INDIA BUDGET

Amendments relating to International Taxation

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Section 92CE

Secondary Adjustment

Sec 92CE – Secondary Adjustment

- New section 92CE to provide for secondary adjustments in certain cases, in order to align TP provisions with OECD TP Guidelines and "international best practices"
- If total income increases (or loss decreases) as a result of a primary adjustment, the excess money available with the AE will be treated as an advance if not repatriated to India within the prescribed time, and interest on such advance shall be computed as income of assessee
- *"Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee*
- *"Secondary adjustment" means an adjustment in the books of account of the assessee and its AE to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.*

Sec 92CE – Secondary Adjustment

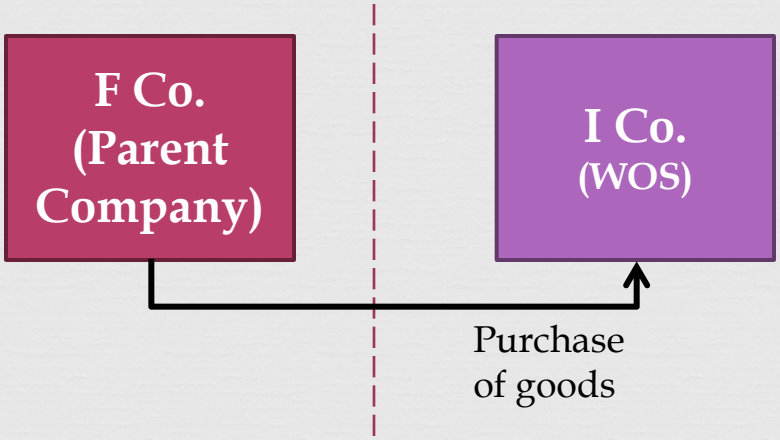
- The secondary adjustment will not be made if primary adjustment does not exceed Rs. 1 Cr **and** if primary adjustment was made for the assessment years upto AY 2016-17

- This amendment will apply from AY 2018-19 and onwards.

- **Additional implication of accepting adjustments and not pursuing appeals or making suo moto adjustments, especially of smaller quantum** – will lead to increased litigation, or higher financial impact on taxpayers

- Threshold for Secondary Adjustments in UK (proposed) is £ 1 million and in Australia is A$ 2 million.

Secondary Adjustment Example -1

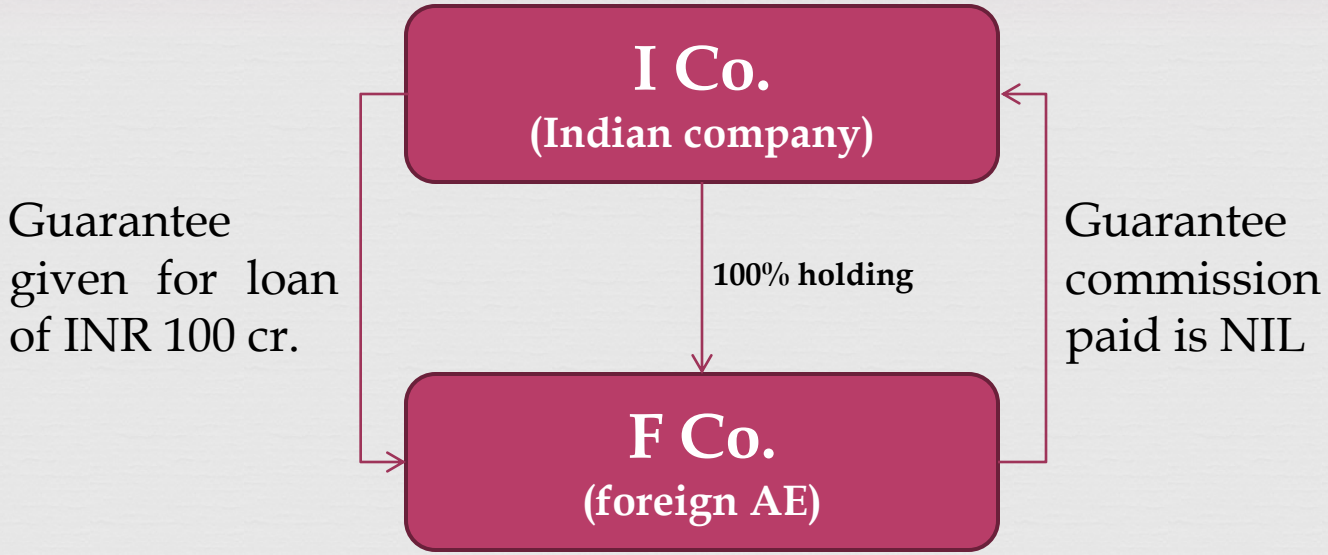


What will be ALP interest rate for secondary adjustment?
LIBOR + mark-up OR
Indian PLR + mark-up?

If SA is treated as a forex advance, what exchange rate will be taken? How will forex fluctuation be treated?

