GLOBAL TAX TRANSPARENCY

Introduction

Recently there have been significant changes both internationally and in India's domestic laws with respect to cross border taxation.

- Amendment/ Renegotiation of tax treaties – Mauritius, Singapore and Cyprus
- Automatic Exchange of Information agreements
- Foreign Account Tax Compliance Act
- OECD's Actions Plan on Base Erosion and Profit Shifting
- Equalization Levy
- Patent Box Regime
- Implementation of Country-by-Country reporting
- Controlled Foreign Corporation regime
- Thin Capitalisation Rules
- Signing of Multilateral Convention to amend tax treaties
- General Ant-Avoidance Rules

Amendment to India-Mauritius DTAA

Amendment to India-Mauritius Treaty

- Protocol signed to amend the 33 year old Tax Treaty
- Article 13 was amended to give India the right to tax capital gains on transfer of Indian shares acquired on or after 1 April 2017.
- However, existing investments will be grandfathered.
- A two year transition period up to 31 March 2019 is provided during which the tax rates will be 50% of the prevailing domestic tax rates, subject to an LOB clause.
- After 31 March 2019, tax will be charged at full domestic tax rates.
- Capital gains on derivatives and fixed income securities will continue to be exempt.
- Effectively nullified the benefit of taking the 'Mauritius route' for making investment in India

Share of countries with equity inflow into India

Countries	April 2000-Sep 2016 (Amount in USD)	% of total
Mauritius	101,759.68	32.81
Singapore	50,559.91	16.30
U.K.	24,072.30	7.76
Japan	23,760.47	7.66
U.S.A.	19,380.43	6.25
Netherlands	18,929.16	6.10
Germany	9,217.02	2.97
Cyprus	8,933.35	2.88
France	5,294.36	1.71
U.A.E.	4,384.82	1.41

Source: http://dipp.nic.in/English/Publications/FDI_Statistics/2016/FDI_FactSheet_April_Sep_2016.pdf

Amendment to India-Mauritius Treaty

- Article 11 was amended such that interest arising in India and paid to a Mauritian resident will be taxed at 7.5% in India
- Article 12A covering FTS was introduced: FTS paid from India would be taxed at 10% in India if the beneficial owner of the FTS is a resident of Mauritius
- "Other Income" referred to in Article 22, will now be taxed in the country of source
- Article 27A (Limitation of Benefits) requires the Mauritius resident to meet the following two tests in order to qualify for treaty benefits:

  (a) Main purpose test; and

  (b) *Bonafide* business test to avail the 50% reduction in tax rate.
- Further, as per the LOB article, a Mauritius resident is deemed to be a shell/conduit company, if its total expenditure on operations in Mauritius is less than INR 2.7 million or Mauritian Rupees 1.5 million

Amendment to India-Singapore DTAA

Amendment to India-Singapore Treaty

- Due to amendment of the India-Mauritius DTAA, the capital gains tax exemption for shares in the Singapore-India DTAA, which had been pegged to the India-Mauritius DTAA, has had to be similarly amended.
- The Third Protocol amends the India-Singapore DTAA to give India the right to tax capital gains on transfer of Indian shares acquired on or after 1 April 2017.
- However, preserves the existing tax exemption on capital gains for shares acquired before 1 April 2017, subject to LOB clause.
- A two year transition period up to 31 March 2019 is provided during which the tax rates will be 50% of the prevailing domestic tax rates.

Amendment to India-Cyprus DTAA

Amendment to India-Cyprus Treaty

- Governments of India & Cyprus signed a revised DTAA effective in India from 1st April, 2017
- The new DTAA provides for source based taxation for capital gains arising from the alienation of shares.
- Investments undertaken prior to 1st April 2017 are grandfathered
- Definition of PE has also been expanded
- Withholding tax for royalty reduced to 10% from existing 15%
- Indian Authorities also retrospectively rescinded the classification of Cyprus as 'Notified Jurisdictional Area' from November 2013

Automatic Exchange of Financial Account Information
& Foreign Account Tax Compliance Act

Automatic Exchange of Financial Account Information (AEOI)

Country A

Country B

Taxpayer in Country A has a bank account in Country B

Authorities in Country A can examine foreign financial account data

Financial Institutions in Country B reports relevant information to authorities in Country B

Authorities in Country B automatically exchange information with authorities in Country A

AEOI

- On 3rd June 2015, India joined the Multilateral Competent Authority Agreement (MCAA) on Automatic Exchange of Financial Account Information (AEOI) under the Common Reporting Standard (CRS)
- Section 285BA was amended and Rules 114F to 114H and Form 61B was inserted to enable implementation of reporting requirements under FATCA & CRS
- Guidance note on implementation of FATCA & CRS issued in December, 2015
- From 2017 onwards, 54 countries will start exchanging information automatically. And from 2018 onwards, it is expected that another 47 countries will start exchanging information automatically.

AEOI

Information to be exchanged –

- Name, address, TIN(s), date and place of birth (individual) of each Reportable Person;
- Account number;
- Name and identifying number of the Reporting FI;
- Account Balance/Value
- Any depository account
- Any Custodial account
- Any other account not mentioned above

AEOI

Currently India has bilateral exchange relationships with **43 jurisdictions** including, inter alia, the following:

Jurisdiction	Legal Instrument
Mauritius	CRS MCAA – Activated on 22 December 2016 – Effective for taxable periods starting on or after 01 January 2016
Jersey	CRS MCAA – Activated on 20 October 2016
Guernsey	CRS MCAA – Activated on 20 October 2016
Malta	CRS MCAA – Activated on 20 October 2016
Isle of Man	CRS MCAA – Activated on 20 October 2016
Netherlands	CRS MCAA – Activated on 20 October 2016
United Kingdom	CRS MCAA – Activated on 20 October 2016

