Volume No 3 / 2 – July – September 2014

IFA News Letter
India Branch - Western Chapter

Chairman Speaks

As India promises to usher in a new era of stability, one hopes that this quickly translates into greater clarity & certainty in terms of both policies & practices on the ground.

The environment globally continues its march towards far greater transparency, integration & sharing - & automatic exchange of information.

In the meantime the BEPS project continues to make rapid progress with UK becoming the first country to formally commit implementation of the country-by-country reporting template released by the OECD recently.

The European Commission as you may be aware, has been looking into rulings granted by various member countries – including Ireland, Netherlands & Luxembourg. The European Commission recently published its decision in regard to the rulings granted to Apple group in Ireland. The Commission's preliminary view is that the ruling in favour of Apple group constituted "state aid". The decision inter alia states that:

"the Commission is of the opinion that the contested rulings do not comply with the arm's length principle. Accordingly, the Commission is of the opinion that through those rulings the Irish authorities confer an advantage on Apple. That advantage is obtained every year and on-going, when the annual tax liability is agreed upon by the tax authorities in view of that ruling."

This could have a direct impact on the confidence of taxpayers in the prevailing practice of obtaining such rulings in some of these jurisdictions.

The Mumbai Congress is now just round the corner & there is considerable excitement & expectation all around. The Organising Committee is sparing no efforts to make this a memorable event. As we prepare to welcome some of the finest brains on International Tax to India, I would urge each one of you to actively participate & take full advantage of this unique opportunity.

Editor Speaks

Friends,

It gives me immense pleasure in presenting this issue of News Letter.

From New Delhi in 1997 to Mumbai in 2014! Long passage of 17 years. The 68th Congress of the International Fiscal Association will take place in Mumbai between 12th and 17th October. The preparations are in full swing. The Co Chairmen and the Members of the Organising Committee are looking forward to your valuable participation.

Along with the fun and frolic, this issue contains many important decisions and news items. After the General Elections and the change in the Governing Party in India, the first Annual Fiscal Budget was presented by the Finance Minister. This contains several provisions concerning the International Tax Regime and rationalisation of Transfer Pricing provisions. The other International updates in India, the Global and Indian Court rulings are significant and enchanting as usual.

Transfer Pricing provisions in various dimensions are assuming importance all over the World as counties like Albania, Malaysia, Greece and Czech republic are gearing themselves to tax the profits relating to the transactions giving rise to transfer Pricing. In Spain the entire Tax System is being reformed. FATCA having born in the United States of America is being recognised across the world through Intergovernmental Agreement.

The effort of OECD in the arena of international tax is immense. The OECD has released discussion drafts on taxation of digital economy under Action 1 of BEPS project and on Transfer Pricing documentation. Further, they have released standard for automatic exchange of information in tax matters.

So much for the contents of this issue.

Cheers,

Tara.

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Courts Speak

I. Indian Rulings

Anand Patel
Chartered Accountant

1. Centrica India Offshore Private Limited[1]

The High Court held that employees seconded to provide business support services constitute Service PE in India. Further, such services also "make available" technical knowledge, skills, etc and therefore, are taxable as FTS

The Taxpayer, an Indian company, provided back office support services to its overseas group entities. During initial years of its operation, the taxpayer sought few employees on 'secondment' from its overseas entities. Salary payments of these employees were reimbursed at cost.

On application before AAR, based on terms of the secondment agreement, the AAR held that overseas entities constitute Service PE on account of secondment of employees.

On filing of writ petition before the Delhi High Court, the Court held that secondment of employees amounts to provision of services and since their services to the taxpayer make available technical knowledge, reimbursement to overseas entities is Fees for Technical Services as per India-USA and India-Canada DTAA.

On question of Service PE, the Court observed that there does not exist employment relationship between the taxpayer and secondees. This was based on certain clauses of the secondment agreement which provided that the taxpayer did not have right to terminate the secondment arrangement, no clear obligation on the taxpayer to pay and bear salary costs of the secondees, etc. Based on the same, the Court held that secondees in India constitute Service PE in India.

2. Renoir Consulting Limited[2]

The Tribunal holds that continuous performance of service from hotel rooms, being place at disposal, constitutes fixed place PE in India

The Taxpayer, a Mauritius Company, had entered into is a service contract with its India clients. Its employees had visited India. The revenue authorities assessed the income from such service contracts as business income on the ground that taxpayer had a PE in India.

The Tribunal observed that the word 'Permanent' in the term Permanent Establishment does not signify a permanent character, or that the right to use the place should be perpetual, but that there must be a certain degree of permanence.

The Tribunal held that a fixed place PE, as contemplated under Article 5 of the DTAA, does not imply to be a place where the top management of the company is located. Also, such fixed place PE may be owned, rented or otherwise acquired in any other manner. In order to complete huge contract from the Indian company, the taxpayer's extensive execution and continued presence over the indefinite period of the contract was required for which the taxpayer had some place at its disposal. Based on the nature of work and method of operation of the taxpayer, the Tribunal held that there is a fixed place PE of the taxpayer in India.

3. Redington (India) Limited[3]

The Tribunal held that, in absence of cost to the taxpayer, the transaction of provision of corporate guarantee does not fall under purview of transfer pricing

The Taxpayer, an Indian company, provides supply chain solutions for various categories of Information Technology products. The Taxpayer had two wholly owned overseas subsidiary namely RGF Gulf and RIML Mauritius and a step down subsidiary namely RIHL Cayman. The Taxpayer had transferred the entire shareholding in RGF Gulf to RIHL Cayman without any consideration. The Taxpayer also had outstanding corporate guarantee on behalf of its AEs without any guarantee fee in prior years. Further, the taxpayer had paid trademark fees for use of the 'REDINGTON' trademark from its AE.

The Taxpayer considered the transfer as exempt under Section 47(xii) of the Income-tax Act, 1961 ("the IT Act") and also claimed that the provisions of transfer pricing were not applicable in the given case. The Tribunal also observed that corporate guarantee was extended by the Taxpayer for the overall interests of its business. Further the TPO held that there was no rationale for the taxpayer to pay trademark fee and accordingly determined the arm's length price of the fee at Nil.