Goods purchased by I Co. from F Co.	10,00,00,000
ALP (determined suo moto & adjustment made by I Co.)	7,50,00,000
Primary Adjustment (since not disputed)	2,50,00,000
Secondary Adjustment – amount not repatriated 2,50,00,000 treated as advance by ICo to F Co. ALP Interest on advance @ LIBOR (3%) + 2% mark-up	12,50,000
Secondary Adjustment in next year – amount not repatriated 2,50,00,000 X 5% **OR** (250,00,000 + 12,50,000) X 5%?	12,50,000 **OR** 13,12,500

Secondary Adjustment Example -2



Guarantee commission charged	0%
Guarantee commission as per ALP (under Safe Harbour)	1.75%
Primary Adjustment (adjustment made by ICo under Safe Harbour provisions)	1,75,00,000
Secondary Adjustment – amount not repatriated Deemed Advance of 1.75 crore from I Co.to F Co. ALP interest @ LIBOR (3%) + Mark up 2% - Year 1	8,75,000
Secondary Adjustment in next year [year 2: amount not repatriated] 1,75,00,000 X 5% **OR** (1,75,00,000 + 8,75,000) X 5%?	8,75,000 **OR** 9,18,750

Methods of SA

OECD TP Guidelines discuss two methods of making Secondary Adjustments:

- Constructive Dividends – excess profits are treated as a deemed dividend
- Equity Contribution Rule – excess profits are treated as deemed equity contribution

These 2 methods benefit from being one-off adjustments that require minimal on-going monitoring or administration.

Third method:

- Constructive loans – excess profit is treated as a deemed loan

Secondary Adjustment

South Africa tried the deemed loan route and moved to a deemed dividend about three years after introducing the deemed loan. The main issues faced in South Africa were:

- If a taxpayer did not repay the deemed loan, interest would incur. The first issue was to calculate a deemed (arm's length) interest rate
- Should one get across the hurdle of calculating the deemed interest which incurs annually, the other related party does not have an obligation in its books to actually repay the loan (as there is no corresponding entry)
- Furthermore, in South Africa, no one (neither taxpayer nor tax authority) really kept track of the increasing deemed debt which could render a taxpayer insolvent if this carried on for too long, which brings other issues.

http://www.transferpricing.co.za/tag/secondary-adjustment/

SEC 92CE – SECONDARY ADJUSTMENT

- **<u>Does treaty permit Secondary Adjustments?</u>**

OECD Commentary on Article 9 of the OECD Model Tax Convention (clause 8 and 9 on article 9):

"It is not the purpose of this paragraph to deal with what might be called "secondary adjustments". ...

... These secondary adjustments which would be required to establish the situation exactly as it would have been if transactions had been at arm's length, depend on the facts of the individual case. It should be noted that nothing in paragraph 2 prevents such secondary adjustments from being made where they are permitted under the domestic laws of Contracting State."

Sec 92CE – Secondary Adjustment

- **<u>Economic Double Taxation:</u>**

  The OECD commentary on Article 9 of the OECD Model Tax Convention states *[clause 5 and 6 on article 9]:*

  "The re-writing of transactions between associated enterprises in the situation envisages in paragraph 1 may give rise to economic double taxation, insofar as an enterprise of State A whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in State B. Paragraph 2 provides that in these circumstances, State B shall make an appropriate adjustment so as to relieve the double taxation.

  It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length."

- Even the European Commission's **Final Report on Secondary Adjustments** of 2012 reiterates this stance.

- **Access to MAP to redress Economic Double Taxation may be difficult.**

SEC 92CE – SECONDARY ADJUSTMENT

- **RETROSPECTIVE EFFECT?**

Proviso to section 92CE(1) reads as under:

Provided that nothing contained in this section shall apply, if,–

(i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; ***and***

(ii) the primary adjustment is made in respect of an assessment year commencing ***on*** *or before the 1st day of April, 2016.*

- If an adjustment of more than Rs. 1 crore was made for an AY commencing prior to 1st April 2016, secondary adjustments can be made – this implies that 92CE has retrospective applicability.
- If an adjustment of Rs. 100 is made for AY 2018-19 and subsequent AYs, secondary adjustment can be made – this implies that threshold of Rs. 1 crore will never apply.

SEC 92CE – SECONDARY ADJUSTMENT

- **Practical difficulties in repatriation of "advance"**
  - law of AE's jurisdiction may not allow repatriation if the order making the primary adjustment is passed with respect to transaction 4-5 years ago
  - The exchange control regulations of AE's jurisdiction may prevent such repatriation
  - if the entity with which transaction took place ceases to be an AE
  - if the AE ceases to be in existence when order making primary adjustment is passed

- **If repatriation is not possible, impact of secondary adjustment will be PERPETUAL**

- **Should secondary adjustment be in the nature of constructive capital contribution?**

SEC 92CE – SECONDARY ADJUSTMENT

- **Will Secondary Adjustment also be made in the hands of a foreign AE which has been subjected to a Primary Adjustment?**
  - For example, Indian Co receives interest free loan from foreign AE and TP adjustment (primary adjustment) is made and interest income is imputed in the hands of foreign AE.
    - Will Indian Co be bound to repatriate the "advance" to the foreign AE?
    - Will Indian Co get deduction for interest so paid, though as per contract the loan was interest free?
  - If such is the case, will decision and argument made in the case of Instrumentarium Corporation Ltd stand good?
  - If not, can this be litigated under Non-Discrimination Articles of various tax treaties?

SEC 92CE – SECONDARY ADJUSTMENT

- **<u>Distinction between DEPENDENCE v/s CONTROL</u>** – if the entity is an AE due to clause (g) [IPR dependency] or clause (h) [supply dependency] or clause (i) [sale dependency] of section 92A(2), it may not be possible to direct AE to repatriate.

