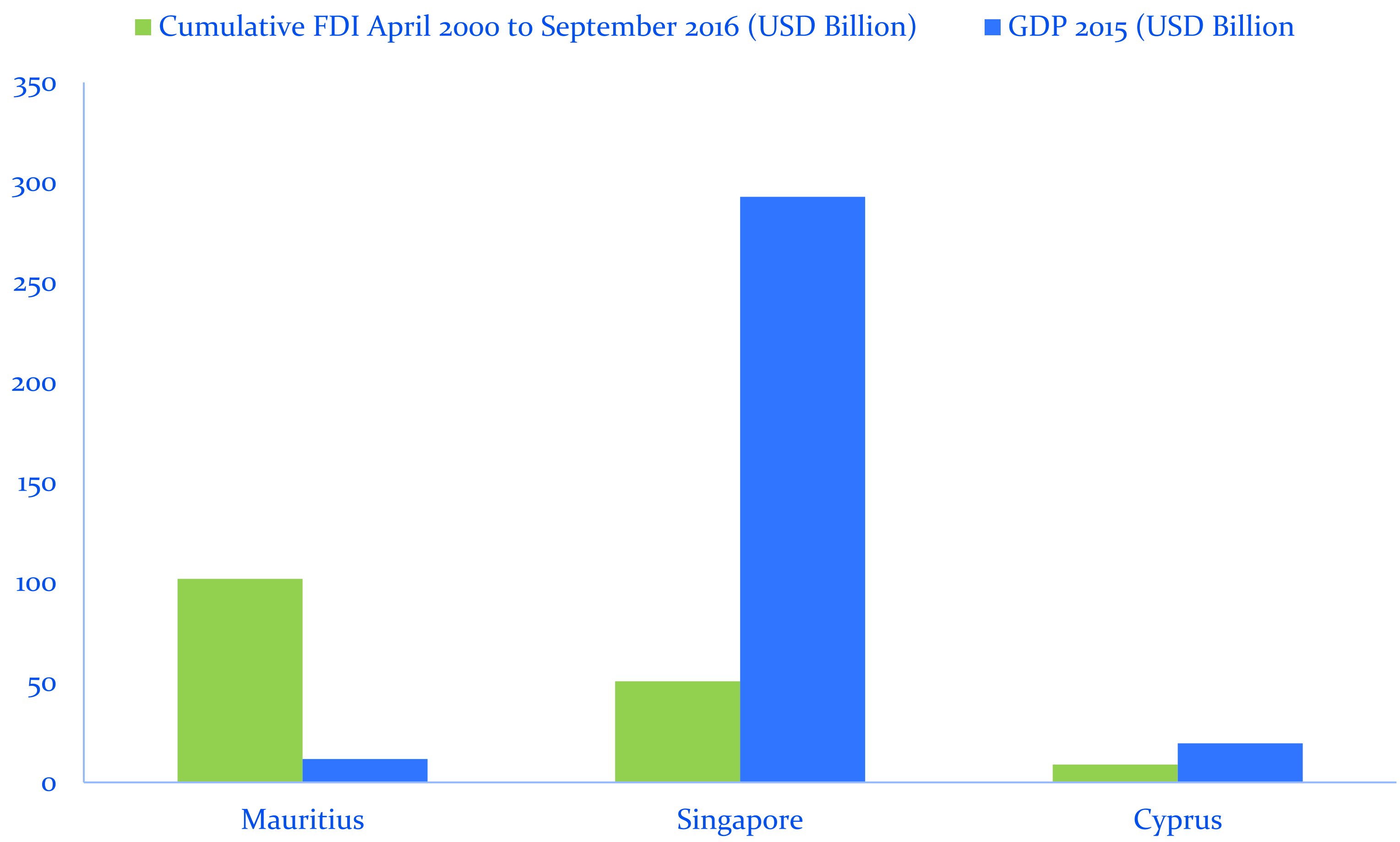
FDI in India and GDP



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Need for Amendment

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

India - Mauritius DTAA

Protocol – July 19, 2016

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Capital Gains

- Capital gains to be taxable in Source Country w.e.f. 1.4.2017
  - On transfer of shares of companies
  - 50% tax in FY 2017-18, FY 2018-19; 100% tax thereafter
    - Subject to Limitation of Benefit (‘LOB’) clause
- Grandfathering for shares acquired before April 1, 2017
  - Continue to be taxed only in country of residence
  - NOT Subject to LOB Clause

LoB Clause

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

Service Fees and Other Income

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

Interest

- Tax on interest in Source State capped at 7.5%
  - Currently, interest is taxed in sources state as per domestic laws (5% /20% /40%+ in India)
- Withdrawal of exemption given to Banks
  - Interest arising to banks now taxable @ 7.5%
  - Grandfathering w.r.t. debt claims existing prior to April 1, 2017
- Exemption in Source State continued for Government / local authority, etc.