Foreign Account Tax Compliance Act

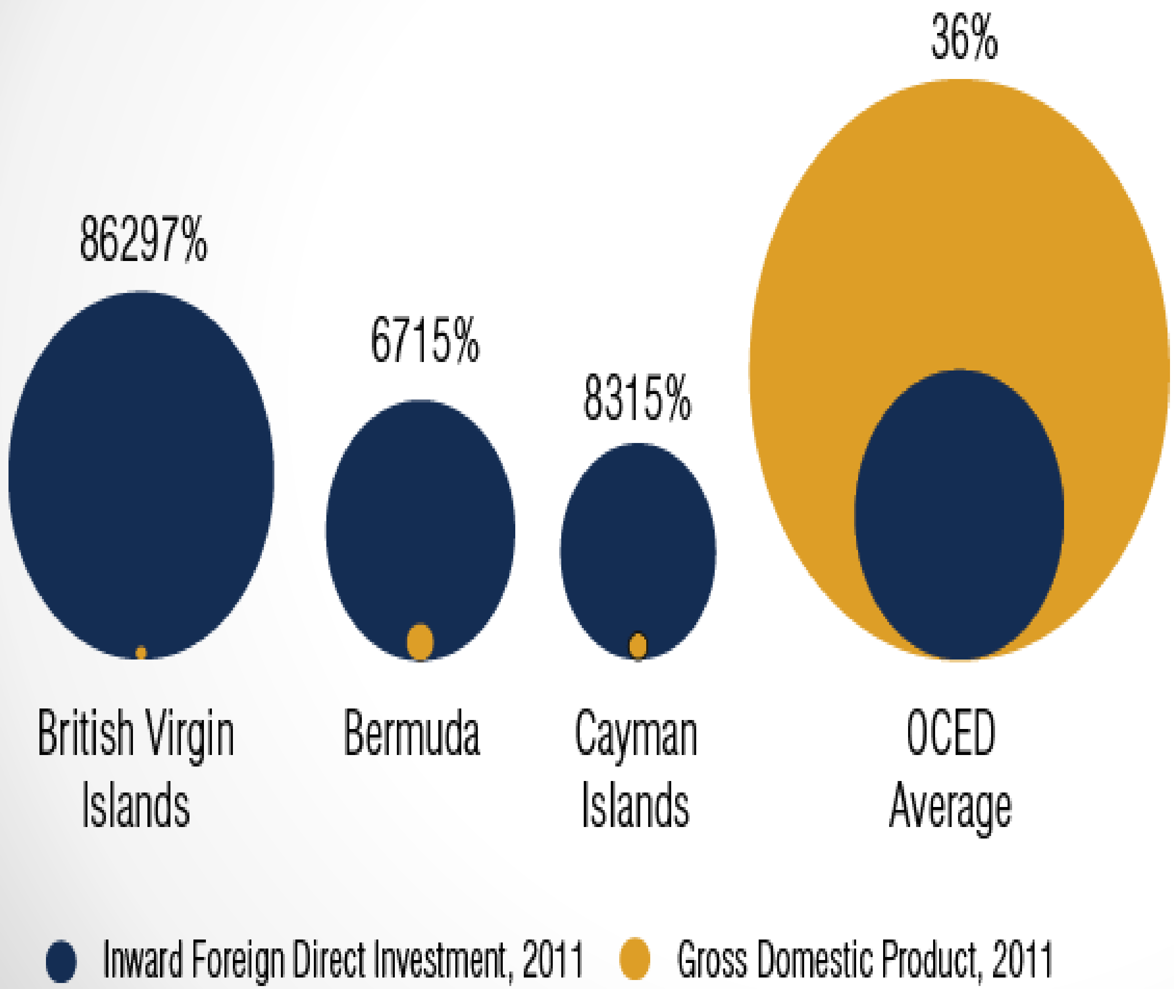
- In July 2015 India-USA signed an Inter-Governmental Agreement (IGA) to implement FATCA
- Under the IGA, the USA will provide certain information to India, which includes
  - the name, address and Indian TIN of any person that is resident of India and holds a reportable financial account in USA
  - account number
  - gross amount of interest, US source dividends or other income paid or credited
- On the similar lines, India will also provide the information to USA
- Reporting under the IGA began in September, 2015 and information pertaining to calendar year 2014 & 2015 has already been exchanged.

AEOI and FATCA

- What are the main differences between 'AEOI under CRS' and 'FATCA'?
- What are the implications for developing countries?
- How is the confidentiality of the information exchanged ensured?
- What are the main benefits of automatic exchange?

Base Erosion and Profit Shifting

Need for BEPS



"The empirical evidence suggests that income-shifting by multinational corporations is a significant concern that should be addressed through tax reform."

The potential for misalignment of profits and value creation may arise from misalignment of form and substance, and in particular exclusive reliance on

1)mere contractual ownership;