- Chennai Tribunal decision Orchid Pharma Ltd v. DCIT – [2016] 162 ITD 30

  The fact that an enterprise can "influence prices and other conditions related to sale" does not make it an AE of the assessee if it does not participate in the (a) capital, (b) management, or (c) control of the assessee and thus does not fulfil the basic rule u/s 92A(1). S 92A(2)(i) has to be read with section 92A(1). Even if the conditions of section 92A(2)(i) are fulfilled, these enterprise cannot be treated as AEs if the requirements of section 92A(1) are not fulfilled."

- A moot question for considerations, as a common sense approach:

  A teenager is dependent on the parents, but in today's context, can the father say that he controls the teenager?

Sec 92CE – Secondary Adjustment

- **92A.** *(1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise –*
- *(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or*
- *(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.*

Sec 92CE – Secondary Adjustment

- Is section 94B (2) to be read independent of section 94B(1)?
- It seems that legislature has omitted to cover FY 2016-17 (corresponding to AY 2017-18) in the ambit of secondary adjustment]
- The date from and up to which interest will be imputed
- Will SA be subject to MAT in year of receipt – this can lead to double taxation, 1st when adjustment is made and again when amount is actually received?
- What if AE is financially unsound and is unable to repatriate – will year-on-year SA be made?
- Will SA interest be included while computing accumulated reserves for deemed dividend considerations?
- Compatibility with Company law provisions relating to 'loans or advances'? Could create complications under company law [e.g.: due to such advance exceeding limits u/s. 186 of the Companies Act 2013]

SEC 92CE – SECONDARY ADJUSTMENT

- Will SA entail penal consequences?
- Will TP documentation & reporting requirements apply to the "advance" and the imputed interest?
- If foreign withholding tax applies while repatriating the "advance" will foreign tax credit be given in India? At what rate will such FTC be given? What would be the nature of such receipts – if the jurisdiction of the foreign AE treats the payment as a dividend and accordingly WHT applies, will India still give FTC?
- In case foreign AE is subsidiary, if the "advance" arising out of SA is capitalized under FEMA's ODI regulations, or if such amount is adjusted against amounts payable to AE, will the advance be considered to have been repatriated?

Conflict with Non-Discrimination Article

Article 24(5) (Non-Discrimination) of the OECD's Model Tax Convention reads as under:

"Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first mentioned State are or may be subjected."

Secondary Adjustment Provisions In UK – BEST PRACTICE

The UK's HMRC proposes to introduce SA provisions in Finance Act 2017. In May 2016, it published a consultation paper, inviting comments and feedback from stakeholders. The questions put forth discussed the following:

- Alternative & appropriate manner/ modes of making Secondary Adjustments
- Appropriate threshold for invoking Secondary Adjustments
- Interaction between SA and accounting standards
- How and what interest rates should be set?
- Tax implications on repatriation of the amount representing the deemed loan
- Ring-fencing SA provisions from other domestic tax provisions – for example interplay with Sec 2(22)(e)
- Effectiveness of the SA in case of treaty with a country with non-discrimination clause
- Legislative difficulty to invoke MAP if the treaty do not cover the corresponding adjustment with respect to SA
- Interactions with APA – how to address non-relievable double taxation

Secondary Adjustment in MLI

The MLI on which negotiations were recently concluded should have included an Article on Secondary Adjustments so that the practice became standardized across countries and at the same time the issue of relief from double-taxation, either through corresponding relief or MAP access would have been clarified