The Tribunal held the term gift is not limited to gifts granted by natural person as it is not qualified by attributes like love and affection. As the essential ingredients of a valid gift being existence of a property, voluntary transfer, and absence of consideration was present in the transfer made by the Taxpayer, although being a company, to its AE, the transaction is in the nature of gift under Section 47(xii) of the IT Act. Accordingly, such transfer is not taxable as capital gains under the IT Act. Transfer of shares by the Taxpayer without any consideration that in case of gift since no income arises in the hands of the Taxpayers, the provisions of transfer pricing are not applicable. The Tribunal, relying on the decision of Bharti Airtel Ltd., held

[1] 364 ITR 336 (Delhi)
[2] 64 SOT 28 (Mumbai)
[3] ITA No.513/Mds/2014

that as extension of corporate guarantee does not have any bearing on the profit, income, losses or assets of the Taxpayer, such transaction is not covered within the ambit of transfer pricing. With respect to the determination of arm's length price of trademark fee, the Tribunal observed that there was nothing unusual in paying fees for use of trademark if such expenditure is justified by commercial expediency which is to be determined by the Taxpayer. Accordingly, the Tribunal deleted the transfer pricing adjustment made on payment of trademark fee.

4. *M/s MISC Berhad*[4]

The Tribunal held that, in cases where there is a compete linkage of voyage, the entire profit earned by the taxpayer including the profits earned under slot charter arrangement for a part of the voyage, is covered by Article 8 of the India-Malaysia DTAA

The Taxpayer, a tax resident of Malaysia, is engaged in the business of shipping in international traffic. With respect to India, the Taxpayer books cargo from customers in India. The transportation of the cargo from the Indian port to the hub port is carried out under a slot charter arrangement. Thereafter from the hub port to the final destination port, the cargo is transported through the mother vessel, owned or leased by the Taxpayer.

The tax authorities contended that the benefit the India- Malaysia DTAA should not be available to that part of the transaction, where the cargo is transported under slot charter arrangement with a third party feeder vessel as chartering of some space or a slot cannot be the same as chartering the entire ship. What is envisaged to be covered within Article 8 is a case where the entire ship is chartered thereby allowing the Taxpayer to exercise substantial control over the ship. The Taxpayers, on the other hand contended that the entire transaction was inextricably linked and cannot be segregated. This was also supported by the fact that the Taxpayer had issued a single invoice for the entire voyage and had also borne the risks and responsibilities associated with the entire voyage.

The Tribunal held that operation of a ship can be done either through one's own/ leased ships or through a charter arrangement. Further the word charter includes chartering a part of the ship/slot. To arrive at this conclusion it placed reliance on Chapter – XIIG of the IT Act where charter of a ship includes slot charterer arrangement. It also found support in the decision of Balaji Shipping UK Ltd. The fact that the Taxpayer had established complete linkage of the voyage (bill of lading being the documentary evidence for the same) also proved that the entire transaction in one and cannot be segregated from the scope of "operations of ship" as defined in Article 8 of India-Malaysia DTAA. Accordingly, the benefit of the treaty provisions cannot be denied to the Taxpayer.

5. *GFA Anlagenbau Gmbh v DCIT*[5]

The Tribunal held that PE does not get constituted in absence of an independent site operation under India-Germany DTAA

The Taxpayer, a tax resident of Germany, is engaged in operation of supervision, erection and commissioning of Steel and allied plants. It had entered into contracts with 4 Indian entities with plants in India and received consideration for technical and supervision services.

The Taxpayer had engaged foreign technicians at work sites to carry out technical and supervisory services. The total stay of these technicians on one project (out of four projects) had exceeded 183 days. The tax authorities contended that the Taxpayer had a PE in India and also its services in India were effectively connected to the PE.

The Tribunal held that supervisory services are considered as fees for technical services under the IT Act. Also, in absence of right to operate India project sites independently, supervisory activities would not constitute PE under the IT Act.

On question of constitution of PE under India-Germany DTAA, the Tribunal observed that the Taxpayer did not have construction site of fixed place at its disposal. Thus, only supervisory activities by themselves can not constitute PE.

The Tribunal further observed that it is incorrect to aggregate all contracts of the foreign company in India and consider it as one. Unless otherwise linked with each other, contracts should be individually assessed with respect to the duration test.

II. Overseas Rulings

Pratikshit Misra
Chartered Accountant

1. *Marzen Artistic Aluminum Ltd (Tax Court of Canada)*[6]

Payment of service fees to a wholly owned subsidiary which is a shell company and subsequent earning of exempt dividends from such shell company viewed adversely. Accordingly, the payment of service fee is not allowable as deduction for tax purposes from a Canadian transfer pricing perspective

The taxpayer (tax resident of Canada) had a group company ('SWI') in United States of America to which it sold goods. SWI sold goods in Washington but was incurring losses. The taxpayer approached a management consultant ('Mr C'). Mr C was a tax

[4] TS-418-ITAT-2014(Mum)

[5] TS-383-ITAT-2014 (Hyd)

[6] 2014 TCC 194 dated 10th June 2014

resident of Barbados and was engaged in providing management and administrative services to various companies globally for approx. USD 32,500 per company. Mr C advised the taxpayer to focus on selling its goods in California instead of Washington. Mr C was not provided any remuneration for such advise. The taxpayer subsequently set up a company ('SII') in Barbados of which Mr C was a director.SII entered into a Marketing and Sales service agreement with the taxpayer for which it was remunerated by SII. Further, SII was entitled to a onetime bonus of 10% of the sales by the Taxpayer in USA if the sales exceeded USD 10 million. Subsequently, the taxpayer sold goods to SWI, which were sold by SWI to customers in USA without profit. However, the sales in USA increased significantly for the Group as a whole. *The payments by the taxpayer to SII was claimed as tax deductible expenditure by the taxpayer. Subsequently, SII declared dividend to the taxpayer, which was exempt from tax in Canada.*

The Canadian Revenue authorities ('CRA') contended that the payment by the taxpayer to SII under the Marketing and Sales service agreement as well as the onetime bonus did not meet the arm's length price as per the Canadian transfer pricing regulations. The CRA observed that there was no evidence of SII rendering any meaningful services to the taxpayer. The CRA also levied penalty on the taxpayer for the transfer pricing adjustment.

