



Quarterly India Tax updates

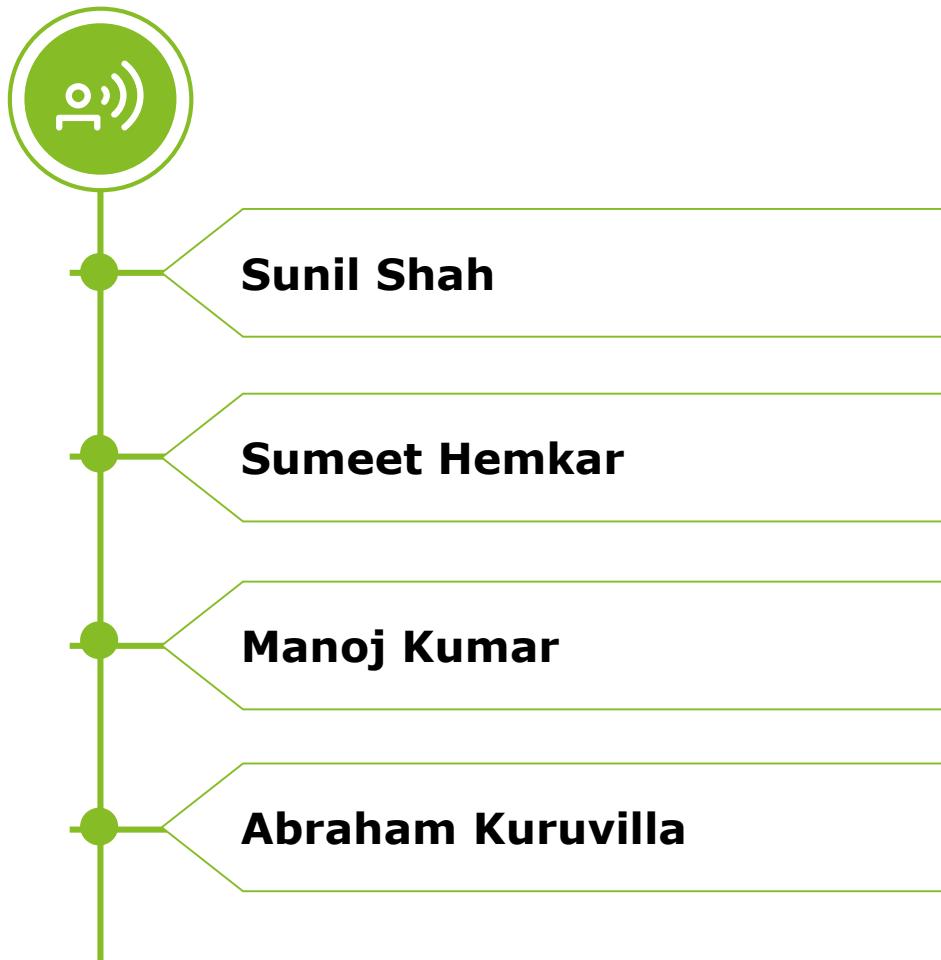
July – September 2019

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India **TaxHour**

Presenters

Subject matter experts



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- Intermediary services - ITeS
- In-bond manufacturing
- Input credit computation





Recent developments

Key direct tax announcements

Recent Updates

Important CBDT notification and Tax Rate Cut

E-assessment Scheme, 2019

- CBDT issued a new notification introducing e-assessment scheme and directions for applicability of the scheme.
- CBDT will set up following Centres and units for this scheme:
 - **National e-assessment Centre** for e-assessment proceedings in centralized manner
 - **Regional e-assessment Centre** for e-assessment proceedings in jurisdiction of Principal Chief Commissioner
 - **Assessment units** to identify issues related to determination of liability, seeking and analyzing information provided by the taxpayer
 - **Verification units** to perform functions for verification including enquiry, cross verification, examination of books of accounts recording of statements
 - **Technical units** to provide technical assistance – legal, accounting, forensic, valuation or any other technical matter
 - **Review unit** to review draft assessment order
- The new E-assessment scheme is supposed to give greater transparency and accountability, by eliminating interface between assessing officer and taxpayer.

Taxation Laws (Amendment) Ordinance, 2019

- Base tax rate of 15% for new domestic manufacturing companies; 22% for all other companies.
- In both cases above, specified tax incentives cannot be claimed and MAT not applicable. Further, lower surcharge of 10% applicable to these companies.
- **CBDT Clarification:** Brought forward MAT credit not allowed in case of 22% tax rate.
- Enhanced surcharge brought by Finance Act, 2019 withdrawn in respect of capital gains taxable under section 111A and 112A and specifically for FPIs on derivative income also.