2)mere contractual assumption of risk; and

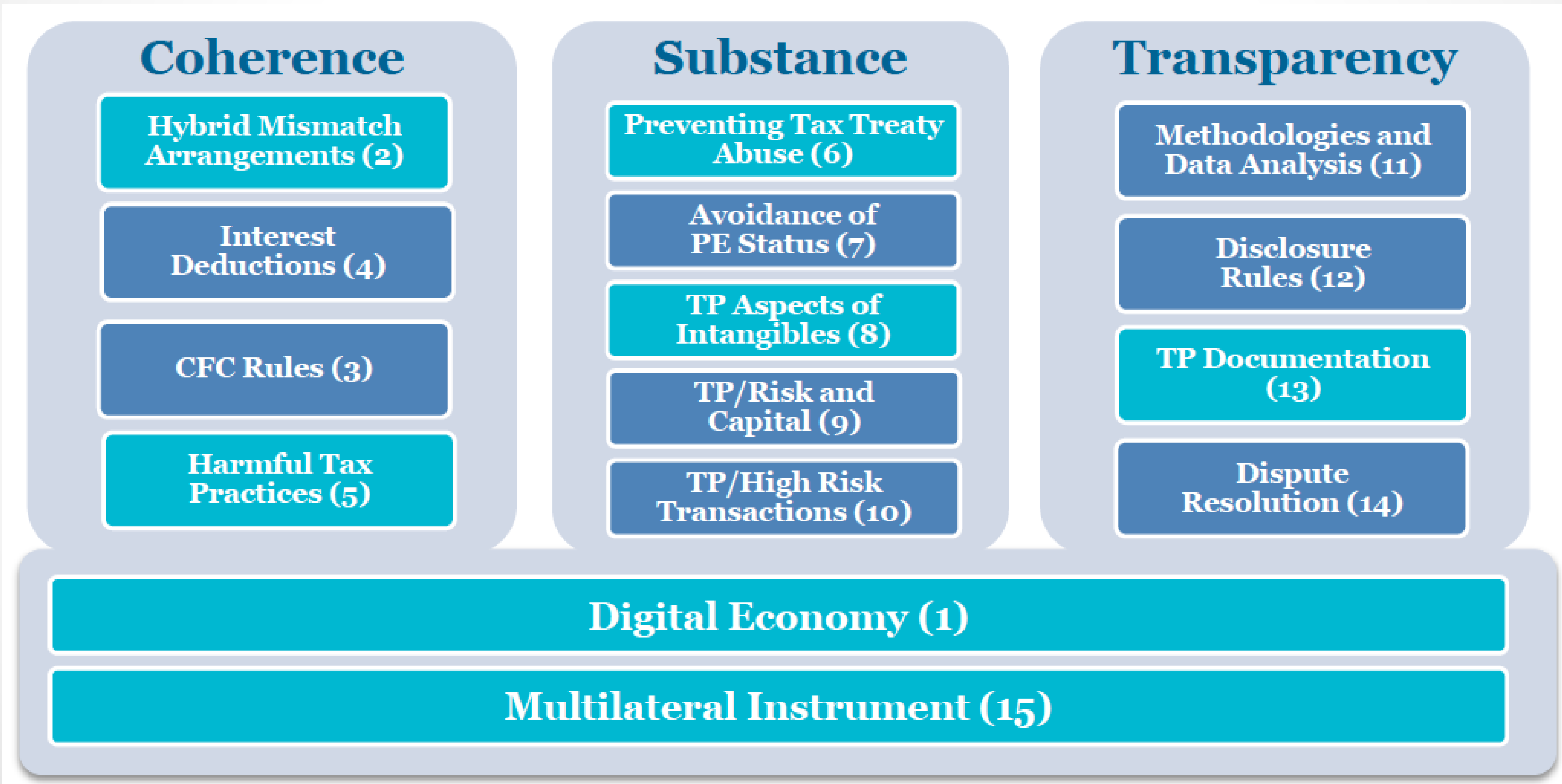
3)provision of capital

OECD BEPS – *In a nutshell*

- On 19 July 2013 OECD released an Action Plan on Base Erosion and Profit Shifting (BEPS) which was presented to the meeting of G20 Finance Ministers in Moscow
- Purpose of BEPS - <u>"to prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from activities that generate it."</u>
- <u>"No or low taxation is not per se a cause for concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it."</u>

15 Actions organized around *three* main pillars

15 Actions around 3 main pillars



Equalization Levy

Equalization levy

- Finance Act, 2016 introduced a new tax in India called the 'Equalisation Levy' at 6%. This tax will be levied on:
  - Payments for online advertisements, provision of digital advertising space or any other facility or service for the purpose of online advertisements
  - Received or receivable by a non-resident not having PE in India
  - From a resident in India who carries on business or profession, or from a non-resident having PE in India.
- The tax will have to be collected by the payer and deposited with the government.

Equalization levy – Persons impacted

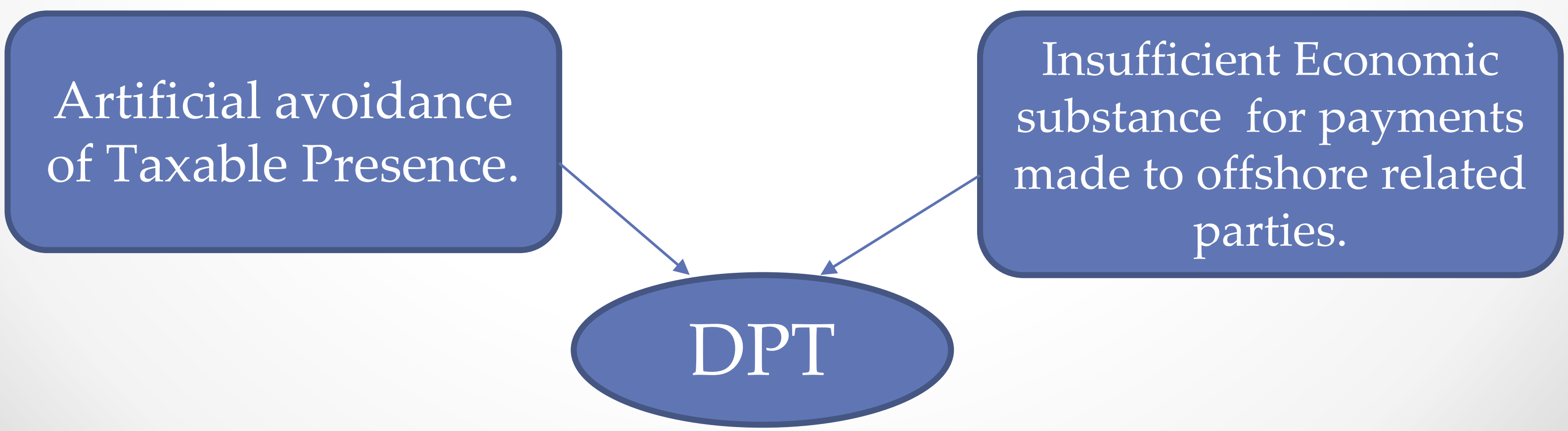
Foreign Internet companies such as social media companies, internet search engines, media websites, e-commerce companies, apps and games developers that do not have any presence in India	Foreign broadcasting network companies that derive revenue from Indian companies for advertisement in television and radio
Digital advertisement intermediaries that render digital ad-related services such as ad management, website management, uploading of ads, ad trading agencies, etc., as it may also get covered under the residuary clause "any other facility or service for the purpose of online advertisement"	Small Indian companies, startups, and e-commerce entities may be impacted as the foreign digital media companies hold the market and they may dictate that the Indian companies have to absorb tax costs which eventually leading to grossing up of the payments