The Canadian tax court ruled against the taxpayer observing that SII is a shell entity with no personnel and assets. Further, the role of Mr C (as a director of SII) is unclear and the advice rendered by Mr C to the taxpayer appears to be in his personal capacity. The tax court thus held that the payments to SII were only to secure a tax benefit for the taxpayer and subsequently earn dividends which were exempt in Canada. Accordingly, the Court held that only payment of USD 32,500 (which was generally charged by Mr C for management and administrative services) to SII meet's the arm's length price.

2. Lehigh Cement Limited (Federal Court of Appeal of Canada)[7]

Anti-avoidance provisions cannot be invoked unless tax avoidance was the 'principal purpose' for acquiring shares of foreign company and earning exempt foreign dividends

Lehigh Cement Limited ('Lehigh) is a Canadian tax resident. Lehigh borrowed funds and invested in shares of CBR ICA (a tax resident of Luxembourg). CBR USA (a group company in USA)had incurred significant losses. CBR USA had borrowed funds from CBR ICA and another Belgian entity. Lehigh and the group entities engaged in a series of transactions to shift the loan of CBR USA and allow Lehigh to earn exempt dividends as under:

(i) Lehigh took a loan from Citibank; (ii) Citibank sold the loan to a group company of Lehigh in Belgium; (iii) Lehigh invested in shares of a new USA entity ('NAM LLC'); (iv) NAM LLC granted a loan to CBR USA; (v) CBR USA repaid its existing loan from CBR ICA and also paid dividends to CBR ICA; (vi) CBR ICA used such funds to declare dividend to Lehigh; (vii) CBR USA claimed deduction for the interest on loan from NAM LLC; (viii) NAM LLC declared dividend to Lehigh from such interest income.

The relevant tax benefits for Lehigh from a Canadian tax perspective were (i) the dividends from CBR ICA and NAM LLC were exempt from tax in Canada; (ii) the interest paid by Lehigh on the loan from Citibank was claimed as tax deductible expenditure.

The CRA invoked the anti-avoidance provisions to hold that Lehigh's investment in NAM LLC was designed to gain tax advantage in Canada due to the tax exemption for dividends.

Ruling in favour of Lehigh, the Federal Court of Appeal held that (i) for invoking the anti-avoidance provisions, it needs to be established that the principal purpose for Lehigh to acquire shares in NAM LLC was tax avoidance; (ii) in invoking the anti-avoidance provisions, the CRA cannot see the principal purpose of the entire series of transactions and can only evaluate the principal purpose for acquisition of shares; (iii) for invoking the anti-avoidance provisions, the acquisition of shares for tax avoidance has to be the main / dominant purpose and not just one of the purposes (iv) in the present case, the main purpose for acquisition of shares in NAM LLC was not tax avoidance.

3. Resource Capital Fund III LP (Federal Court of Australia)[8]

A limited partnership which is treated as transparent entity in USA cannot seek exemption from tax in Australia under the Australia – USA tax treaty

Resource Capital Fund III LP ('taxpayer') was a limited liability partnership registered in Cayman Islands. 97% of its partners were tax residents of USA. The taxpayer was a transparent entity for US tax purposes. The taxpayer held shares in an Australian mining company. The taxpayer earned capital gains on sale of shares of the Australian mining company. The taxpayer claimed that it was not liable to tax in Australia on such capital gains.

The Australian tax authorities observed that the taxpayer is a corporate entity as per Australian domestic tax rules. The Australian tax authorities further held that the capital gains of the taxpayer would be taxable in Australia.

The taxpayer *inter alia* argued that Article 13 – capital gains of the Australia-USA tax treaty did not grant taxing rights to Australia.

Ruling against the taxpayer, the Federal Court held that the taxpayer (being a transparent entity) was not a tax resident of USA and thus the provisions of Australia-US tax treaty would not apply. Accordingly, Australia had the right to tax the capital gains earned by the taxpayer from sale of shares of an Australian mining company.

[7] 2014 FCA 103 dated 23rd April 2014

[8] 2014 FCAFC 37 dated 3rd April 2014

International Tax Updates - India and Global

Isha Sekhri, Sagar Wagh
Chartered Accountants

I. India

1. Indian Government releases Direct Taxes Code 2013

The Government of India has released a revised version of the Direct Taxes Code, 2013, which aligns with the provisions of the Income-tax Law, including introduction of General Anti Avoidance Rules, provisions for transfer of indirect transfer of assets and widened source rule in case of royalty and fees for technical services.

Source: Press Release dated 31 March 2014

2. CBDT signs 5 Advance Pricing Arrangements

The CBDT has signed the first batch of 5 unilateral Advance Pricing Agreements ('APA') on 31st March 2014. The agreements cover a period of 5 years from AY 2014-15 to AY 2018-19 and specify the arm's length price for the covered international transactions entered into by the taxpayers. These agreements cover a range of international transactions, including interest payments, corporate guarantees, non-binding investment advisory services and contract manufacturing. The agreements pertain to different industrial sectors including pharmaceuticals, telecom, exploration and financial services.

The agreements provide a complete certainty to the taxpayers for 5 years with regard to the covered international transactions.

Source: Press Release No.402/92/2006-MC, dated 31-3-2014

3. India has adopted a declaration on automatic exchange of information in tax matters

On May 6, 2014, 46 countries, including India, besides the European Union, meeting under the auspices of the OECD, adopted a Declaration on Automatic Exchange of Information in Tax Matters.

The Declaration recognises that investments kept offshore by tax payers should not go untaxed. It stresses that a key aspect of cooperation between tax administrations is effective exchange of information on automatic basis subject to appropriate safeguards.

The Declaration has referred to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters that has been signed by over 60 countries including almost all OECD countries and all G-20 countries. Switzerland is a signatory to the Convention but it is reported that Switzerland has not yet ratified the Convention. The Declaration called upon all countries to sign and ratify the multilateral Convention.