Section 94B

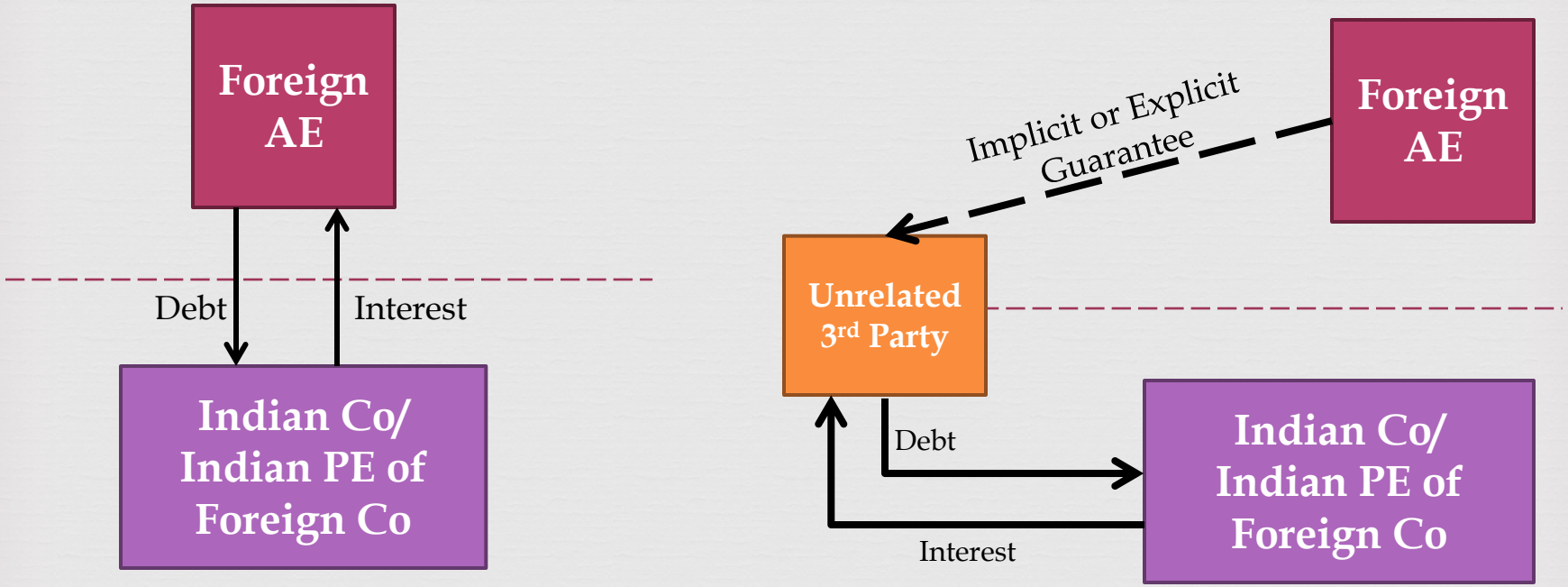
Interest Deduction Limitation

Sec 94B – Interest Limitation

- **Section 94B (BEPS Action Plan 4)**

  Finance Bill proposes to insert Sec 94B in line with recommendation of BEPS Action Plan 4 restricting deduction towards interest paid to non-resident AE to 30% of EBITDA (earnings before interest, taxes, depreciation and amortization).
- Excess interest shall be **lower** of:
  - Total interest paid (to both AE and non-AE) in excess of 30% of EBITDA; or
  - Interest paid to AEs
- Borrowers being **Indian company** and **Indian PE of foreign entity**
- Lender or guarantor has to be non-resident AE
- Excludes banks and insurance companies
- Disallowed interest can be carried forward for 8 subsequent years
- Bombay HC judgement DIT v/s Besix Keir Dabhol S.A. (2012) 210 Taxman 151 (Bombay) – no longer stands as good law

Applicability of Sec 94B



If Interest paid to non-resident AEs or interest paid with respect to loans guaranteed by non-resident AE exceeds Rs. 1 crore

Sec 94B Disallowance Examples

Particulars	Case I	Case II	Case III	Case IV
EBIDTA	1000	1000	1000	(1000)
Interest Paid/ Payable to				
Associated Enterprises	90	90	250	90
Non-AEs	250	350	190	250
Total	**340**	**440**	**440**	**340**
Total Interest % of EBITDA	34%	44%	44%	NA
Excess: lower of				
(a) Excess of 30% of EBITDA	40	140	140	340
(b) AE Interest	90	90	250	90
AE Interest disallowed and to be c/f	**40**	**90**	**140**	**90**
AE interest allowed	**50**	**NIL**	**110**	**NIL**
Non-AE interest allowed	**250**	**350**	**190**	**250**

Issues

- The objective is to put a restriction on the interest payments to related parties.

- However, the meaning of AE is fairly wide under the ITA to potentially cover third party lenders who advance a loan constituting more than 51% of the book value of the total assets of the other enterprise and also a guarantor who guarantees 10% or more of the total borrowings of the other enterprise

Issues

- Whether the loan arrangements covered by Sec. 94B be again reviewed by GAAR
- If the interest is to be capitalized to a Fixed Asset, then whether such entire interest which is capitalized or interest in proportion to depreciation claimed shall be considered for the purpose of calculating excess interest
- Is Rs. 1 crore threshold for applicability to be considered on basis of total interest to all non-resident AEs or basis of interest to each non-resident AE?

Issues

- Positive correlation between degree of interest deduction limitation and stage/ level of financial development:

Financial development	Average deduction allowance for internal interest expenses
Low	0.93
Moderate	0.87
High	0.83
Very high	0.75

- Countries where the financial system is under-developed or easy credit is not available, or the cost of borrowing is high – having interest deduction limitations are not justified
- Interest limitation provisions that affect those AEs that are based in jurisdictions where tax-rates are similar to or higher than India is not justified

"Why Countries Differ in Thin Capitalization Rules: The Role of Financial Development" - Mohammed Mardan [CESIFO WORKING PAPER NO. 5295, April 2015]

Issues

- The 94B proposals should not be taken forward as to do so would not be consistent with the Government's commitment to improve the business environment in India and to make the tax system more efficient and competitive – instead they would introduce increased complexity

- Such unilateral rules cause an increase in double taxation, and serious cash flow problems even if the double taxation issue is ultimately resolved

- Introducing such complex rules that impact on international trade and investment require provisions that demonstrate that India is a competitive place to do business

Issues

- Whether the non-discrimination clause in the DTAA can be invoked against Sec 94B which causes discriminating tax rules in respect to borrowing from residents and non-residents?

- Whether the guarantee commission paid to the overseas parent for guarantying the borrowings from a third party lender shall be included in determining the threshold of excess interest?

- Even debt given by highly geared non-resident AE to Indian Co/ PE will be covered by the disallowance?