Equalization levy

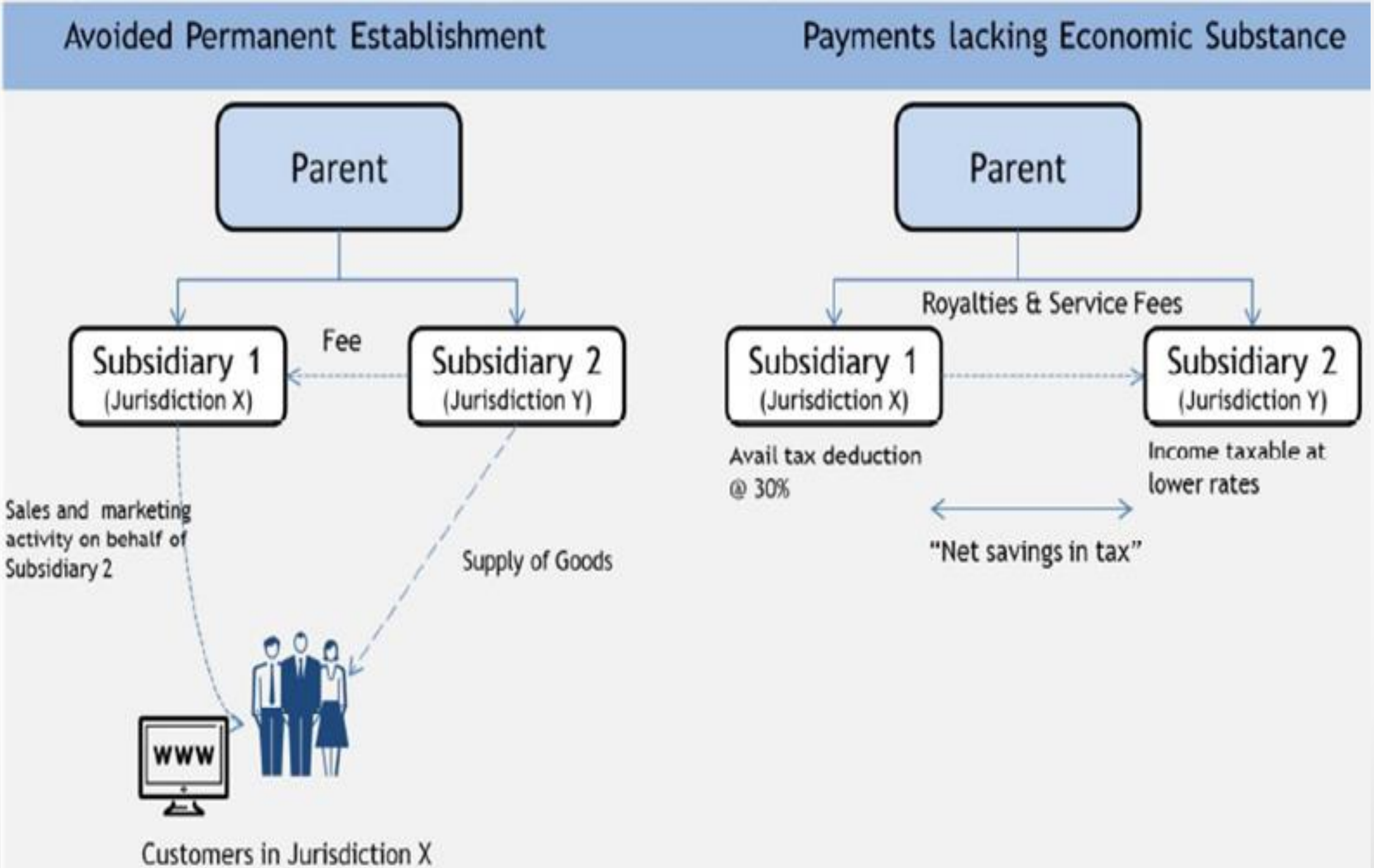
- Aimed at taxing B2B e-commerce transactions. Therefore, the scope of the levy may be expanded to cover a wider gamut of digital goods and services.
- Potential services that could be targeted in the near future may include the following
  - Web developers, server management companies
  - Service providers engaged in the field of uploading, storing or distribution of digital content
  - Online data processing & collection companies
  - Payment gateways
  - Apps market place such as Android, iTunes selling music, online games, online books, online software, etc
  - Online software applications
- The UK w.e.f. 1 April 2015, and Australia w.e.f. 1 January 2016 have levied similar taxes to address shifting of profits earned from by such online service providers.

UK's Diverted Profits Tax (DPT)

- UK diverted profits tax applicable from 1 April 2015
- Stated policy objective: 'counteract contrived arrangements used by large groups that result in the erosion of the UK tax base'
- Tax will be charged at a rate of 25% on diverted profits relating to UK activity
- New tax, not corporation tax
- The trigger points for levy of DPT are:



UK's DPT – Trigger Points



Australia's Multinational Anti-Avoidance Law

- The MAAL is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia.
- The MAAL commenced from 1st January 2016 (irrespective of when the scheme was entered into) and will apply to tax benefits derived after that day.
- Applies to significant global entities; i.e. entities with annual global income or consolidated group income of A$1 billion or more.
- MAAL applies at the corporate tax rate and a base penalty equal to 100% of the tax liability can be imposed

Australia's Diverted Profits Tax

- Distributed Profits tax introduced to ensure that Australian taxation cannot be avoided by transferring profits, assets or risks offshore through related party transactions that lack economic substances.
- The Consultation Paper suggests that integrity measures such as the MAAL were difficult to enforce where a taxpayer was not co-operative; hence the need for a Diverted Profits Tax.
- Australia's Diverted Profits tax proposed to be applicable from 1 July 2017.
- Penalty tax will be charged at a rate of 40% on profits artificially diverted.
- Will apply to global entities with an annual global income of A$1 billion or more (USD 750 million) and an Australian turnover of more than A$25 million
- However, may not be imposed of one of the following tests apply to the taxpayer
  - Sufficient economic substance test
  - Sufficient foreign tax test

Patent Box Regime

Patent Box Regime

- Introduced in 2000 by the Irish & 2001 by France as a reduced rate of tax on revenue from licensing or transfer of qualified IP.
- Belgium, Hungary, Luxembourg, Netherlands, Spain and UK have since introduced similar regimes

Finance Act, 2016 introduced the Patent Box regime in India

- Gross amount of royalty from patents developed and registered in India will be taxed at 10% u/s 115BBF.
- Such rate is optionally available to Patentee resident in India.
- Bill provided for 100% expense on patent to be incurred in India – Act allowed 75%.
- No prohibition on set-off of losses

Country-by-Country Reporting

Country-by-Country Reporting (CBCR)

- Country-by-Country Reporting is a tool intended to allow tax administrations to perform high-level transfer pricing risk assessments
- The country-by-country reporting template will require multinational enterprises (MNE) to provide annually and for each jurisdiction in which they do business, aggregate information relating to the
  - global allocation of the MNE's income and taxes paid
  - certain indicators of the location of economic activity within the MNE group,
  - information about which entities do business in a particular jurisdiction and the business activities each entity engages in.
- More than 50 countries have signed the Multilateral Competent Authority Agreement on the exchange of Country-by-Country reports (CBC MCAA)
- In the Finance Act, 2016, India has inserted section 286 to introduce the requirement of CbC reporting in India