India has signed the Multilateral Convention and, as stated above, is also a signatory to the Declaration adopted on May 6, 2014.

Source: Press Statement, dated 12-5-2014

4. Constitution of special investigating team (SIT) to implement decision of Supreme Court on large amounts of money stashed abroad

The Union Cabinet, on 27 May 2014, has approved constitution of Special Investigating Team (SIT) to implement the decision of the Hon'ble Supreme Court on large amounts of money stashed abroad by evading taxes or generated through unlawful activities.

The SIT will be headed by Hon'ble Mr. Justice M.B. Shah, former Judge of the Supreme Court as Chairman and Hon'ble Mr. Justice Arijit Pasayat, former Judge as Vice Chairman. It will have a high level committee. The SIT has been charged with the responsibility and duties of investigation, initiation of proceedings and prosecution in cases of Hasan Ali and other matters involving unaccounted money. SIT shall have jurisdiction in the cases where investigations have already commenced or are pending or awaiting to be initiated or have been completed. SIT will prepare a comprehensive action plan including creation of necessary institutional structure that could enable the country to fight the battle against unaccounted money.

Source: Press Release, dated 27-5-2014

5. Remittances to Non-Residents – Tax deducted at source

The Reserve Bank of India has reviewed the policy relating to issue of instructions under Foreign Exchange Management Act, 1999 (FEMA), clarifying tax issues. It has now been decided that Reserve Bank of India will not issue any instructions under the FEMA, in this regard. It shall be mandatory on the part of Authorised Dealers to comply with the requirement of the tax laws, as applicable.

Source: A.P. (DIR Series) (2013-14) Circular No. 151, dated 30-6-2014

6. Agreement for exchange of information with respect to taxes with Principality Of Liechtenstein

The GOI had entered into an agreement with the Government of the Principality of Liechtenstein, for the exchange of information on tax matters on the 28th day of March, 2013. The date of entry into force of the said agreement was 20 January, 2014. This agreement has effect for all requests made in respect of taxable periods beginning on or after 1st April, 2013, in accordance with paragraph 2 of the Article 11 of the said agreement. The Central Government, vide notification dated 6 June 2014, has amended articles in the said agreement and such regulations shall have effect for all requests made in respect of taxable periods beginning on or after 1st April, 2013.

Source: Notification No. 30/2014[F.NO.503/4/2009-FTD-I]/SO 1458(E), dated 6-6-2014

II. Global

1. Japanese government announces plan to lower corporate tax rate to below 30 percent

On 24 June 2014, his Cabinet approved the 2014 basic policies for economic and fiscal management that includes a plan to reduce the current 35.6% Japanese corporate tax rate over several years to below 30%, beginning in 2015. Although no official announcement has yet been made with respect to an ultimate tax rate, Japanese prime minister informally indicated the first target rate could be as low as the current Germany rate of approximately 29.6%. But to compensate revenue losses resulting from the tax reductions, the Government also plans to broaden the tax base by reducing or eliminating certain credits and deductions.

2. Inland Revenue Board of Malaysia introduces transfer pricing documentation confirmation

The Inland Revenue Board of Malaysia has formally introduced an additional question in the 2014 Income Tax Return (Form C) asking taxpayers to indicate if they have prepared transfer pricing documentation for the year of assessment 2014 by way of a "Yes or No" response.

The first set of taxpayers to be affected by the introduction of this amendment in Form C will be companies with a financial year end of 31 January 2014 for which this their tax return will be due for filing within seven months (i.e., 30 August 2014).

3. Singapore issues guidance on income tax treatment of hybrid instruments

On 19 May 2014, the Inland Revenue Authority of Singapore (IRAS) issued guidance on the income tax treatment of hybrid instruments (eg. redeemable preference shares, convertible bonds, perpetual notes and profit participating loans). The IRAS has prescribed two step approach for characterization of hybrid instruments.

The first step is to characterize the instrument as per its legal form. For example : If the legal terms of the instrument indicates the ownership instruments in the issuer, then the hybrid instrument would be characterized as equity. If the legal form is not indicative of or does not reflect the legal rights and obligations then, the IRAS will adopt step 2 i.e. examining the facts and circumstances surrounding the instrument, as well as a combination of factors. The IRAS has listed eight factors (on illustrative basis) which may be considered for characterizing an instrument. They are as follows : nature of interest acquired, right to participate in issuer's business, voting rights conferred by the instrument, obligation to repay the principal amount, payout, Investor's right to enforce payment, classification by other regulatory authority, ranking for repayment in the event of liquidation or dissolution.

The characterization of the hybrid instrument will be determined based on a combination of the above factors and the facts and circumstances of the case.

If hybrid instrument is characterized as equity, then the payment by issuer of instrument will be characterized as dividend. Such dividend payment will not be tax deductible in hands of issuer, while the receipt will be exempt in hands of investor. On the other hand, if the instrument is characterized as equity, then payment by issuer of instrument will be characterized as interest. Such interest payment will be tax deductible in hands of issuer, while the receipt will be taxable in hands of investor (unless contrary provided)

4. Australian Tax Office issues final guidance on deductibility of support payments to foreign subsidiaries

On 4 June 2014, the Australian Tax Office (ATO) released a tax determination (TD 2014/14) addressing the income tax deductibility of payments made by Australian companies to foreign subsidiaries.

As per new guidance, except capital support payments (relating to assets or other capital items), all other support payments would be tax deductible in hands of Australian holding companies, provided such support payments are genuine.

The examples of deductible support payments include : service fees paid by an Australian parent company to a foreign subsidiary that are wholly based on the achievement of a particular level of profit or the avoidance of losses in that subsidiary, direct payment of third party expenses by an Australian parent company for services that are provided directly to a foreign subsidiary, Excess marketing and brand building expenses paid by an Australian parent company to a foreign subsidiary over an extended period of time, payments made by an Australian parent company to a foreign subsidiary in connection with financial or performance guarantee arrangements etc.