Exchange of Information

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

India - Singapore DTAA

Protocol - December 30, 2016

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3rd Protocol

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

Capital Gains

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

LoB

- LoB clause similar to 2005 protocol, expenditure test modified
- Annual expenditure test
  - Average Annual expenditure on operations in residence state >= SGD 0.2 mn or INR 5 mn
  - For each of 12 months period in 24 months preceding date of gain (for investments prior to April 1, 2017)
  - For 12 months preceding date of gain (for transition relief)
- Other tests
  - Primary purpose (PPT), Bonafide business activities, Not Shell / conduit company
    - Similar to India-Mauritius DTAA

Other Amendments

- Mechanism of corresponding tax adjustments introduced
  - In transfer pricing cases
  - to prevent economic double taxation

Applicability of GAAR?

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

India - Cyprus DTAA

November 18, 2016

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Capital Gains

- Capital gains on alienation of shares of company taxable in source state if alienated company
  - is resident in source state or
  - derives value from immovable property in source state
- Shift from residence based to source based taxation
  - Gain on alienation of Shares acquired prior to April 1, 2017 grandfathered
- No LoB Clause in revised DTAA also

Royalty and FTS

- Tax in Source state on Royalty reduced from 15% to 10%
- Article 12 (Royalties and FIS) and Article 13 (FTS) merged
- Revised definition of "Source" – Country of -
  - Residence of Payer
  - PE / fixed base
  - Utilization of property / Performance of service
    - Now added

FTS and Service PE

- FTS to be taxed @ 10%
  - Currently, FIS taxed @ 15%; includes services -
    - (i) in relation to IPR or industrial / commercial / scientific equipment / information or
    - (ii) Made available technical / consultancy services
  - Make-Available Clause removed
- Service PE introduced
  - > 90 days in any 12 months
  - Including FTS

Elimination of Double Tax

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

Other Key Amendments

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

Other Key Amendments

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

Other Key Amendments

- Source State may now tax Specified Other Income
  - Income from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting..
- Insertion of new Articles on assistance in the collection of taxes
- Article on Exchange of Information and Non-discrimination amended
- Rolling period concept in IPS & DPS

Summary

Revised DTAAs

Transactions	Source Taxation in India under DTAA		
	Singapore	Mauritius	Cyprus
CG from alienation of shares of Co. acquired after 1-4-2017	√	√	√
Grandfathering for shares acquired till 31-3-2017	√	√	√
Lower taxation for transitory period of 2 years	√	√	×
LOB provisions (for CG exemption on alienation of shares)	√ (Applicable for grandfathered and transitory relief)	√ (Applicable only for transitory relief)	×

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Revised DTAAs

Transactions	Source Taxation in India under DTAA		
	Singapore	Mauritius	Cyprus
Gains from alienation of shares of foreign Co. deriving value from assets in Source State	×	×	√ (If value is based on immovable property situated therein)
Gains from alienation of immovable property	√	√	√
Gains from alienation of assets of OE / fixed base	√	√	√
CG from alienation of debt instruments including convertible debts, derivatives	×	×	×

Revised DTAAs

Transactions	Source Taxation in India under DTAA		
	Singapore	Mauritius	Cyprus
Interest	10/15%	7.5%	10%
FTS	10%	10%	10%
Service PE	90 days in fiscal year (30 days in case of related enterprises) (Other than FTS as per Article 12)	90 days within 12 months	90 days within 12 months
Other Income	√	√ (If arises in source state)	√ (Only specified incomes – winnings from lottery, race, etc.)

Consequential Effects

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Consequential Effects

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

Consequential Effects

- Inter-play with GAAR provisions
  - Overriding effect on DTAA with Mauritius and Cyprus?
- Impact on volume of investments
- Rescindment of notification considering Cyprus as an NJA
  - Quick de-notification of Cyprus as an NJA
    - Encourage fresh investments
    - Through Cyprus prior to 1-4-2017

Case Studies

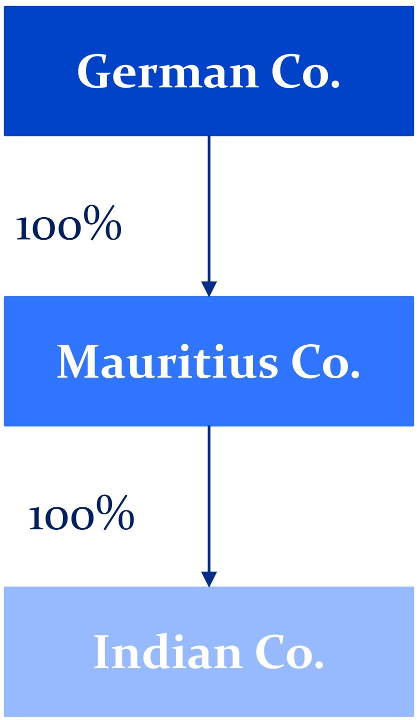
Case Study 1

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

Case Study 2

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

Case Study 3



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

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