OECD's proposal for a 'Unified Approach' under Pillar One

OECD's Unified Approach: Proposal

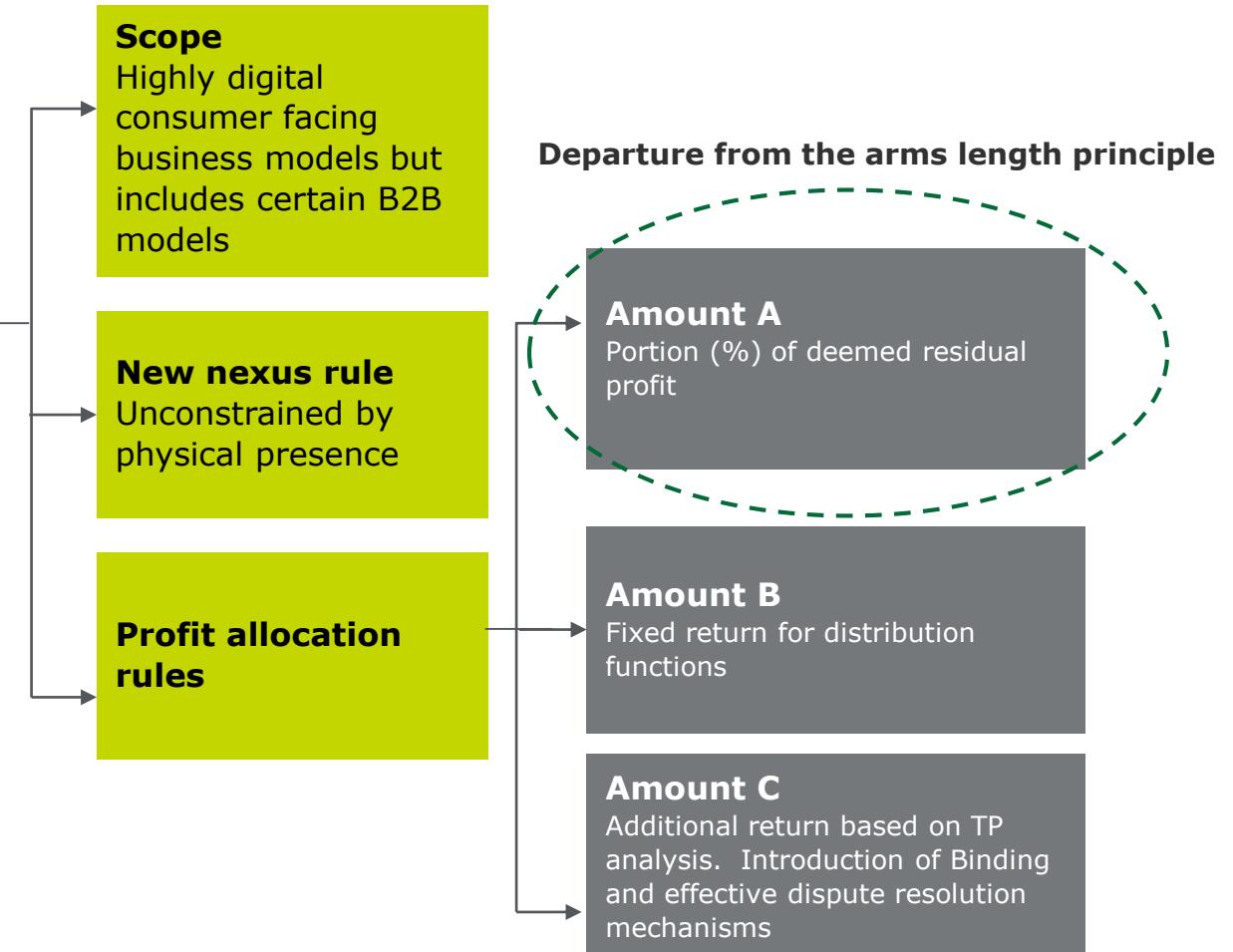


Pillar One

Proposal of the Secretariat for a “Unified Approach”
Multiple-tier approach

Pillar Two

Global Anti-Base Erosion (GLOBE) proposal



Amount A

- New taxing right to market/user jurisdiction
- Independent of physical presence
- Formulaic approach based on group/business line profits
- No link to ALP

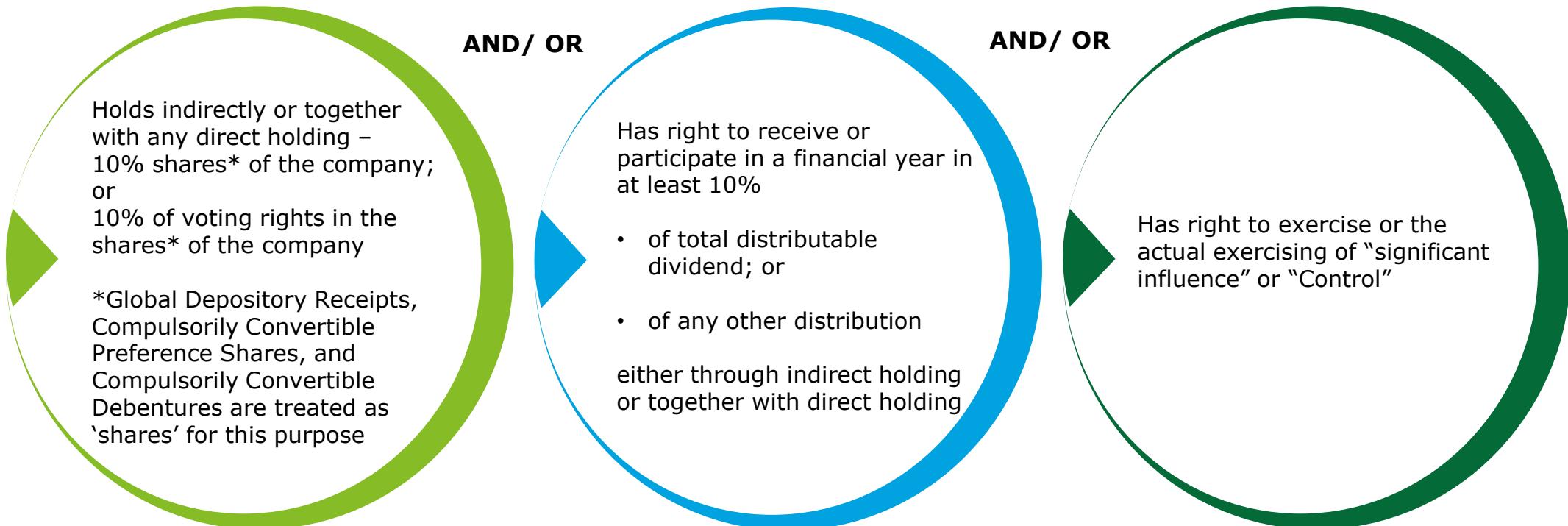
Amount B and C

- No new taxing right – merely a modified operation of the ALP
- Follows the separate entity approach
- Introduce effective and binding dispute resolution mechanisms

Companies (Significant Beneficial Owners) Amendment Rules, 2019

Concept of Significant Beneficial Ownership (SBO)

SBO is defined to mean every individual who acting either alone or together, or through one or more persons or trust, possesses **one or more** of the following rights or entitlements in the Indian company, namely:



"Majority Stake" means; -

- holding more than 50 percent of the equity share capital in the body corporate; or
- holding more than 50 percent of the voting rights in the body corporate; or
- having the right to receive or participate in more than 50 percent of the distributable dividend or any other distribution by the body corporate.