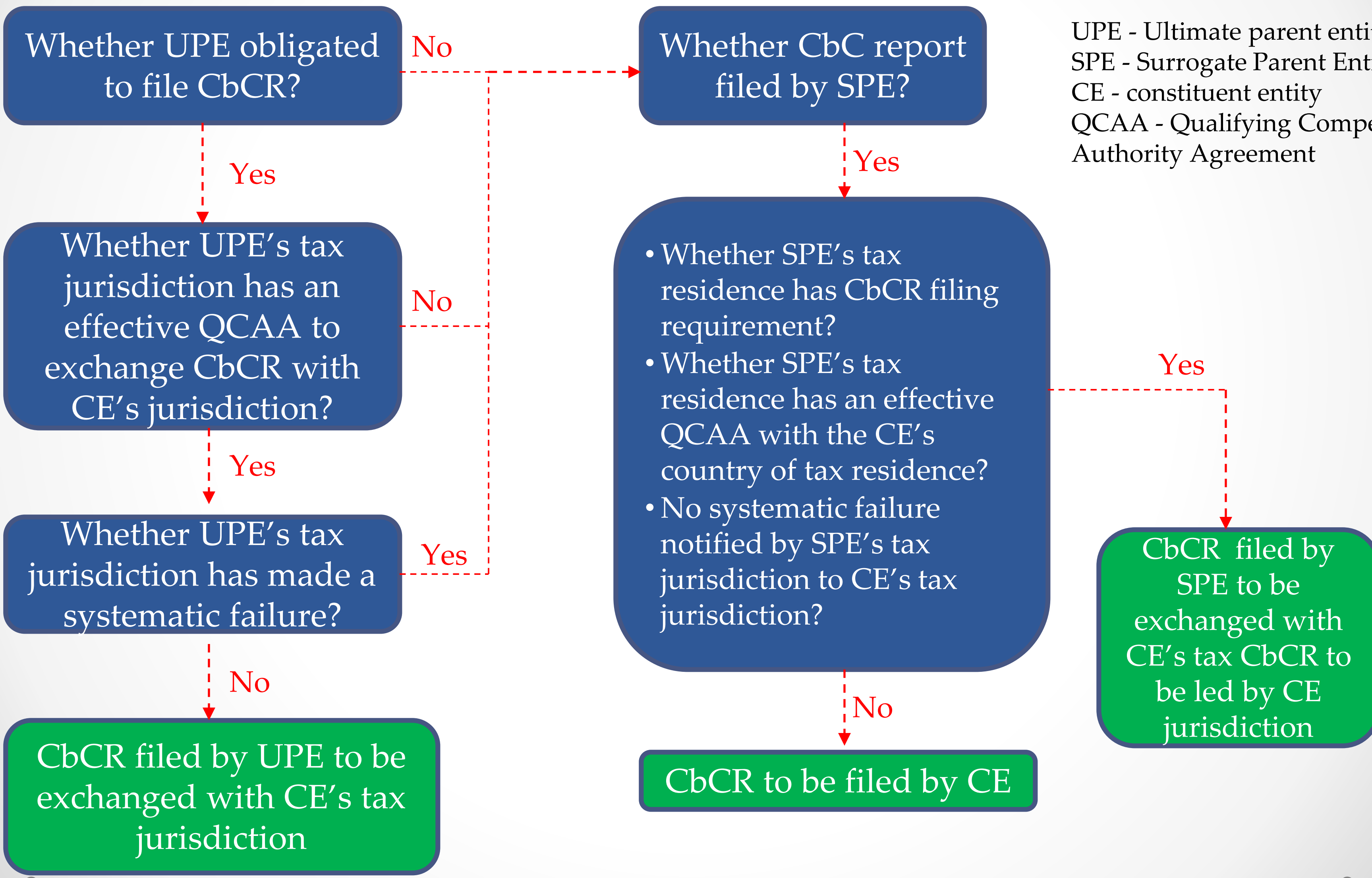
CBCR - Three tiered approach

Three-tier documentation structure applicable to Multinational Enterprises having a consolidated group revenue greater than EUR 750 million.

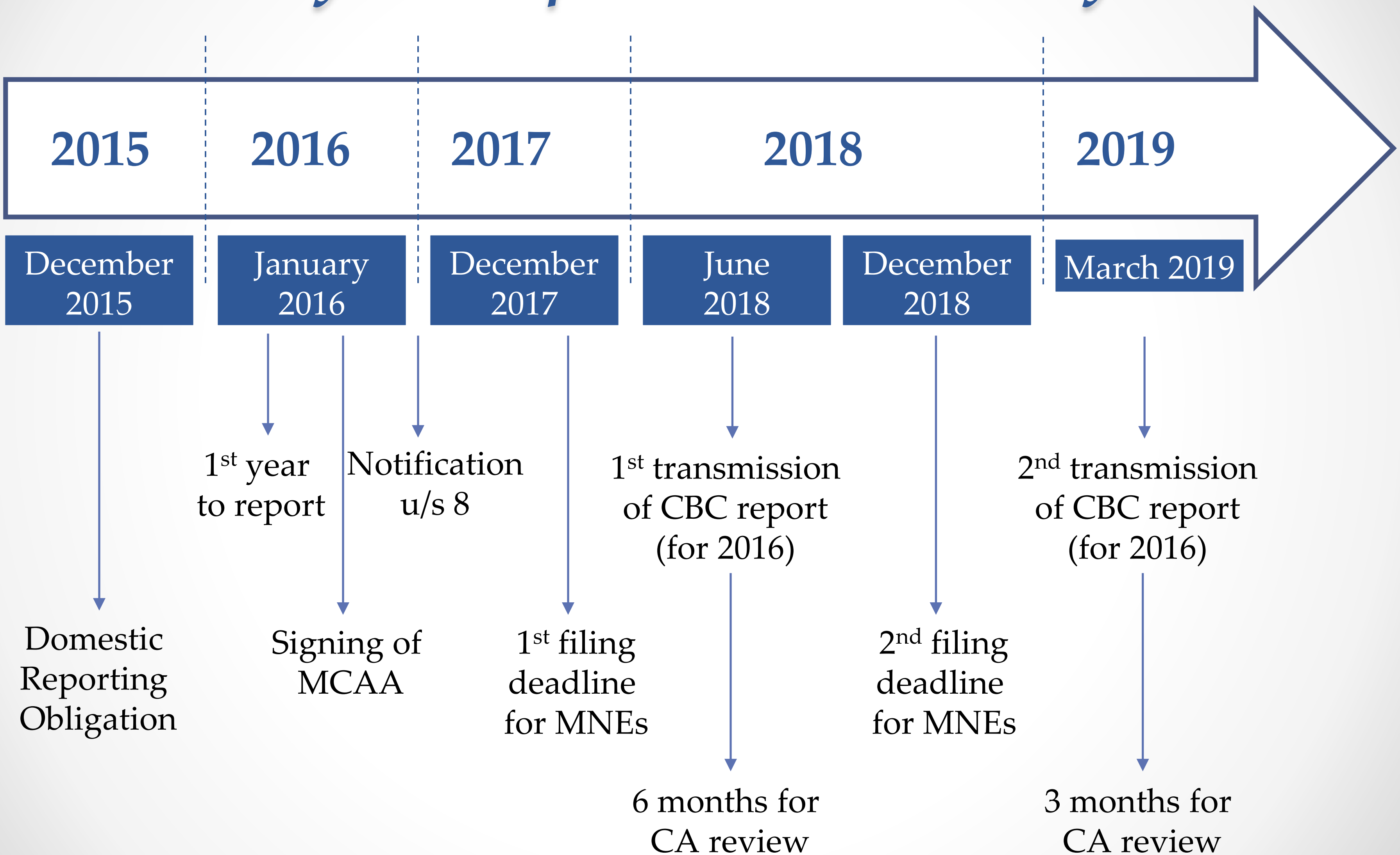
- **Master File**
  - Provides a blueprint of MNE group's business
  - Provides a high-level overview of the MNE group's TP policies (on goods, services, intellectual property, treasury, etc.)
- **Local File**
  - Provides detailed information of inter-company transactions of the taxpayer
  - Demonstrates that the taxpayer has complied with the arm's length principle in its material intragroup transactions
- **CBCR**
  - Aggregated tax jurisdiction-wise information on global allocation of income, taxes and indicators of economic activity supports high-level TP risk assessment.