- Increased cost of borrowing – it discourages cheaper borrowing in foreign jurisdictions and re-lending to Indian Co/ PE

Implicit Support v/s Implicit Guarantee

The concept of "Implicit Support" has been discussed in the case of ***GE Capital Canada, Inc v/s The Queen (2009)***: Implicit support is the assumption that a parent would not permit its subsidiary (if it is a ''core'' subsidiary) to become insolvent and, with or without the guarantee, the parent would be expected to take actions to protect the subsidiary's creditworthiness in order to, among other things, protect the parent's investment and its own good name and reputation.

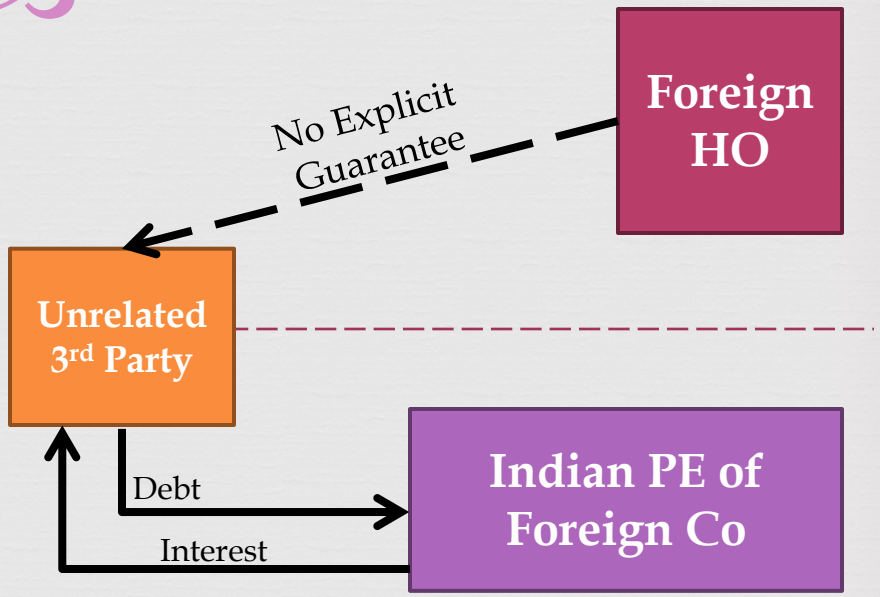
However, it is accepted that in general, there is often a substantial difference between an explicit guarantee and implicit support since implicit support may be limited to the hope that the parent company will act even though it is not legally bound to do so. There are many examples where parents walk away from subsidiaries in financial difficulty, which indicates that implicit support assumption by a subsidiary's external creditors can, in practice, be worthless.

Implicit support can also be assumed where an entity is able to take a loan beyond its standalone credit-worthiness due to the credit-worthiness of the entity as part of a larger MNE group.

But what is Implicit Guarantee?

Implicit Guarantee

- **Ambiguity with respect to meaning of 'implicit guarantee'**
  - letter of comfort or similar undertakings
  - AO may contend that any borrowing by Indian PE from 3rd party lender has HO's implicit guarantee



- Third party Bank giving loans to the Indian PE of the foreign party where no explicit guarantee is given by foreign party
- However, if the Indian PE defaults, then the assets of the foreign HO shall be exposed to the default of Indian PE
- **Can this be an implicit guarantee or implicit support so as to attract section 94B limitations?**

Conflict with Non-Discrimination Article

Article 24(4) (Non-Discrimination) of the OECD's Model Tax Convention reads as under:

"Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State."