Concept of Significant Beneficial Ownership (SBO)

In relation to the indirect holdings, where the member of the reporting company is:

A body corporate, in India or abroad:

SBO is the natural person, who, holds:

- Majority stake in that member; or
- Holds majority stake in the ultimate holding company (in India or abroad) of member

A Hindu Undivided Family (HUF):

SBO is the natural person, who is the Karta of the HUF

A partnership entity/LLP through itself or a partner:

SBO is the natural person who;

- is a partner; or
- holds majority stake in body corporate which is a partner of the partnership entity; or
- holds majority stake in the ultimate holding company of the body corporate (in India)

Trust (through trustee):

SBO is the individual who;

- is a trustee in case of discretionary trust or a charitable trust;
- is a beneficiary in case of a specific trust;
- is the author or settlor in case of a revocable trust

Pooled investment vehicle or an Entity controlled by the pooled investment vehicle:

And such a concern is based in a member State of the Financial Task Force on Money Laundering (FATF) and the regulator of the securities market in such member state is the member of the International Organization of the Securities Commission (IOSCO) then SBO is an individual who;

- is a general partner; or
- is a investment manager; or
- is Chief Executive Officer where the investment manager of such pooled vehicle is a body corporate or a partnership entity

However, if the pooled investment vehicle or an entity controlled by the pooled investment vehicle is based in a jurisdiction which is not a member state of FATF and IOSCO, then for determination of SBO, rules applicable to body corporate, partnership or Trust will be considered.

Key Indirect tax developments

Recent indirect tax notice / notification / circular



Trade Notice No. 34/(2015-20) - DGFT dated 19 September 2019 – Online issuance of Certificate of origin

- As a part of automation process, Government has launched online platform for issuing preferential Certificate of Origin (CoO).
- All CoOs will be issued electronically in a phased manner and the new system will do away with the paper submissions and physical interface with the Govt agency.
- Currently, the portal has been made live for registration purposes.



Notification No. 12/2019 – CT(Rate) dated 31 July 2019 – Change in GST rate for EV and charger and charging station

- GST rate has been amended for Electric Vehicles and Charger / Charging Station for EVs from 12% and 18 % respectively to 5%.
- This is effective from 1 August 2019.

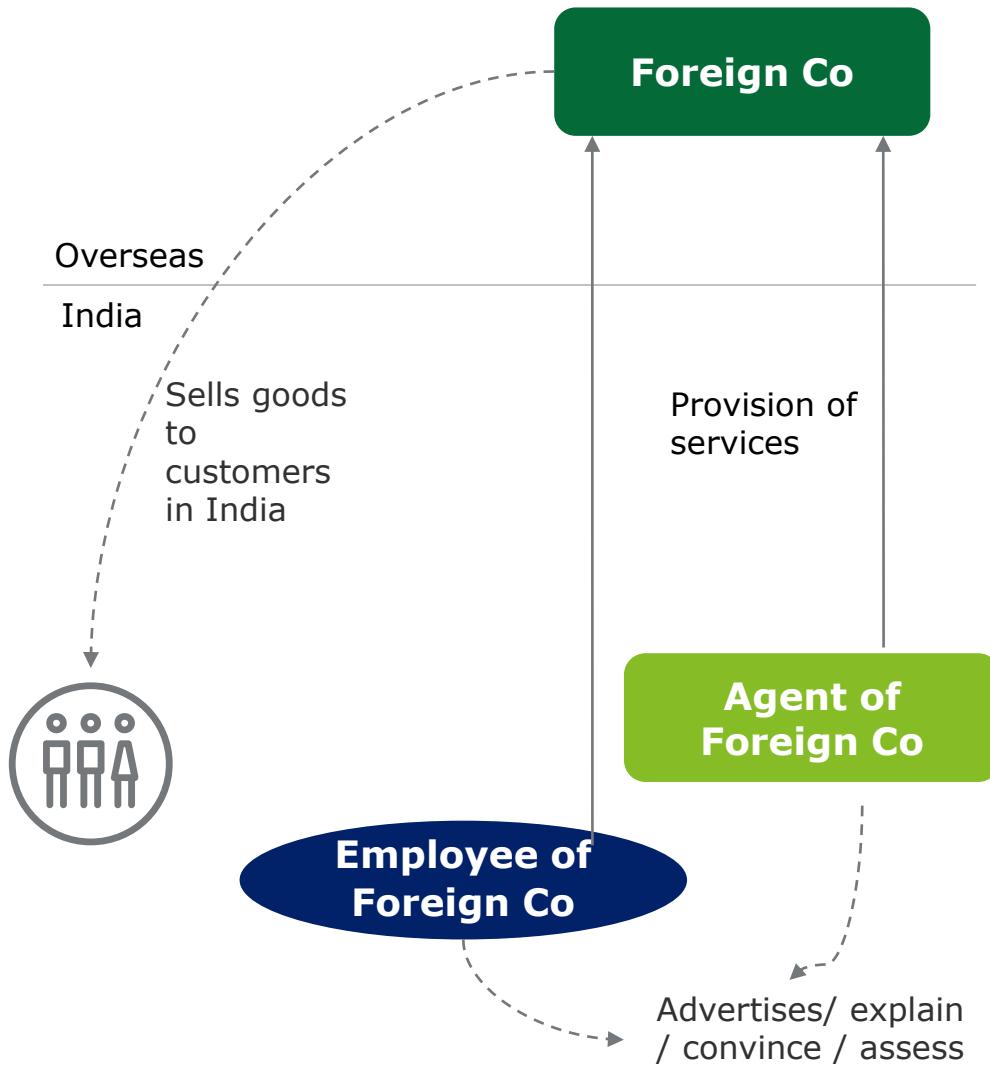


Direct tax updates

MLI impact on tax treaties

Case studies

Case Study 1 – Agency arrangements (Article 12 of MLI)



Query 1

- An agent of the Foreign Co visits customers in India for promoting sales. With the help of the agent the customer would directly place an order on the company's website and the order acceptance is electronically signed by an executive of the Foreign Co sitting outside India. Will the same trigger a PE in India [Para 88 of OECD MC Commentary 2017].
- Whether the answer would differ if instead of agent an employee of the Foreign Co is visiting customers [Para 83 of OECD MC Commentary 2017].