Responsibility to file CBCR

UPE - Ultimate parent entity
SPE - Surrogate Parent Entity
CE - constituent entity
QCAA - Qualifying Competent Authority Agreement



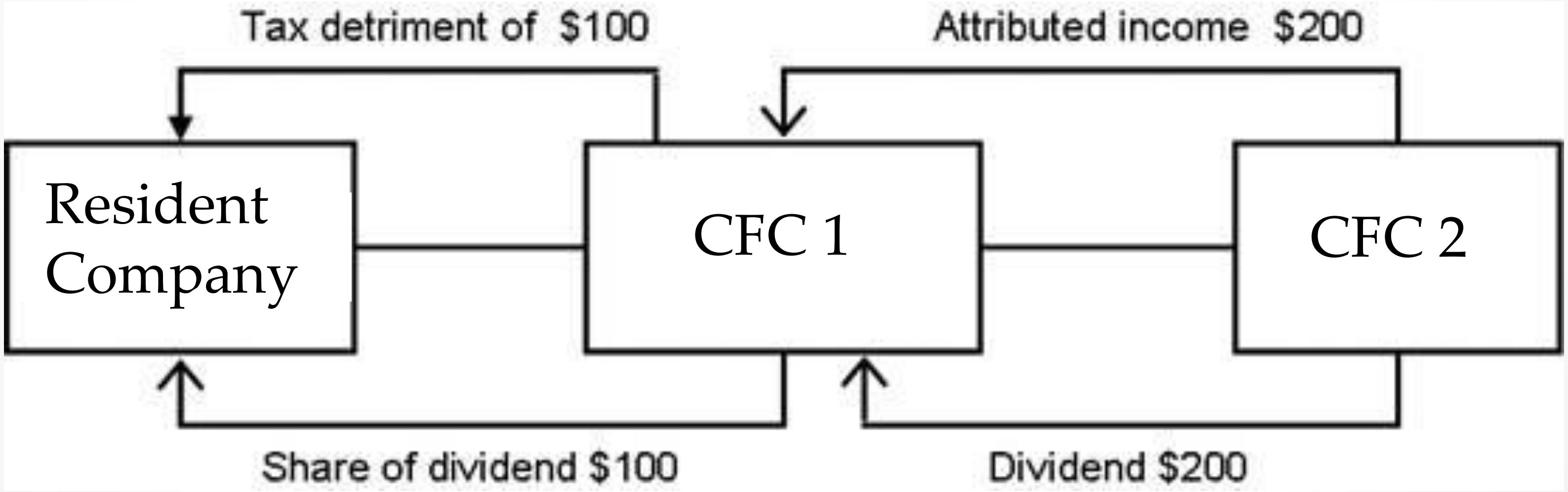
Timeline for implementation of CBCR



Controlled Foreign Corporation

Controlled Foreign Corporation (CFC) Rules

The objective of this rule is to prevent long term deferral or avoidance of tax on attributable foreign passive income (eg. Dividend).