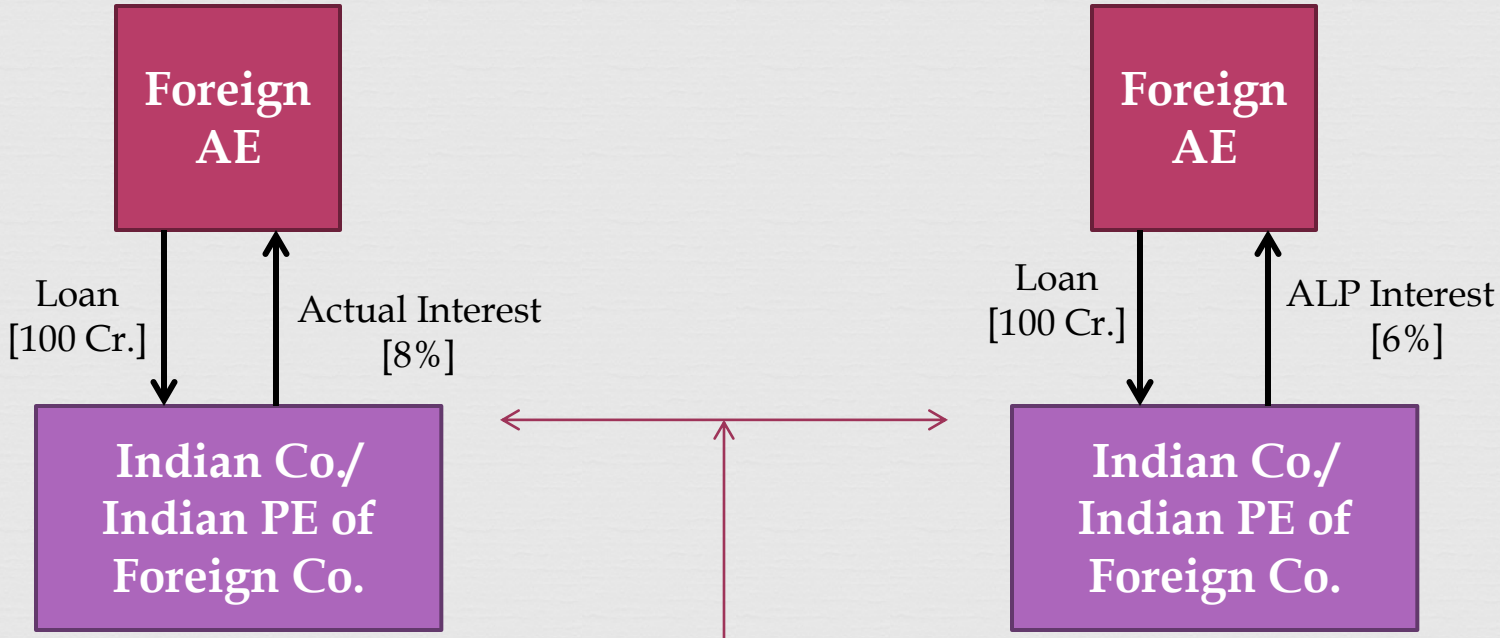
BEPS 4 v. SEC 94B

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Payee of the interest for which the deduction is Claimed	Covers all interest payments, not only AE interest This is to address a situation where an MNE incurs excessive 3rd party interest expenses in high tax country through excessive borrowing, and funds its subsidiaries located in low/ no tax jurisdictions	Covers only interest payments to non-resident AEs. Accordingly, tax planning arrangements involving third party debts would still not be addressed.

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Amount to be considered for applying the Limit	The limit should be applied to a deduction of net interest expenses, wherein the interest expense, net of interest income, will be considered for deductibility purposes	It limits the **gross** interest expenses incurred by a taxpayer. As also recognised by the OECD, a **gross** interest rule could lead to double taxation, where an entity is subject to tax on its full **gross** interest income, but part of its **gross** interest expense is disallowed.
Exclusion of certain sectors from its Applicability	Banks and insurance companies are excluded. Further, the OECD also recommends the exclusion of certain public-benefit infrastructure companies.	Only banks and insurance companies are excluded, without any mention of public infrastructure companies.

OECD Action Plan provision	BEPS Action Plan 4	Budget 2017
Manner of computing the EBITDA	The EBITDA should be computed by considering the taxable income in accordance with the local country tax laws. Action Plan 4 discusses that, rather than linking an entity's ability to deduct net interest expense to economic activity in a single year, the impact of short term volatility could be reduced through the use of average EBITDA of few years.	The proposed provisions are silent on the manner of computation of the EBITDA. The Indian taxpayer will need to wait for any clarifications to be issued by the CBDT.
Carry forward/ Carry back provisions	The OECD recommends carry forward and carry back of disallowed interest expenses, wherein the disallowed interest expenses in the current year are allowed to be set-off against future profits and past profits	Only carry forward of disallowed interest expenses is allowed. No carry-backs allowed.

Double Edged Sword Section 92CE And Section 94B



I. ALP Interest = Rs. 6 Cr. Therefore, Primary Adjustment of Rs. 2 Cr. [(8%-6%)*100 Cr.] and Secondary Adjustment on Rs. 2 Cr. if amount not repatriated

II. If EBITDA = Rs. 10 Cr., Interest allowed u/s 94B = Rs. 3 Cr. (30% of EBITDA).
Therefore, c/f amount = Rs. 3 Cr.

Section 115JAA / 115JD & Section 155

Foreign Tax Credits

Foreign Tax Credit

- **Limiting the excess MAT / AMT credit in case of FTC**
  - Excess MAT / AMT credit =

    FTC against MAT/AMT liability

    Less: FTC against normal provisions tax liability

- Such **Excess MAT / AMT** shall be ignored while calculating MAT / AMT credit

EXAMPLE

Particulars	Case -1	Case -2
Income Tax liability as per MAT / AMT	100	100
Income Tax liability as per normal provisions	90	90
FTC u/s 90/90A/91	120	95
In absence of amendment :		
FTC allowed in current year	100	95
MAT/ AMT credit carried forward	**10**	**10**
In light of amendment:		
Excess MAT/AMT credit	10	5
FTC in current year	100	95
MAT / AMT credit carried forward	**Nil**	**5**

SEC 155(14A) - FTC IN CASE OF DISPUTE

- Applicable in cases where no FTC was given in the intimation u/s 143(1) or assessment order since FTC is in respect of taxes paid is under dispute in foreign country

- AO shall rectify the intimation u/s 143(1) or assessment order if the assessee within 6 months from the end of month of settlement of dispute:
  - Furnishes the proof of settlement of dispute
  - Evidence that the foreign tax liability is discharged
  - Furnishes an undertaking that credit of such foreign tax paid is not directly or indirectly taken for any other assessment year

- FTC shall be allowed for the year in which such foreign income is offered / assessed to tax in India

Section 9(1)(i)

Indirect Transfer Provision

Indirect Transfer Provision

Clarifications relating to Indirect transfer provisions

- In order to address concerns raised by stakeholders seeking clarification on the scope of indirect transfer provisions, it is proposed to amend Section 9(1)(i) so as to clarify that Explanation 5 shall not apply to any asset or capital asset mentioned therein being investment held by non-resident, directly or indirectly, in an FII registered as Category-I (sovereign fund) or Category-II (broad-based) FPI with SEBI as these entities are regulated and broad based.
- The proposed amendment is clarificatory in nature & will take effect retrospectively from April 1, 2012.