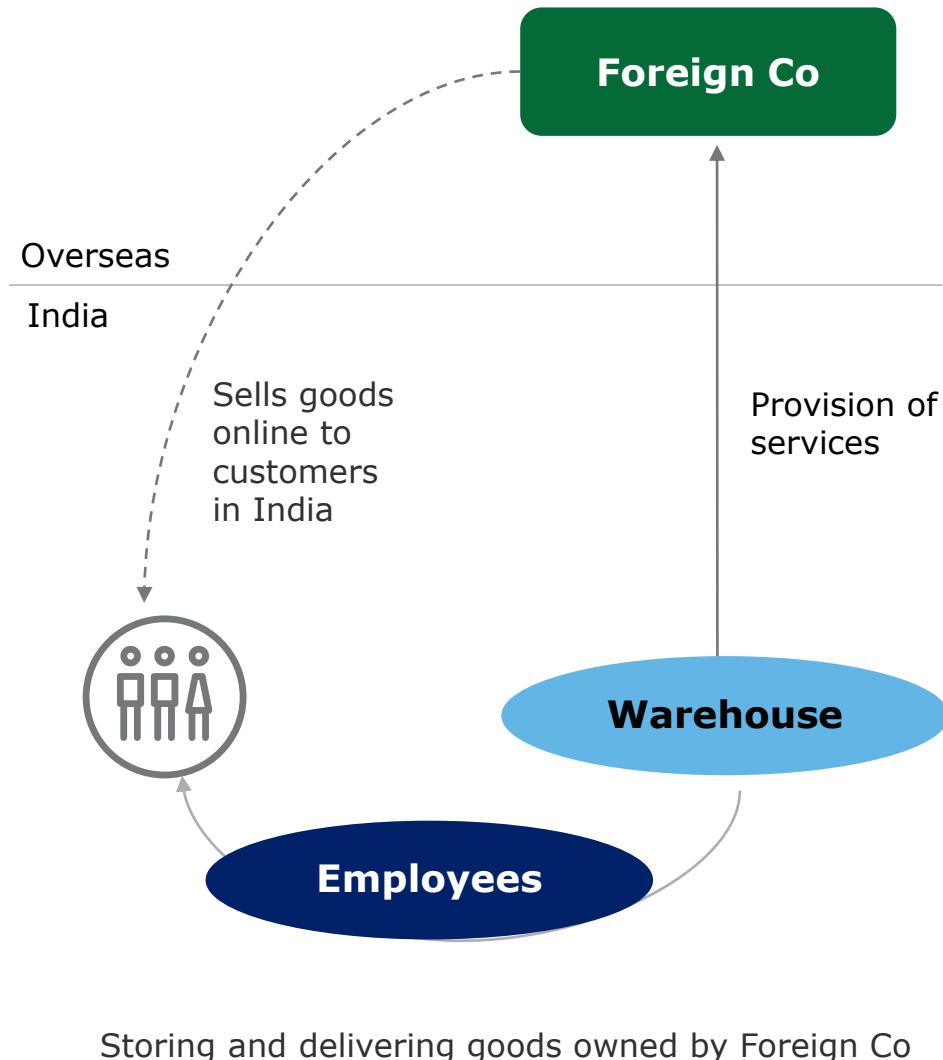
Query 2

- The Foreign Co has standard terms & conditions for entering into any sales contract with the customers in India. The Foreign Co has given a range for negotiating the sales price to its agents in India. Will the same trigger a PE in India [Para 87 of OECD MC Commentary 2017].
- Whether the answer would differ if the Foreign Co also fixes the sales price (i.e. standard contract).

Query 3

- The Foreign Co carries on the sales and marketing function from offices located outside India. A customer can place an order on the online portal (complex and not user friendly) of the Foreign Co and also has an option to visit Foreign Co's agent's office in India for requisite assistance to place an order on the online portal. Will the same trigger a PE in India.

Case Study 2 – Preparatory or auxiliary activities (Article 13 of MLI)



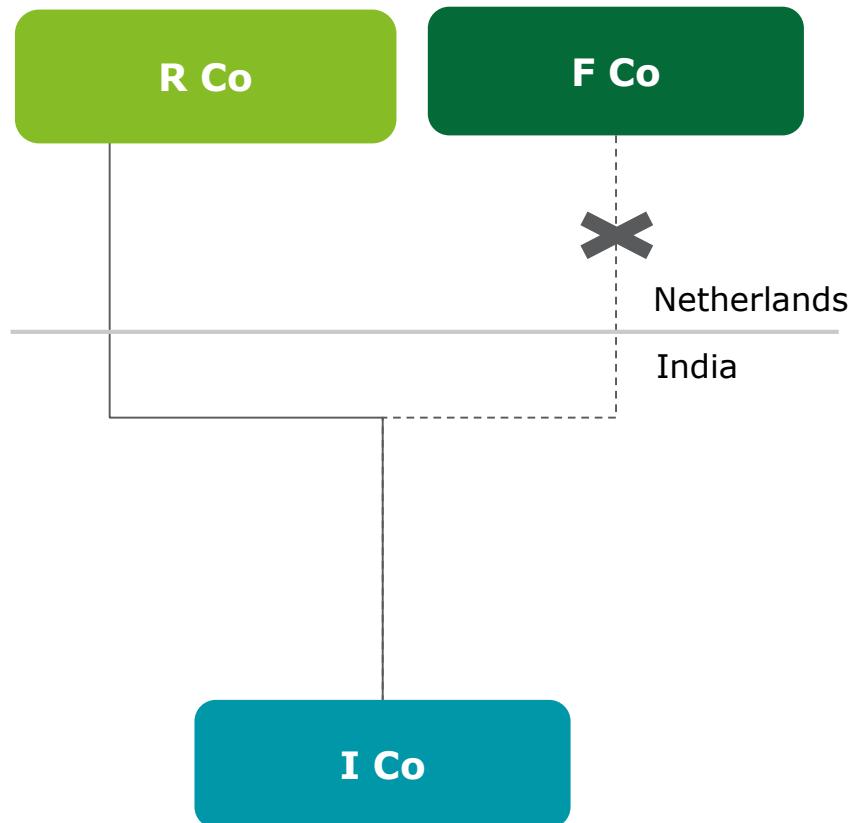
Facts

- Foreign Co is a Company incorporated outside India and is an e-commerce company.
- Foreign Co sells goods in India online through its own website.
- Foreign Co maintains a very large warehouse in India in which significant number of employees work for the main purpose of storing and delivering goods owned by Foreign Co.