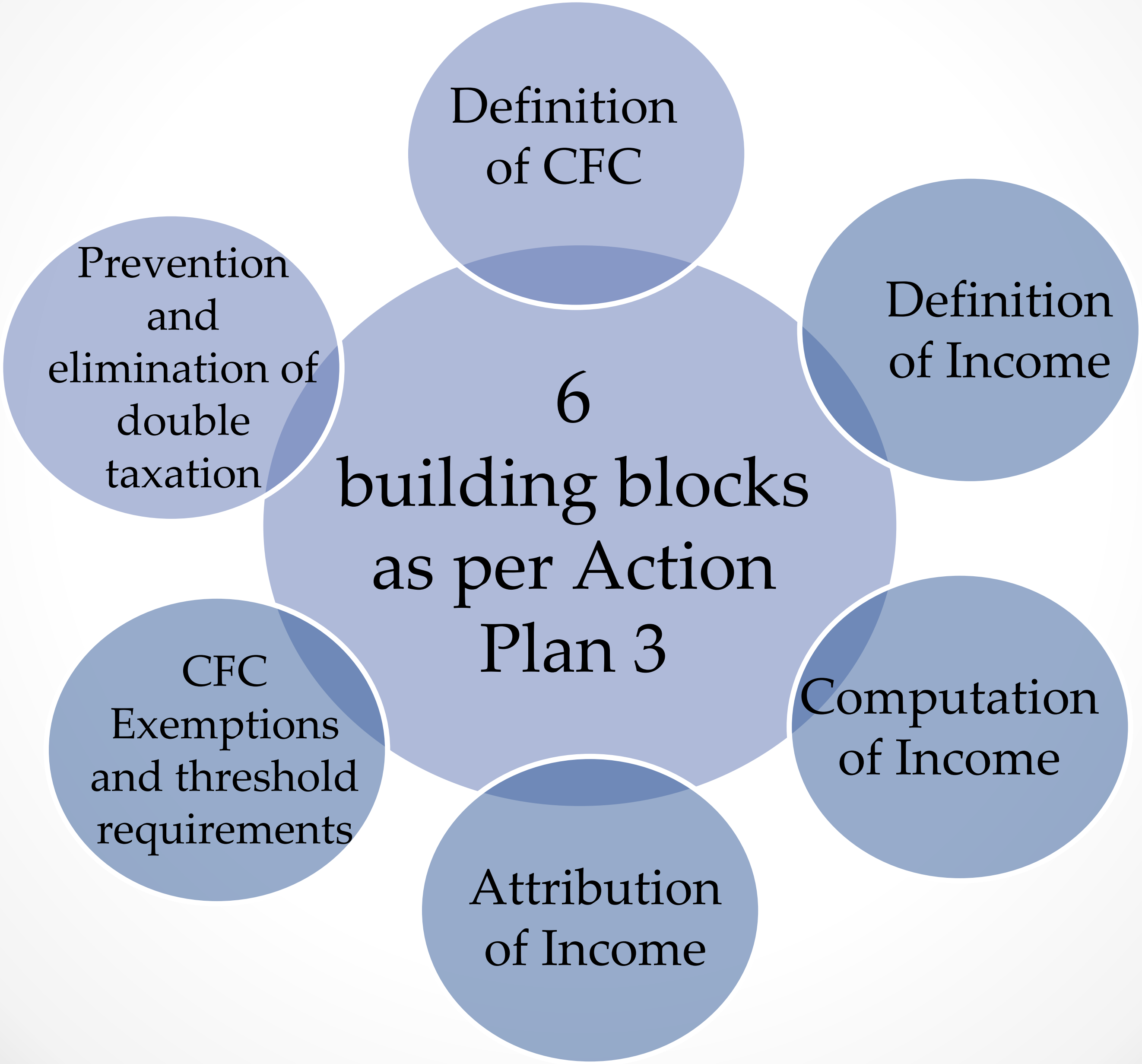


CFC Rules ensures that overseas subsidiaries are not merely shell companies created to avoid or defer taxes.

CFC Rules

- Computation of income attributable to CFC -
  - Look-through Approach - Attribution of income earned by a CFC to the shareholder of that entity; or
  - Deemed Dividend Approach - Deeming shareholders to have received dividends from the entity
- CFC legislation may adopt a designated jurisdiction (low-tax countries) approach or global approach (tainted income)
- Other provisions addressing offshore passive or lowly taxed income are so-called switchover clauses
  - exemption method is substituted by a foreign tax credit method or
  - flat denial of an exemption without a credit

CFC & BEPS Action Plan 3



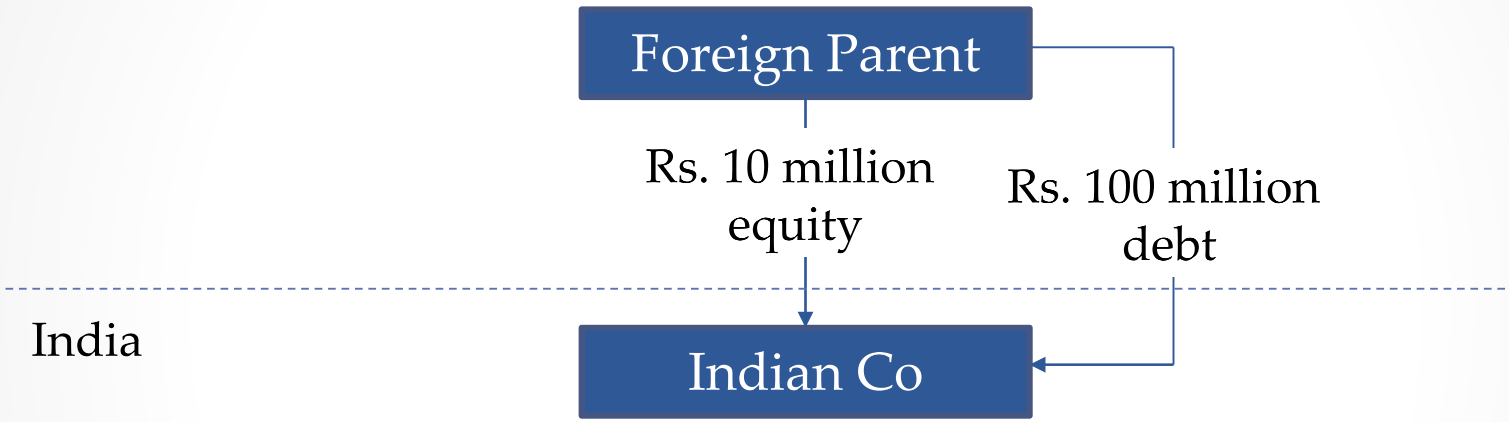
CFC Rules

- Previously Sections 104 to 109 levied additional tax on certain closely-held companies if they failed to distribute a specified percentage of profits as dividends. These sections were later repealed in 1987. CFC regime works similarly but taxing companies for deferring taxes by accumulated dividends
- Presently sec. 115BBD provides for taxation of foreign income @ 15%.
- Further, sec 2(22)(e) provides for deemed dividend.
- However, present law does not address the issue of long term deferral of income. CFC Rules would address this issue.
- CFC Rules may be of relevance in the near future looking at the sharp rise in outbound investments.

Thin Capitalization Rules

Thin Capitalization

Thin capitalization refers to a high level of debt compared to equity



Equity	Debt
1. Distributed profit (dividend) not deductible	1. Interest is tax deductible
2. Dividend is also subject to DDT	2. Interest is not subject to any distribution tax

Thin Capitalization

- Thin capitalization rules limit deduction of interest paid on an excess part of 'in-house' debt. However, India does not have thin capitalization rules.
- Current transfer pricing regulations only address interest rate and not the amount of loans itself
- Deemed dividend u/s 2(22) does not include interest on thin capital
- Limited protection is provided under Exchange Control Regulations

  – Debt : Equity of 4:1 permitted where external commercial borrowings exceed USD 5mn

  – Higher Debt (up to 7:1) is permitted with approval of RBI
- GAAR contains provisions allowing the taxman to re-characterize debt as equity and vice versa but no guidelines for such re-characterization
- The Bombay High Court held in the case of **DIT v. Besix Kier Dabhol SA** (ITA No.776 OF 2011) that in absence of thin capitalization rules, there can be no disallowance of interest expense despite a high debt-equity ratio.

Multilateral Convention

Multilateral Convention (MLI)

- Implements changes in accordance with BEPS action plan
- Implemented since executing changes on a treaty-by-treaty basis would have been a lengthy process
- Affects more than 2000 tax treaties worldwide and almost all of India's tax treaties
- In the last week of November, 2016, more than 100 countries, including India, concluded negotiating the convention
- A formal signing ceremony will be held in June 2017 in Paris

MLI Overview

- The Convention applies in relation to a treaty (“Covered Tax Agreement”) where both contracting states (the “Parties”) have notified the Secretary-General of the OECD (the **“Depositary”)** that they intend the Convention to apply to it

- In relation to BEPS minimum standards (for example, in relation to treaty abuse, PPT or full LOB clause), such minimum standard to apply automatically, with limited exceptions, to all Covered Tax Agreements

- In relation to provisions which are not minimum standards (for example, the changes to the definition of PE), a Party to the Convention is entitled to opt out of that provision by expressing a “reservation”; this has the effect that the provision in question does not apply to any of that party’s treaties

MLI Overview

- In a number of cases, the Convention allows a Party to opt out of applying a provision to a subset of its Covered Tax Agreements in order to preserve the operation of existing provisions that have specific, objectively defined characteristics

- There are number of alternatives and optional provisions that generally will apply only where both Parties to a Covered Tax Agreement affirmatively choose to apply them.