- Amendment leaves out a large chunk of entities affected by these provisions – Category III FPIs, Pes & VCs that have invest in Indian securities

- No clarity on how off-shore mergers/ demergers/ business re-organisations of foreign companies that result in indirect transfer be dealt with? If the issue comes up, can "Non-Discrimination" Article in tax-treaties come to the rescue in such cases?

Section 9A

Special Regime For Off Shore Funds

SEC 9A – OFF-SHORE FUNDS

Sec 9A : Modification in conditions of special taxation regime for off shore funds u/s 9A

- **Amendment :** In order to rationalize the regime and to address the concerns of the stakeholders, it is proposed to provide that in the previous year in which the fund is being wound up, the condition that the monthly average of the corpus of the fund shall not be less than Rs. 1000 crore, shall not apply.
- Amendment will take effect retrospectively from April 1, 2016.
- PE Funds and VCs are unlikely to consider this section due to the minimum investor requirement, limit on investing more than 20% of corpus in single entity, and restriction on managing or controlling the entity in which investment is made – this is a mismatch since India-focused funds have greater need to

Capital Gains

Rupee Denominated Bonds

- Foreign exchange gain at the time of redemption of Rupee Denominated bond of an Indian company shall be ignored for the purpose of computing full value of consideration.
  - Investors looking to gain from long term rupee appreciation will benefit & calculation of gains is more straightforward

- Transfer of rupee denominated bond of an Indian company issued outside India from by a non-resident to another non-resident shall not be regarded as transfer.
  - move increase the depth of the bond market & make masala bonds more attractive for foreign investors.

Capital gains

- Conversion of preference shares into equity shares will not be regarded as a transfer.

- In case of demerger of foreign company, the cost of acquisition of shares of an Indian company of acquired by a demerged company will be the COA in the hands of the resultant company

Sec 194LC & 194LD

TDS on Certain
Interest Payments

TDS u/s 194LC & 194LD

Sec. 194LC & 194LD : Extension of eligible period of concessional rate of TDS from 2017 to 2020

- It is proposed to amend Sec. 194LC to provide that the concessional TDS rate of 5%on interest payment will now be available in respect of borrowings made before the July 1, 2020. Amendment proposed shall take effect from April 1, 2018 i.e., AY 2018-19.
- It is further proposed to extend the benefit of Sec. 194LC to rupee denominated bond issued outside India for the period before the July 1, 2020. Amendment proposed shall take effect from April 1, 2016.
- Presently concessional rate of 5% on the interest payable/paid up to 1st July, 2017 to FIIs/ QFIs from G-Secs/ rupee denominated corporate bonds. It is proposed to extend this rate to 1st July, 2020.

Sec 90 & 90A

Terms Not Defined in The Treaties

Terms not Defined

Sec. 90 & 90A : Clarification with regard to interpretation of 'terms' used in an agreement entered into under section 90 and 90A

- Explanation 4 inserted which states that any term used in DTAA, the meaning of the term is as defined in the agreement or if the term is not defined in the agreement, reference should be made to the ITA or any explanatory statement as issued by the Central Government.

- With effect from AY 2018-19 onwards.

- **STATIC Interpretation or AMBULATORY Interpretation?**

  OECD commentary explicitly calls for ambulatory interpretation

Does this override treaty?

Sec 6(3)

Place of Effective Management

POEM Guidelines

- On 24th January, 2017, before the Budget was announced, the CBDT issued a circular containing Guiding Principles for determination of POEM of a Company.

- The guidelines contain the manner in which a company's POEM has to be determined under different circumstances and situations, considering various factors. The guidelines also contain illustrations to clarify the situations whether POEM shall or shall not apply.

- The Press Release states that the POEM guidelines shall not apply to companies having turnover or gross receipts of Rs. 50 crore or less.

POEM GUIDELINES

Few Important Aspects from the Guidelines

- Fact based, Year on Year determination of POEM.
- Intent not to target MNEs – shell/ conduit overseas companies are target
- POEM of "active" business entity is outside India if majority Board meetings are held outside India
- AO shall take prior approval of Pr. CIT.
- 3 member collegium to take final call if POEM held to be in India
- Opportunity to taxpayer before adjudicating the issue
- Active & Passive Business Outside India – definition & guidelines
- Determination of POEM to be a two-staged process