Query

- Will such an activity carried out by Foreign Co through a warehouse in India constitute 'preparatory and auxiliary activity under MLI [Para 62 of OECD MC Commentary 2017].

Case Study 3 – Preamble to MLI



Facts

- F Co and R Co are Companies incorporated in Netherlands.
- I Co is a subsidiary of F Co and is incorporated in India.
- F Co transfers its shares held in I Co to R Co.
- F Co enjoys participation exemption in Netherlands with respect to gains from transfer of shares in I co to R Co.

Query

Impact on taxability of the capital gains on transfer of I Co shares under the following case:

- Impact on account of preamble;
- Impact on account of Principal Purpose Test of the MLI and interplay with GAAR.

Article 6 of MLI – Preamble Text

Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)

Article 7 – Prevention of Treaty Abuse

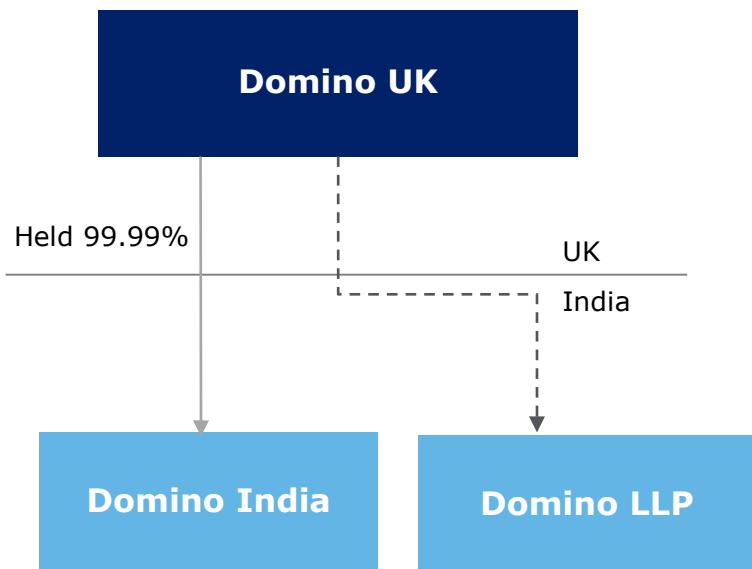
Notwithstanding any provisions of a CTA, a benefit under the CTA shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the CTA.

Recent direct tax rulings

Domino Printing Science Plc.

Domino Printing Science Plc (AAR)

Taxability of capital gain for shareholder on conversion of company into LLP



Facts:

- Domino Printing Science Plc (Applicant or Domino UK) had a WOS -
 - Domino Printech India Private Limited (Domino India); held 4,079,998 equity shares in Domino India
- Applicant proposed to convert Domino India into Limited Liability Partnership (LLP). Application was filed with The Foreign Investment Promotion Board (FIPB) for approval for conversion and approval was obtained in May 2012 subject to certain conditions
- On conversion of Domino India, equity shares held by Applicant were converted into partnership interest in LLP equivalent to amount of paid-up share capital held in Domino India prior to conversion
- As per section 47(xiiib) any transfer of shares held in a company by a shareholder as a result of the conversion of company into an LLP is not considered as a taxable transfer subject to certain conditions
- Domino India did not satisfy one of the conditions prescribed under section 47(xiiib)

Questions before Authority for Advance Ruling (AAR):

- Whether conversion of equity shares into partnership interest resulting from conversion of company into LLP can be qualified as a 'transfer' under section 2(47) for levy of capital gain tax?
- Whether computational provisions of capital gain tax fail on such conversion?

Domino Printing Science Plc (AAR)

Taxability of capital gain for shareholder on conversion of company into LLP

Questions before Authority for Advance Ruling (AAR) (cont):

- Since the value of the partner's (Applicant's) right or interest in the proposed LLP would not exceed the value of the shareholder's (Applicant's) interest in the company, would the conversion give rise to taxable capital gains?

AAR ruling:

On first question

- On conversion of company into LLP, all assets/liabilities vested in the company would vest in LLP
- This would **extinguish** both share capital of the company and the shareholder's interest in the shares of that company
- Hence, the transaction falls within the definition of a transfer under section 2(47)
- Existence of 2 parties not mandatory for the purpose of assessing capital gains; the legislation provides for situations where the transferor and transferee are a single person
- Section 47(xiiiib) creates a presumption that non-compliant conversions are liable to tax

On second and third question

- AAR ruled that the computational mechanism is capable of being applied
- The full value of the consideration for the purpose of computing the shareholder's (Applicant's) capital gain would be the value of the Applicant's partnership interest in the LLP, and the cost of acquisition of the shares would be the amount paid by the Applicant to purchase the shares
- The AAR ruled that the Applicant's partnership interest in the LLP is capable of being evaluated by reference to commercial and accounting principles and if it cannot be done, the Fair Market Value (FMV) would be determined in accordance with section 50D