5. US Senator introduces bill to tighten inversion rules under Section 7874

On 20 May 2014, Sen. Carl Levin introduced *The Stop Corporate Inversions Act of 2014* (the Bill), which is intended to significantly expand the scope of transactions subject to the anti-inversion rules. The Bill introduces a new category of foreign corporations that would be treated as domestic for US federal tax purposes. Specifically, the Bill would treat as domestic any foreign corporation that acquires substantially all the properties held directly or indirectly by a domestic corporation or substantially all the properties (or substantially all the properties constituting a trade or business) of a domestic partnership, and either: (1) more than 50% of the stock of the foreign corporation is owned by former shareholders or former partners of the domestic entity by reason of their interests in the domestic entity; or (2) the foreign acquiring corporation has significant domestic activities and its "mind" and management is primarily in the United States.

The effective date of the Bill is retroactive to 8 May 2014, and will sunset two years after that date. According to Sen. Levin, the two-year sunset is intended to give Congress time to "consider a long-term solution as part of general corporate tax reform

6. Albania introduces new transfer pricing legislation

The Albanian Parliament passed new transfer pricing rules that become effective on 4 June 2014. The new legislation is aimed at providing a more comprehensive regulatory framework on transfer pricing, aligned with the OECD Transfer Pricing Guidelines of 2010.

Failure to prepare transfer pricing documentation is not sanctioned with penalties, but fulfilling such requirement protects the taxpayer from the assessment of penalties in case of transfer pricing related audit adjustments.

The first period of application of the transfer pricing documentation requirement is for transactions carried out 4 June 2014 or later and for recurring transactions continuing after that date.

The new rules provide definitions of controlled transactions, which, among others, include transactions with any entity resident in a tax haven jurisdiction, related parties and comparability. Moreover, the new law contains a description of the accepted transfer pricing methods, which are in line with the OECD Guidelines.

7. Greece reforms mandatory contents of transfer pricing documentation file

On 29 May 2014, Greece published a new Ministerial Decree (Decree) that amends the one issued in April to regulate the mandatory contents of the Transfer Pricing Documentation File in light of the new Income Tax and Tax Procedures Codes. This Decree affects intercompany transactions pertaining to fiscal years starting from 1 January 2014 onward.

The documentation requirement applies to taxpayers with total value of intercompany transactions of more than €200,000 or €100,000, depending on whether their turnover is more or less than €5,000,000 (turnover based on tax accounting rules or based on the amount considered for IFRS consolidation purposes). The two-tier approach, with a Master File and a Local File, is adopted by the new Decree.

8. Spanish Government approves draft bill extending responsibility for tax significant transactions to Board of Directors

On 23 May 2014, the Spanish Government approved a draft bill which modifies the Spanish Company Law with the stated aim of improving corporate governance practices of listed companies.

As per proposed amendments to Spanish Company Law:

The non-transferrable duties of board of directors would include: (i) the determination and management of the company's tax risk policy; (ii) the approval of investments or transactions with a high tax risk; (iii) the approval of the incorporation or acquisition of special purpose vehicles or entities located in a tax haven; and (iv) the determination of the company's tax strategy.

Further, the duties of company's audit committee would include the supervision of the efficiency of the tax risk management control systems, as well as the obligation to inform the Board of Directors of the incorporation or acquisition of special purpose vehicles or entities located in a tax haven.

The annual corporate governance report would include a description of tax risk management control systems of the company.

9. Czech Republic - New statement for related-party transactions

The Czech tax administration has introduced a new attachment that will be required for reporting certain related-party transactions and filed with the taxpayer's tax return. Partly inspired by the OECD's BEPS (base erosion and profit shifting) plan, the new mandatory attachment is intended to allow for the systematic collection of basic information on selected transactions with related parties—such as the residence of the related parties, the transaction volume, and an overview of the transaction. Completing the attachment will be mandatory for companies that satisfy a specific requirement—such as having assets in excess of CZK 40 million, net turnover of CZK 80 million, or an average number of 50 employees

10. Spain releases draft bill of Spanish tax system reform

The draft bill gradually reduces the corporate income tax (CIT) rate from 30% to 25% in 2016 with an interim 28% rate applicable in 2015 while eliminating most of the tax deductions and other benefits.

In line with the CIT proposed amendments, the tax rate applicable to permanent establishments in Spain is reduced from 30% to 28% in FY 2015 and to 25% from FY 2016 onwards.

The Spanish non-resident income tax rules provide for a 0% withholding tax on dividend and royalty payments made to EU resident recipients, where certain requirements are met.

11. OECD Updates

OECD releases discussion draft on transfer pricing documentation

On 30 January 2014, as a part of Action 13 of BEPS project, the OECD released the discussion draft on transfer pricing documentation and country by country reporting template. The Discussion Draft is in the form of a proposed revision to the documentation chapter of the OECD Transfer Pricing Guidelines. The discussion draft proposes three tiered documentation viz. master file, local file and country by country reporting template.

OECD releases discussion draft on taxation of digital economy under Action 1 of BEPS project

On 24 March 2014, the OECD released a discussion draft in connection with Action 1 on addressing the tax challenges of the digital economy under its Action Plan on BEPS. The document, "BEPS Action 1: Address the Tax Challenges of the Digital Economy," (the Discussion Draft) contains a discussion of the key features and business models in a digital economy, the opportunities for BEPS that can arise in a digital economy, and some potential options (eg. virtual PE, withholding tax etc...)to address the tax challenges raised by the digital economy.

OECD held its annual tax conference in Washington DC

On 2-3 June 2014, OECD held its annual tax conference in Washington DC. The agenda focused almost exclusively on the Base Erosion and Profit Shifting (BEPS) project. Several senior members of the OECD Secretariat participated in the conference, along with tax officials with responsibility for work on the BEPS project from several OECD and G20 countries, including officials from the United States, Canada, China, France, Germany, Mexico and the United Kingdom. Panel discussions reviewed developments on key 2014 Actions. The OECD secretariat and country officials also provided updates regarding the next steps in the BEPS project, looking both at the specific output to be delivered in September 2014 and the work that will continue on those 2014 Actions beyond 2014 and at the ongoing work on the 2015 Actions. In addition, one panel focused on developments on the US FATCA rules and the related OECD project on development of a global common reporting standard for information about financial accounts.