  (1) identifying KMPs & decision makers

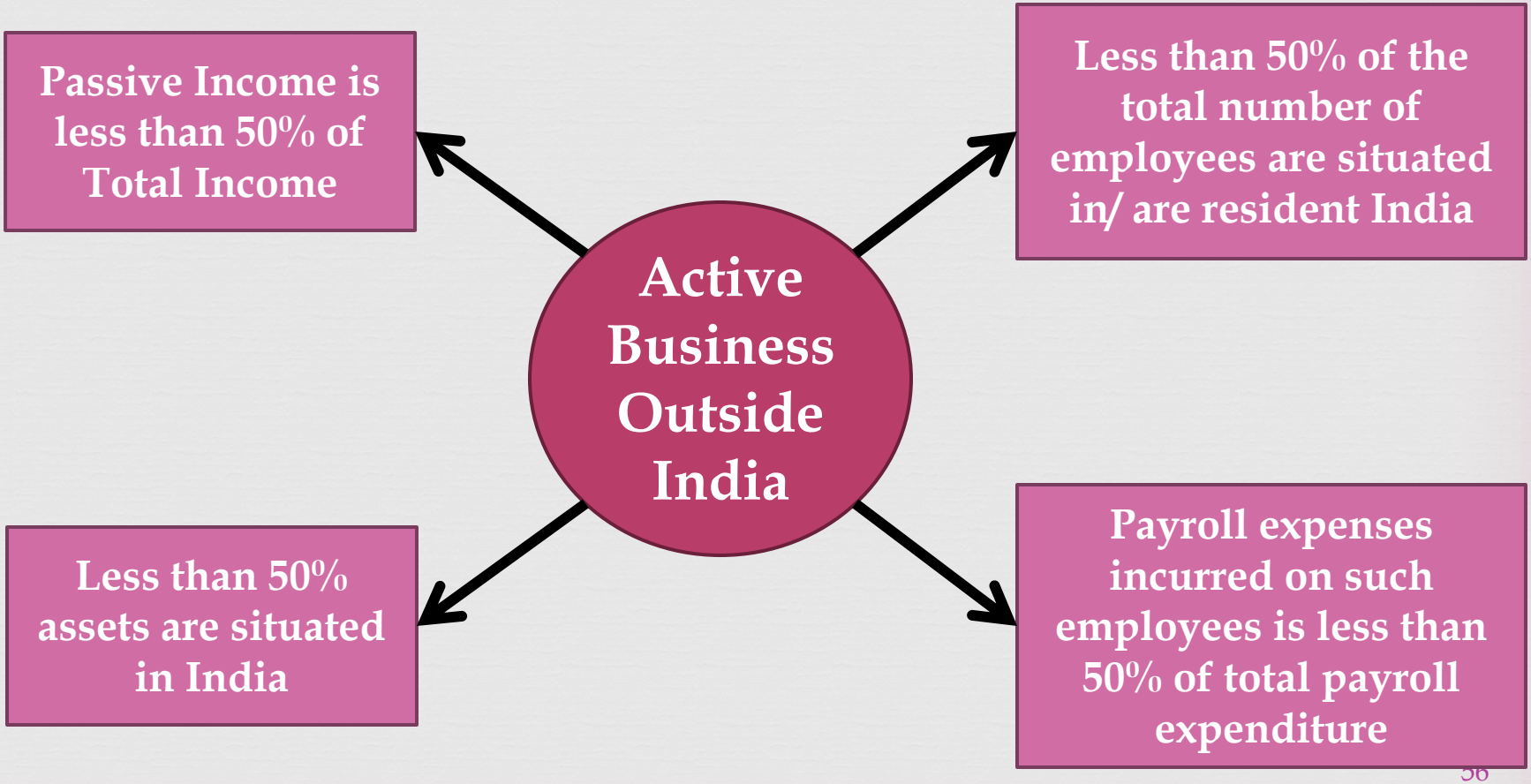
  (2) Determination of place where decisions are in fact made

POEM GUIDELINES

Few Important Aspects from the Guidelines

- Guiding principles to be taken into account
  - Location where Board meetings regularly take place & where decisions are taken/ exercised
  - Location of Executive Committee in cases where authority is delegated
  - Location of company's Head Office
  - Decisions by shareholders where required to be made by Company Law not relevant in determination of POEM
  - Day to day routine operational decisions are irrelevant
- If these factors don't lead to clear identification of location of POEM then following secondary factors to be considered
  - (a) Place where main & substantial activity of company is carried out
  - (b) Place where the accounting records of the company are kept
- 5 examples are given to elaborate the concept

POEM Guidelines



GAAR

FAQs on GAAR

- Soon after the circular on POEM, on 27th January, 2017 the CBDT issued a circular containing clarifications in the form of answers to 16 "Frequently Asked Questions" on GAAR.

- The FAQs dealt with topics like GAAR v/s SAAR, grandfathering of previous actions, AAR and court approved structures, and the manner of invoking GAAR.

- FAQ 1 – Coexistence with SAAR
- FAQ 2 – Treaty override where LOB test is satisfied
- FAQ 3 – Right of taxpayer to implement transaction
- FAQ 4 – GAAR in certain situations relating to FPIs
- FAQ 5 – Grandfathering of Bonus, Conversions and Share splits
- FAQ 6 – Coverage of grandfathering
- FAQ 7 – GAAR v/s AAR
- FAQ 8 – Arrangements sanctioned by judiciary
- FAQ 9 – Fund choosing treaty in one year and domestic law in next
- FAQ 10 – Invoking GAAR
- FAQ 11 – Notional income & disallowance of actual expenditure
- FAQ 12 – Time periods where GAAR will not apply
- FAQ 13 – Safeguards/ Procedures to invoke GAAR
- FAQ 14 – Calculation of Tax Benefit for invoking GAAR
- FAQ 15 – Can contrary view be taken in subsequent year?
- FAQ 16 – No penalty proceedings under GAAR for 1st 5 years

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