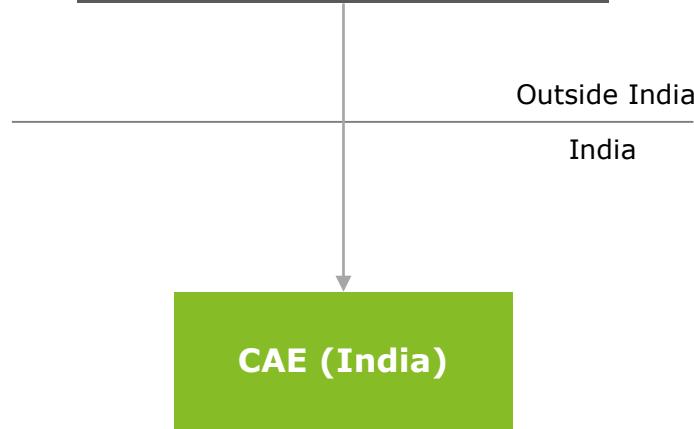
Recent direct tax rulings

CAE Flight Training (India) Pvt Ltd

CAE Flight Training (India) Pvt Ltd (Bang ITAT)

Deductibility of interest on CCDs - CCDs not to be re-characterized as equity

Investments in the form of CCDs (Mauritius/ Dubai/ Hungary)



Particulars	Amount
Equity share capital	12.73 crores
CCDs	110.29 crores

Facts:

- CAE Flight Training (India) Pvt. Ltd ["CAE (India)"] had paid interest at the rate of 15 percent upon issue of CCDs to its three AEs during AYs 2009-10 to 2013-14
- Upon the matter being referred to the TPO, the TPO proceeded to determine whether the amount paid by CAE India to its AE is in the nature of interest or not
- Further, the TPO concluded that the debt funding by the AEs can at best be as investors and not as a lender by stating that in a third-party scenario, no entity would lend to a company if its debt-equity ratio was already as skewed as of CAE India
- The TPO re-characterized these CCDs as equity capital and disallowed the interest thereon by relying on the following:
 - UK transfer pricing guidelines (thin capitalization principles) which state such instruments are equity investment rather than debt.
 - RBI policy, issued in 2007, which states that only fully and mandatorily convertible debentures should be considered as FDI. All other preference shares and debentures are to be considered as debt and hence governed by the ECB rules
- Further, the TPO placed reliance on the decision of the special bench of the Hon'ble ITAT in the case of Ashima Syntex (although in a different context) wherein it was held that convertible debentures are nothing but a capital raising method

CAE Flight Training (India) Pvt Ltd (Bang ITAT)

Deductibility of interest on CCDs - CCDs not to be re-characterized as equity

Facts:

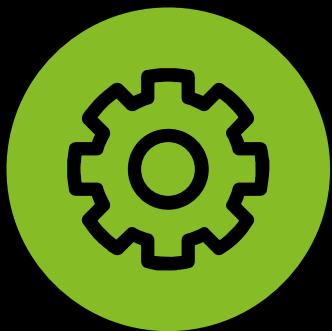
- Aggrieved, the appellant filed appeals before the CIT(A)/ raised objections before the DRP for certain AYs wherein the CIT(A) held that CCDs were debt, and not equity, however, restricted the interest deduction (as per the ALP). Also, for certain AYs where objections were raised before the DRP, the DRP upheld the TPOs position.
- Aggrieved, appeals were filed before the ITAT by CAE India and the Department.

Issue:

- The ITAT, based on the facts of the case, identified the following three questions:
 - Whether CCDs are debt or equity?
 - Whether interest on CCDs is an allowable expenditure?
 - If the interest is allowable, whether the allowed amount, as per arm's length principle, should be based on LIBOR or PLR?

Ruling of the ITAT:

- On the topic of thin capitalization principles, as available in the UK TP guidelines, the ITAT observed that the same should not be applied in the Indian context.
- The ITAT negated the Revenue's reliance on the case of Ashima Syntax as the issue and context were distinguishable
- On the RBI policy 2007, the ITAT observed that each regulation and law is to be read in accordance with its intent and cannot be extended to other regulations and accordingly, the same cannot be applied to Income-tax law
- The ITAT further raised a question, whether the CCDs, before conversion can have voting rights and whether dividend can be paid on CCDs before conversion. Since the same was not possible, it concluded that CCDs are to be considered as debt only and interest can be allowed as a deductible expense.
- On the issue of determination of ALP on interest payment for CCDs, the ITAT observed that the Revenue had done that in a cryptic manner and accordingly remanded the matter to the TPO



Indirect tax updates

Intermediary Services

ITeS

ITeS services - Intermediary services?

Advance Rulings and CBIC Circular

- VservGlobal Pvt Ltd – the applicant provides back office support services (accounting & payroll services) to clients and AR Authority observed that the applicant is facilitating supply of goods or services between its client and client's customers and held as intermediary services.
- CBIC vide Circular 107/26/2019 GST dated July 18, 2019, attempted to clarify the taxability and export position with respect to ITeS vis à vis intermediary services



Non-Intermediary services

- ITeS services defined under rule 10TA(e) of the Income-tax Rules, 1962 such as back office operations, call centers, data processing, etc. do not qualify to be intermediary services, if such services are provided on its **own account**, even if such services are provided to the customers of the client.



Intermediary services

- Support services during pre-delivery, delivery, and post-delivery of supply shall qualify as intermediary services as these services are merely for arranging or facilitating the supply of goods or services or both between two or more persons. Hence, such services do not qualify as export.