OECD releases standard for automatic exchange of information in tax matters

On 21 July 2014, published the first edition of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (The Standard). The Standard includes the text of the Model Competent Authority Agreement, the Common Reporting Standard and the Commentaries thereon as read on 15 July 2014 after the approval of The Standard by the Council of the OECD. he Standard is formed of three sections: Part I provides an introduction to The Standard, Part II contains the text of the Model Competent Authority Agreement (Model CAA) and the Common Reporting and Due Diligence Standard (CRS), Part III contains the Commentaries on the Model CAA and the CRS as well as a number of Annexes

12. Foreign Account Tax Compliance Act Updates

French senate approves FATCA intergovernmental agreement

On 22 July 2014, France's Senate approved the Intergovernmental Agreement (IGA) entered into between the US and France on 14 November 2013 to implement the US Foreign Account Tax Compliance Act (FATCA). The Assembly vote may follow in September after the summer break.

Hong Kong treated as having an IGA in effect, releases FATCA FAQs

On 9 May 2014, Hong Kong was added to the list of jurisdictions that have reached an "agreement in substance" for the pending Model 2 Intergovernmental Agreement (IGA) with the United States under the Foreign Account Tax Compliance Act (FATCA). The US Internal Revenue Service (IRS) had previously announced that it will treat "agreement in substance" IGAs as being an "agreement in effect" as of the consent date so long as the IGA is signed by 31 December 2014

India Budget 2014

An Analysis of International Tax Provisions

Harshal Bhuta, CA, ADIT

Finance (No. 2) Bill, 2014 ('FB') was presented by Finance Minister - Mr. Arun Jaitely in Parliament on 10th July 2014. The Bill was passed by Lok Sabha on 25th July 2014 with some amendments and was cleared by Rajya Sabha on 31st July 2014. FB was enacted into the Finance (No.2) Act, 2014 ('FA') with the assent of the President of India on August 6, 2014.

An analysis of International Tax Provisions of India Budget 2014 has been presented hereunder:

1. Characterisation of Income in case of Foreign Institutional Investors (Sec. 2(14))

FA Amendment: Any security held by Foreign Portfolio Investors (FPI) (referred as Foreign institutional Investors (FII) in the Act) which has invested in such security in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 would be treated as capital asset only so that any income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain.

Date of Effect: From Assessment Year 2015-16.

*(**Analysis:** There have been conflicting judicial pronouncements in the case of FIIs in the past as to whether the income arising from transaction in securities is capital gain or business income. This amendment would put the controversy to rest as far as taxation under Indian Income Tax Act is concerned and would facilitate relocation of fund managers to India who until now have been operating out of India for want of clarity under domestic tax laws. | However, the amendment does not mention anything about characterization of such income under respective DTAAs and therefore, there could arise ambiguity as to whether FIIs operating out of India could claim treaty benefits. Generally, FIIs investing from jurisdictions wherein capital gains is exempt under their DTAA with India, have been arguing that such income is in the nature of capital gains, whereas FIIs investing from jurisdictions other than the former, have been arguing that such income constitutes business income and in absence of Permanent Establishment in the source country, such income is exempt under relevant provisions of the DTAA. Additionally, the residence country could adopt a different characterization of such income in terms of interpretation of DTAA and therefore refuse to grant credit for taxes paid in India, if any. Uncertainty therefore still remains as far as taxability under respective DTAA is concerned. | This amendment brings disparity between tax treatment in the case of FIIs vis-à-vis domestic taxpayers since such controversy would continue to exist in the case of domestic taxpayers notwithstanding that such characterization depends on facts of each case.)*

2. Long-term Capital Gains on debt oriented Mutual Fund and its qualification as Short-term capital asset (Sec 2(42A))

FA Amendment: An unlisted security and a unit of a mutual fund (other than an equity oriented mutual fund) shall qualify as short-term capital asset if it is held for not more than 36 months instead of 12 months at present.

Date of Effect: 11th July 2014 onwards.

*(**Analysis:** This amendment deprives unlisted securities as well as debt mutual funds of the benefit of shorter holding period in order to qualify as long term capital asset. Although its retrospectivity for transfers taking place between 1st April 2014 & 10th July 2014 has been removed subsequently at the time of passing FB in Lok Sabha, FDI investments made in India after 11th July 2013 would be significantly affected since the retrospective nature of the amendment still continues for such investments.)*

3. Transfer of Government Security by one non-resident to another non-resident (Sec. 47)

FA Amendment: Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident shall not be considered as transfer for the purpose of charging capital gains.

Date of Effect: From Assessment Year 2015-16.

*(**Analysis:** As stated in Memorandum explaining the provisions in The Finance (No. 2) Bill, 2014, this amendment has been brought in to with a view to facilitate listing and trading of Government securities outside India.)*

4. Rationalisation of the Definition of International Transaction (Sec. 92B)

FA Amendment: Clarification introduced under Sec. 92B(2) with respect to 'Deemed International Transaction' that the unrelated person may or may not be a non-resident.

Date of Effect: From Assessment Year 2015-16.

*(**Analysis:** Section 92B(2) was enacted to cover those cases where two associated enterprises intend to have an international transaction but want to avoid transfer pricing provisions by interposing a third party as an intermediary. In such cases, the third party intermediary will generally not be the ultimate consumer of the services or goods. The*

intermediary would facilitate the transfer of services or goods from one enterprise to its associate enterprise with no value addition or insignificant value addition. The intermediary is used to break a transaction into two different parts, which parts when viewed in isolation would not satisfy the requirements of section 92A (Definition of Associated Enterprises). The legal form of the transaction in such circumstances is ignored. The substance of the transaction is given effect to, not by disregarding the existence of the intermediary but by deeming the transaction with the intermediary itself to be one with an associated enterprise. | This amendment has been brought in to overturn Hyderabad ITAT decision in IJM (India) Infrastructure Ltd. vs. ACIT [147 ITD 437] and similar decisions in the case of other associated companies. Under the facts of this case, taxpayer was a limited company promoted by a Malaysian Company. The taxpayer was engaged in the business of works contracts, construction and maintenance of roads, bridges, townships, residential and commercial buildings. It had transactions with a PE of the Malaysian Company in India as well as JVs (JV1 where taxpayer was a partner and JV2 where the Malaysian Company was a partner). After hearing contentions of the taxpayer and revenue department, ITAT eventually held that PE of the Malaysian Company and JVs (assessed as Association of Persons) should be treated as residents in India and therefore transactions between the taxpayer and PE/JVs would not be treated as international transactions for purpose of provisions of Sec. 92B(2) since there was no erosion of Indian tax base. | This amendment is in sync with introduction of Domestic Transfer Pricing Provisions in the recent past wherein Transfer Pricing Provisions apply despite tax neutrality within India.)