The MLI does NOT modify or add to the substance of the BEPS action plans. It focuses on how to modify the provisions in the bilateral or regional tax treaties in order to align these treaties with the BEPS structure

Functioning of the MLI

Modifies bilateral tax treaties between two Parties who have ratified the MLI

Sits on top of bilateral treaties, modifying their application – "later in time" rule in Article 30(3) of the VCLT

System of opt-outs, opt-ins and choices

However, with respect to minimum standards, flexibility to opt out will be limited

Treaty Measures covered by MLI

The following areas are covered by the Articles of the MLI

- Hybrid Mismatches (Articles 3 – 5 of the MLI)
- Transparent Entities (Article 3)
- Dual Resident Entities (Article 4)
- Application of methods for elimination of double taxation (Article 5)
- Treaty Abuse (Articles 6 to 13)
- Avoidance of PE status (Article 12 to 15)
- Dispute Resolution (Article 16)

Flexibility provided in MLI

Allowing countries to specify the tax treaties to which MLI applies

With regard to minimum standard - Allows countries to choose the option that fits them best

May opt out when provisions do not relate to a minimum standard

May opt out for treaties with existing specific provisions

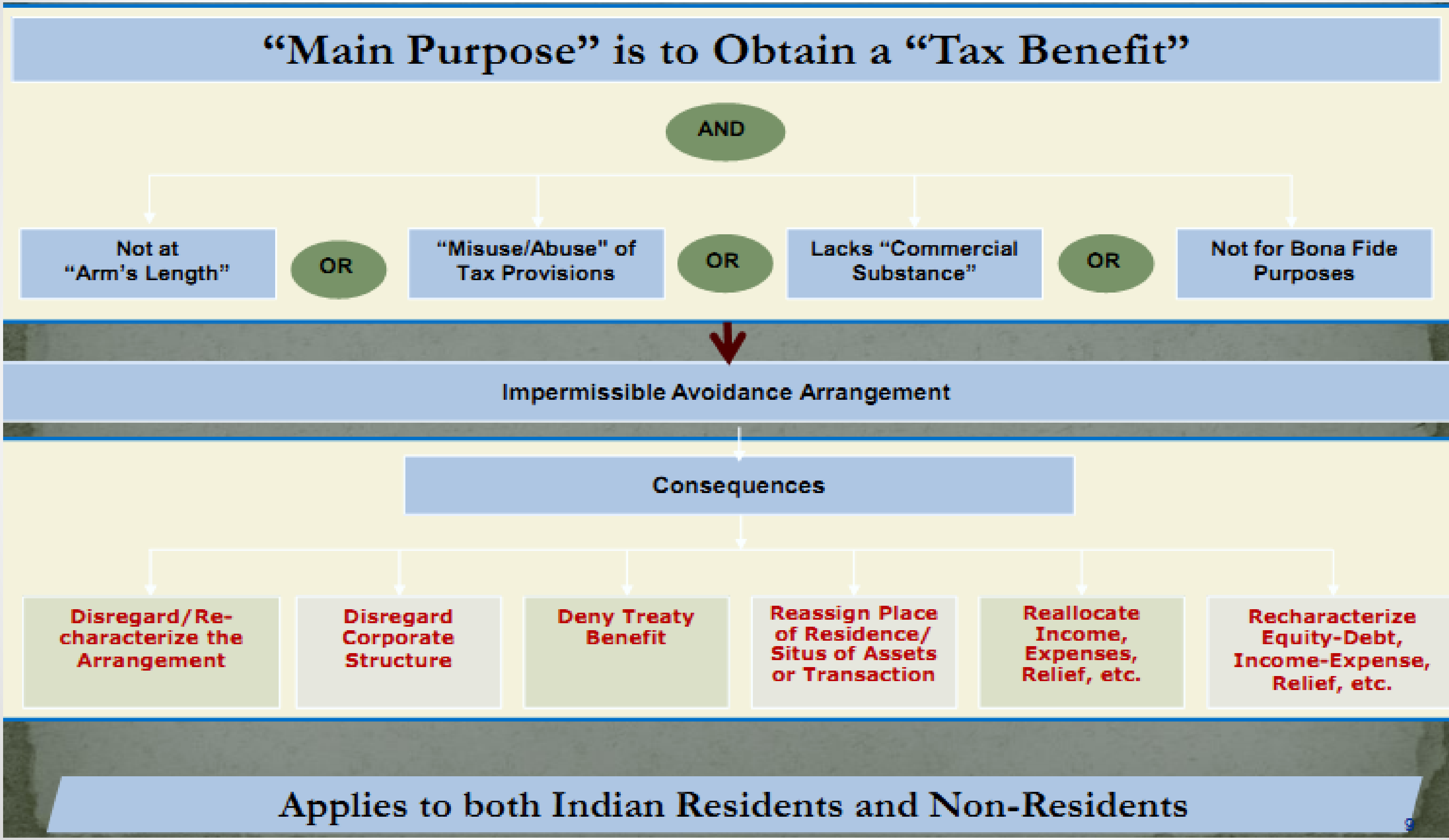
Choice to apply optional or alternative provisions

General Anti-Avoidance Rules

General Anti-Avoidance Rules

- Income Tax Act, 1961 was amended in 2012 to incorporate GAAR with effect from April 1, 2014.
- However, GAAR was deferred to be effective from A.Y. 2018-19.
- In its year-end review, CBDT reiterated the Government's commitment for implementing GAAR from A.Y. 2018-19.
- GAAR empowers the Tax Department to declare an "arrangement" as an "Impermissible Avoidance Agreement" (IAA) and the consequence thereof could be denial of tax benefit either under the Act or the DTAA.
- Not only an arrangement, but also any step in or a part of any arrangement may also be declared as IAA.
- According to the GAAR provisions, the substance of an arrangement or transaction should be selected over its mere legal form.

Snapshot of GAAR



Rules For Application of GAAR

- GAAR would be applicable to arrangements giving rise to tax benefits on or after 1st April, 2017, irrespective of the date on which arrangement has been entered into.
- However, there is a grandfathering provision in respect of income arising from transfer of investments made before 1st April, 2017.
- GAAR would not be applicable in the following situations:
  - Tax benefits arising do not exceed INR 30 million in a year.
  - Where FIIs do not avail DTAA benefits
  - Investment in FIIs (such as Participatory Notes)
- GAAR would override the treaty.


ANY
QUESTIONS
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