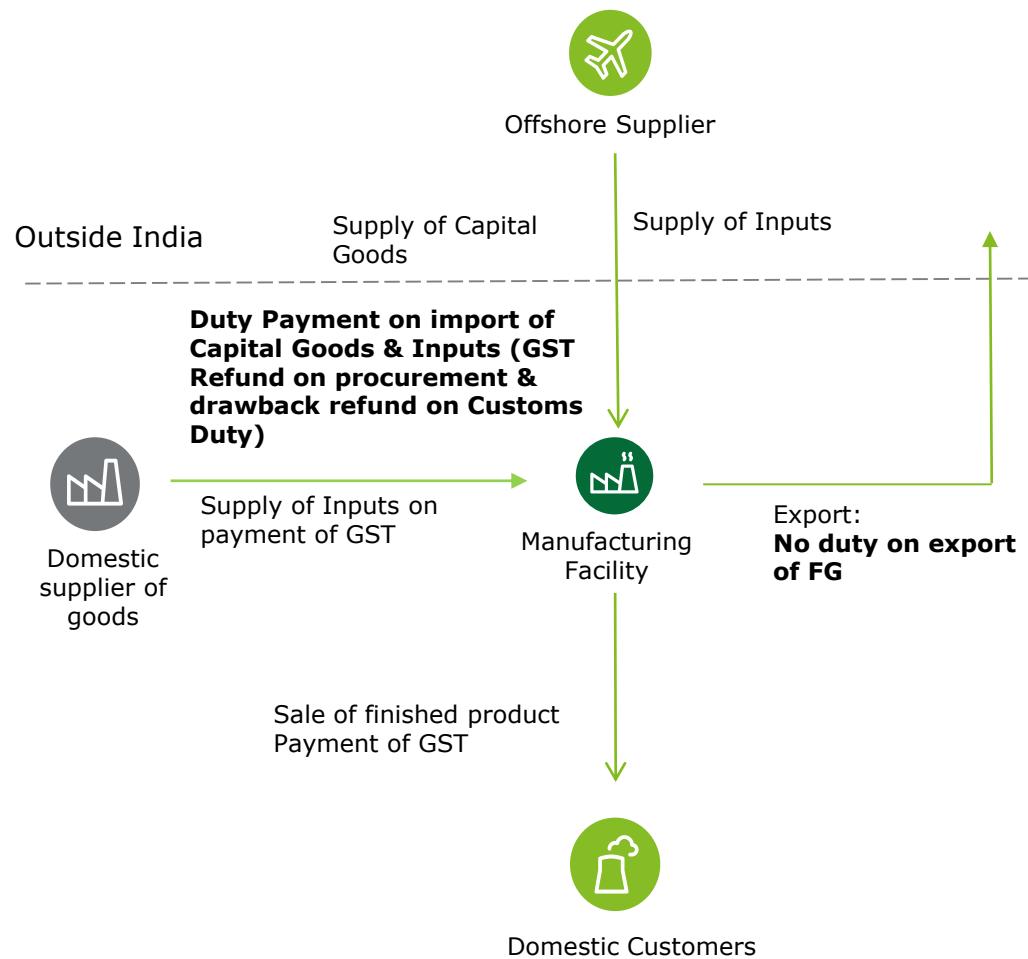
Points for consideration

- Circular provides clarification only with respect to ITeS services defined under Income tax Rules. Clarity needed with regards to other services also.
- 'Outsourcing' of any function – would it tantamount to intermediary service and can it be considered as **service provided on its own account**.
- Circular No. 107/26/2019 appears to broadens the scope of what would qualify as an intermediary service.
- However, in the 37th GST Council Meeting, it has been decided that a new circular, which is awaited, would be issued (in supersession of Circular No. 107/26/2019) regarding supply of ITeS services and is expected to address such issues.
- As this continues to evolve, the criticality remains of carefully reviewing/drafting agreements to be able to better substantiate that services are provided on own account and does not tread into the functions of broker or agent and properly reflect the intention of the parties.