5. Introduction of range concept for determination of arm's length price (Sec. 92C)

FA Amendment: Manner to be prescribed for determination of arms length price where more than one price would be determined by the most appropriate method.

Date of Effect: From Assessment Year 2015-16.

*(**Analysis:** Inter-quartile range is an accepted criterion in many countries when calculating arms length price. One of its key advantages over arithmetic mean is that it would ignore the outliers among comparables (i.e. potential comparables with extreme results). Incidentally, absence of range concept has been listed as one of the emerging Transfer Pricing challenges in India in the United Nations Practical Manual on Transfer Pricing. | The current regulations prescribing applicability of arithmetic mean in such cases have effectively been rescinded from 1st April 2014 although the manner of computation under new provisions is yet to be prescribed creating avoidable confusion.)*

6. Roll back provision in Advance Pricing Agreement Scheme (Sec. 92CC)

FA Amendment: Subject to prescribed conditions, procedure and manner, rollback provisions have been introduced for a period not exceeding four previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction to be undertaken in future.

Date of Effect: 1st October, 2014 onwards**.**

*(**Analysis:** APA mechanism has been hugely popular with large taxpayers, some of whom have suffered humongous transfer pricing additions in recent assessment years and are currently litigating at different stages of the appellate machinery. As acknowledged in the Memorandum explaining the provisions in The Finance (No. 2) Bill, 2014, providing for such a mechanism under Indian legislation would lead to reduction in large scale litigation which is currently pending or may arise in future in respect of the transfer pricing matters.)*

7. Tax on long-term capital gains on units (Sec. 112)

FA Amendment: Concessional rate of tax of 10% under Proviso to Sec. 112(1) to be allowed only on long term capital gain to listed securities (other than unit) and zero coupon bonds.

Date of Effect: 11th July 2014 onwards.

*(**Analysis:** Non-resident tax payers would continue to be taxed @ 10% on unlisted mutual fund units which would create disparity vis-à-vis taxation on domestic taxpayers qua such units who would now be taxed @ 20% with indexation benefit in absence of concessional tax rate of 10% without indexation.)*

8. Reduction in tax rate on certain dividends received from foreign companies (Sec. 115BBD)

FA Amendment: Concessional rate of tax of 15% on qualifying foreign dividends under Sec. 115BBD to be extended without limiting it to a particular assessment year.

Date of Effect: From Assessment Year 2015-16.

*(**Analysis:** This amendment has been brought in with a view to encourage Indian companies to repatriate foreign dividends into the country. It would be particularly beneficial for repatriations from overseas investment holding companies before Controlled Foreign Corporation (CFC) provisions kick in with introduction of Direct Tax Code (DTC) in near future.)*

9. Mutual Funds, Securitisation Trusts and Venture Capital Companies or Venture Capital Funds to file return of income (Sec. 139)

FA Amendment: Mutual Fund, Securitization Trust and Venture Capital Company or Venture Capital Fund shall furnish a return of such income of the previous year in the prescribed forms and verified in the prescribed manner and setting forth such other particulars as may be prescribed, if the total income in respect of which such fund, trust or company is assessable, without giving effect to the provisions of section 10, exceeds the maximum amount which is not chargeable to income-tax. Consequently, all the provisions of the Act, so far as may be, shall apply as if it were a return required to be furnished under sub-section (1) of section 139.

Further, in the case of the Mutual Funds and Securitisation Trusts, the requirement of filing of statements before an income-tax authority has been dispensed with by omitting sub-section (3A) of Section 115R and sub-section (3) of Section 115TA.

Date of Effect: From Assessment Year 2015-16.

10. Concessional rate of tax on overseas borrowing (Sec. 194LC, Sec. 206AA)

FA Amendment: Benefit of concessional rate of withholding tax of 5% u/s 194LC on interest paid by an Indian company to non-residents has been extended to borrowings by way of issue of any long-term bond, rather than limiting it to long term infrastructure bonds solely.

Further, the period of borrowing for which aforesaid benefit would be available has been extended by two years i.e. to borrowings made before 1st day of July, 2017.

Consequential amendment under Sec. 206AA has been made to enable exemption to payment for interest on any long-term bond referred to in section 194LC from its applicability.

Date of Effect: 1st October, 2014 onwards.

*(**Analysis:** Sec. 194LC pertains to lower withholding tax rates on External Commercial Borrowings (ECB) and Foreign Currency Convertible Bonds & Foreign Currency Exchangeable Bonds. It is a welcome amendment wherein the scope has been extended to cover issuance of bonds for end use in any sector rather than restricting it to infrastructure sector. It may be noted that while period of borrowing has been extended under Sec. 194LC, the same benefit has not been granted to borrowing by way of rupee denominated bonds under Sec. 194LD. | Further, while Sec. 206AA contains an exception in respect of payment of interest on FCCB/FCEB, there is no such exception for payment of interest on ECB.)*

11. Levy of Penalty by Transfer Pricing Officers (Sec. 271G)

FA Amendment: Section 271G of the Act has been amended to include TPO, as referred to in Section 92CA, as an authority competent to levy the penalty under Section 271G in addition to the Assessing Officer and the Commissioner (Appeals).

Date of Effect: 1st October, 2014 onwards.