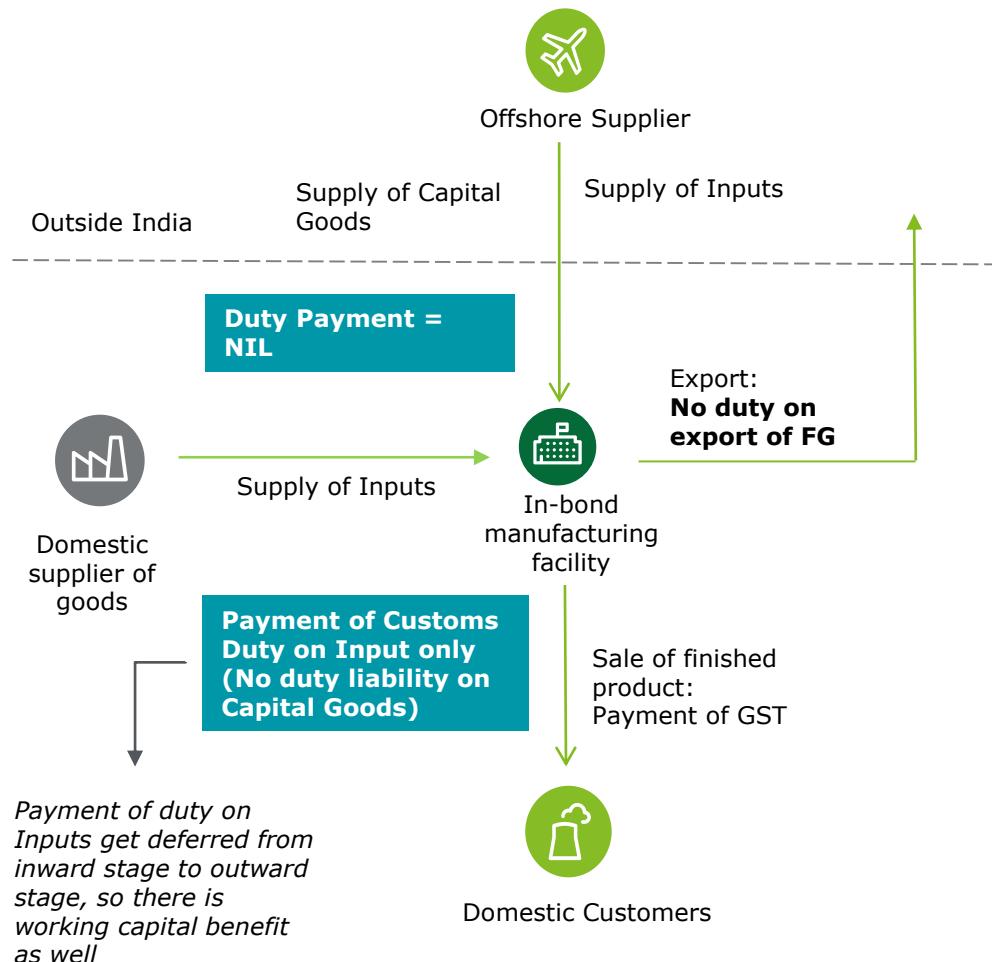
In-bond manufacturing

In-bond manufacturing - An opportunity

Import on payment of duty - Manufacture

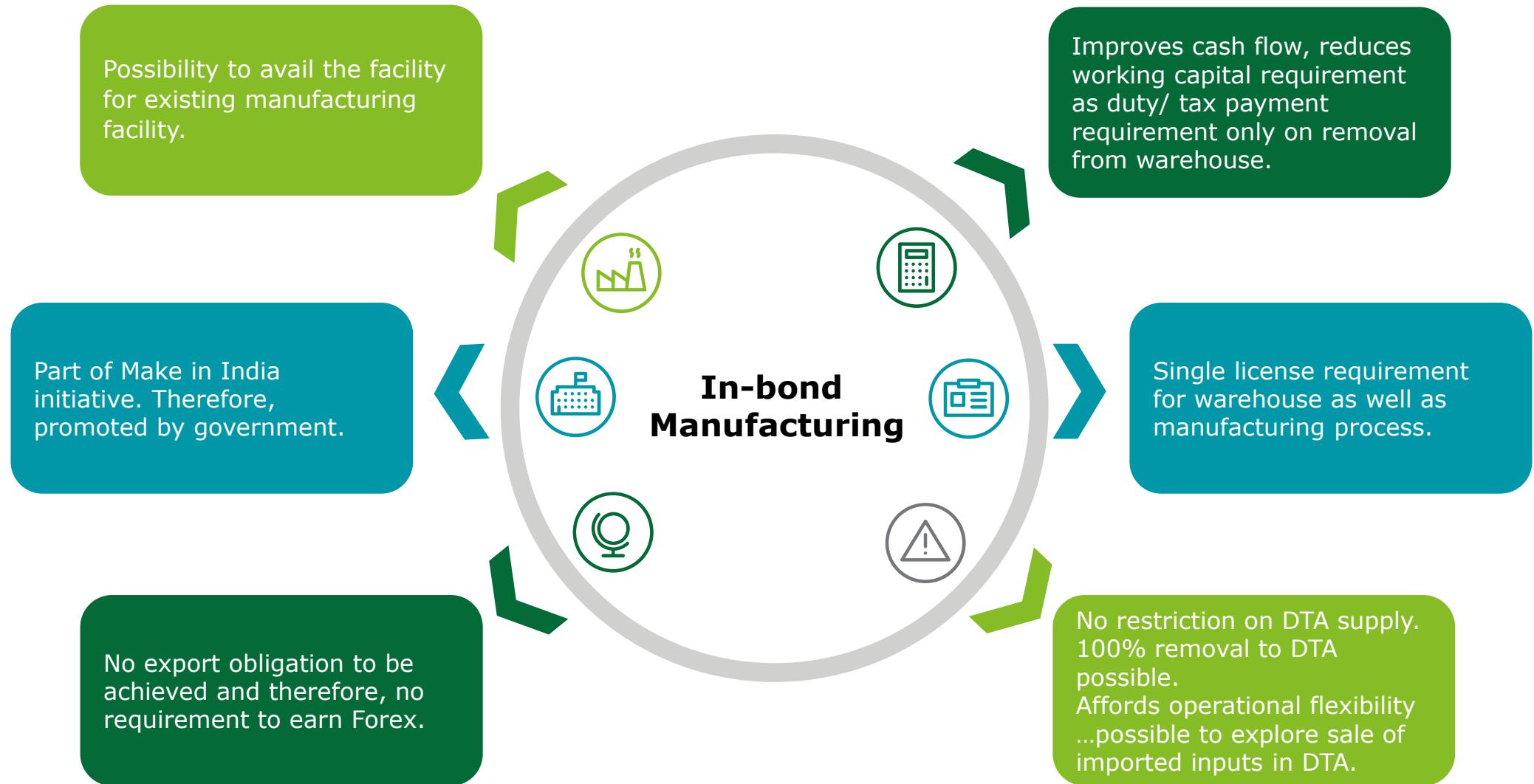


Import under bond – In-bond Manufacturing



Payment of duty on Inputs get deferred from inward stage to outward stage, so there is working capital benefit as well

In-bond manufacturing - An opportunity



**Concept of In bond manufacturing coupled with recent Income Tax rate deduction to 17%
lucrative for new/ expansion of manufacturing facilities in India**

Input credit computation

Input tax credit computation



Amendments

New sub-rule (4) in Rule 36 of the CGST Rules 2017 vide Notification No. 49/2019-Central Tax dated 9 October 2019 has been inserted with respect to availment of input tax credit for invoices/debits notes not uploaded by the vendors.

"(4) Input tax credit to be availed by a registered person in respect of invoices or debit notes, the details of which have not been uploaded by the suppliers under sub-section (1) of section 37, shall not exceed 20 per cent. of the eligible credit available in respect of invoices or debit notes the details of which have been uploaded by the suppliers under sub-section (1) of section 37

Sr.No	Particulars	Computation	Amount
A	Total credit as per Purchase register		1000
B	ITC pertaining to invoices uploaded by suppliers		800
C	ITC pertaining to invoices not uploaded by suppliers		200
D	Credit admissible wrt (C) above	20% of 800	160
E	Total credit admissible	B+D	960
F	Total inadmissible credit	C-D	40

Open issues/ challenges

- Computation on totality level or supplier wise
- Frequency of computation/ reversal
- Time lag between invoice date and reporting of invoice in GSTR-1
- Tracking of invoices not uploaded
- Whether amendment applicable for GSTR-3B of September 2019?
- Accounting of eligible and ineligible credits in books of accounts
- Reconciliation of Electronic credit ledger with ITC receivable as per books of accounts

Needs further clarity to deal with operational issues

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More details to follow, shortly.



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