*(**Analysis:** Bombay High Court in Vodafone India Service (P.) Ltd vs. Union of India [359 ITR 133] has held that AO is bound to pass an order in conformity with the TPO's order and so he is bound by the TPO's determination and cannot sit in judgment over the same in any respect. Therefore, the present amendment would merely expedite conclusion of transfer pricing assessments due to improved cooperation from taxpayers during such transfer pricing assessments. | It may be noted that similar amendment has not been brought in under Sec. 271AA which prescribes similar quantum of penalty of 2% of value of each International Transaction / Specified Domestic Transaction albeit that Sec. 271AA levies penalty for failure to keep and maintain documentation.)*

12. Taxation Regime for Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (Invit)

Introduction: Real Estate Investment Trusts (REITs) have been used as instruments for pooling of investment in several countries. Infrastructure Investment Trusts (InvITs) is a modified REITS type structure for PPP and other infrastructure projects. The income-investment model of such REITs and Invits (referred to as business trusts) has the following distinctive elements:

(i) the trust would raise capital by way of issue of units (to be listed on a recognised stock exchange) and can also raise debts directly both from resident as well as non-resident investors;

(ii) the income bearing assets would be held by the trust by acquiring controlling or other specific interest in an Indian company (SPV) from the sponsor.

FA Amendment: Specific taxation regime providing for taxation of income in the hands of such trusts and the taxability of the income distributed by such business trusts in the hands of the unit holders of such trusts is given below:–

(i) Treatment of Income in nature of Capital Gains in hands of Unitholders other than Sponsor: The listed units of a business trust, when traded on a recognised stock exchange, would attract same levy of securities transaction tax (STT), and would be given the same tax benefits in respect of taxability of capital gains as equity shares of a company i.e., long term capital gains, would be exempt and short term capital gains would be taxable at the rate of 15%.

(ii) Treatment of Income in nature of Capital Gains in hands of Sponsor: In case of capital gains arising to the sponsor at the time of exchange of shares in SPVs with units of the business trust, the taxation of gains shall be deferred and taxed at the time of disposal of units by the sponsor. However, the preferential capital gains regime (consequential to levy of STT) available in respect of units of business trust will not be available to the sponsor in respect of these units at the time of disposal. Further, for the purpose of computing capital gain, the cost of these units shall be considered as cost of the shares to the sponsor. The holding period of shares shall also be included in the holding period of such units.

(iii) Treatment of Income in nature of Interest: The income by way of interest received by the business trust from SPV would be accorded pass through treatment i.e., there would not be any taxation of such interest income in the hands of the trust and no withholding tax at the level of SPV. However, withholding tax at the rate of 5% in case of payment of interest component of income distributed to non-resident unit holders, at the rate of 10% in respect of payment of interest component of distributed income to a resident unit holder shall be effected by the trust.

(iv) Concessional rate of tax on overseas borrowing: In case of external commercial borrowings by the business trust, the benefit of reduced rate of 5% tax on interest payments to non-resident lenders shall be available on similar conditions, for such period as is provided in Section 194LC of the Act.

(v) Treatment of Income in nature of Dividend: The dividend received by the trust shall be subject to dividend distribution tax at the level of SPV but will be exempt in the hands of the trust, and the dividend component of the income distributed by the trust to unit holders will also be exempt.

(vi) Income in nature of Capital Gains in hands of Business Trust: The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder. Any other income of the trust shall be taxable at the maximum marginal rate.

(vii) The business trust would be required to furnish its return of income.

(viii) The necessary forms to be filed and other reporting requirements to be met by the trust shall be prescribed to implement the above scheme.

Date of Effect: 1st October, 2014 onwards.

*(**Analysis:** This amendment has brought in certainty in taxation aspects of REIT/InvITs model and would facilitate exits by promoters as well as raising capital for stressed assets.)*

13. Retrospective amendments

Finance Minister (FM) in his Budget Speech affirmed the Government's right to introduce retrospective legislation. Further, he stated that Government was committed to provide a stable and predictable taxation regime and announced that all fresh cases arising out of the retrospective amendments of 2012 in respect of indirect transfers and coming to the notice of the Assessing Officers will be scrutinized by a High Level Committee to be constituted by the CBDT before any action is initiated in such cases.

*(**Analysis:** Although FM stated that he is committed to provide a stable and predictable taxation regime to the investor community, he stopped short of doing away with the retrospective amendments to the Income Tax Act 1961 undertaken through the Finance Act 2012. Further, although he acknowledged that few cases of dispute arising out of retrospective amendment have come up in various courts and other legal fora, no measures were announced for an amicable solution to them. Such High Level Committee has been constituted by CBDT vide Order dated 28.08.2014 u/s 119. On lines of principles of natural justice, before the committee conveys its decision to the AO on proposed action by him, the assessee would be given an opportunity of representation. Aforesaid order has set an ambitious tentative time line of 60 days for the committee to convey its decision. Further, such committee has to submit a report of its decisions to CBDT on half yearly basis starting with first report for period ending 31.12.2014)*

14. High Level Committee for regular interaction with trade and industry

FM announced that a High Level Committee would be set up for regular interaction with trade and industry and to ascertain areas where clarity in tax laws is required. Based on the recommendations of the Committee, the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) shall issue appropriate clarifications, wherever considered necessary, on the tax issues within a period of two months.

*(**Analysis:** Since the current Government was elected to power recently, it seems that due to inadequate time for consultation with trade and industry and deliberation thereafter, it could not deal with all representations made before it. This is a welcome move which would enable issuance of clarifications through circulars and/or notifications for bringing in clarity in tax laws rather than introducing them at the time of annual Budget.)*

15. Use of Multiple year data

The Indian transfer pricing regulations stipulate that data to be used in analyzing the comparability of uncontrolled transaction with an international transaction should be the data relating to the financial year in which international transactions have been entered into. However, the rule also provides exception and permits the use of data for the preceding two years if and only if, it is proved that such data reveals a fact which could have an influence on the determination of the arm's length price. Therefore, the exception comes into play only when a proof that earlier year data could have an influence on determination of the arm's length price is provided.

FM has proposed to amend the regulations to allow use of multiple year data.

*(**Analysis:** Use of multiple year data has been a bone of contention between taxpayers and revenue department leading to huge scale litigation especially since OECD Transfer Pricing Guidelines prescribes use of multiple year data for its usefulness in providing information about the relevant business and product life cycles of the comparables.)*

IFA - WRC

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