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The Pulse India | FPI Newsletter

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Pulse is a quick guide to the ongoing tax and regulatory developments in India that are relevant to Foreign Portfolio Investors (FPIs). It highlights key components of changes, their impact on FPIs and the way forward. Our endeavor is to help you comprehend the changes easily and equip you with the requisite knowledge to assist you in staying ahead of the curve.

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Key changes enacted by the Finance Act, 2021 | Impact on FPIs



The Indian President gave his assent to the Finance Act, 2021 on 28 March 2021.

The amendments introduced in the Finance Act, 2021 are effective from 1 April 2021, unless specified otherwise. These amendments are generally in line with those proposed in the Finance Bill, 2021 (issued in February 2021) except for a few modifications. In this alert, we are summarising the final amendments that are relevant for FPIs.

Dividends

Pre-April 2021 position

The Finance Act, 2020 had amended the dividend taxation framework whereby dividends received from Indian Companies (which were earlier exempt in the hands of FPIs) are taxable at the rate of 20 percent plus applicable surcharge and cess, effective 1 April 2020.

Indian companies are required to withhold tax on such dividend income. Until 31 March 2021, Indian companies were mandated to withhold tax at the rate of 20 percent on dividend income paid to FPIs. As a result, wherever a lower tax rate under a tax treaty applies, the excess tax withheld by the company could be utilised against taxes payable on other incomes of the FPI such as capital gains tax payable or it could be reclaimed as a refund from the Indian tax authorities in the annual tax return filed by the FPI.

Amendment in Finance Act, 2021

- Indian companies can withhold taxes at tax treaty rates where such rates are lower than the prescribed withholding tax rate of 20 percent, provided the FPI furnishes tax residency certificate (TRC) to the Indian companies.
- Advance tax liability on dividend income would arise only after declaration / payment of dividend.

Our comments

Though the Finance Act, 2021 has enabled Indian companies to withhold tax (on dividends paid to FPIs) at treaty rates, there could be certain operational challenges in collation and furnishing of TRC and other documents (including Form 10F, no PE declarations, etc.,), needed by Indian companies from the FPIs for this purpose.

Revision in statute of limitations and related timelines

The Finance Act, 2021 has revamped the timelines to initiate / complete scrutiny assessments (i.e., audit by tax authorities) and filing of belated / revised tax returns. Please refer to the table below:

Particulars	Existing timeline	Revised timeline
Statute of limitation	 a) 5 years from the end of the fiscal year to which the income pertains, where income in question is less that INR 100,000 b) 7 years from the end of the fiscal year to which the income pertains, where income in question is equal to or more than INR 100,000 c) 17 years from the end of the fiscal year to which the income pertains, where income is in relation to an asset located outside India 	which the income pertainsb) 11 years from the end of the fiscal year to which the income pertains, if tax authorities have evidence which reveal that the income chargeable to tax of INR 5 million or more, represented in the
Completion of regular scrutiny assessment where transfer pricing provisions do not apply	24 months from the end of the fiscal year to which the income pertains	21 months from the end of the fiscal year to which the income pertains
Completion of regular assessment where transfer pricing provisions apply	36 months from the end of the fiscal year to which the income pertains	33 months from the end of the fiscal year to which the income pertains
Filing of belated / revised tax returns	1 year from the end of the fiscal year to which the income pertains	9 months from the end of the fiscal year to which the income pertains



Additional tax incentives for funds and other entities under International Financial Services Centre

Pre-April 2021 position

To promote the development and growth of International Financial Services Centre (IFSC), the Indian Government has doled out a spree of tax incentives for investment funds and other financial services entities set up under IFSC.

Amendments in Finance Act, 2021

The Finance Act, 2021 has extended the following additional tax incentives to funds / entities set up in IFSC:

• Fund Manager of an offshore fund: As per section 9A of the Indian Income Tax Act, 1961 (ITA), an offshore fund (i.e., a fund set up outside India) would not be construed to have a business connection (akin to permanent establishment) or place of residence in India merely because its fund manager is located in India provided the conditions stipulated in this section (as modified by the government by issuing a notification) are met both by the fund as well as the fund manager.

The Finance Act, 2021 provides that the government would issue a notification whereby conditions stipulated in section 9A would either not apply or would apply with certain modifications, in situations where the fund manager of an offshore fund is located in IFSC.

- Investment Division of an offshore banking unit: Investment Division of an offshore banking unit set up in IFSC which registers in India as a Category-I FPI would qualify for similar tax incentives as available to Category III Alternative Investment Funds (AIF) set up in IFSC.
- **Relocation of offshore funds to IFSC**: To encourage relocation of offshore funds to IFSC, the following tax incentives have been provided:
 - Capital gains arising to the offshore fund on transfer of capital assets held by such fund [on its own or through a wholly
 owned special purpose vehicle (SPV)] to an AIF set up in IFSC (IFSC Fund) would be exempt from tax, provided the
 consideration for such transfer is discharged in the form of share or unit or interest in the IFSC Fund.
 - Capital gains arising to investors in an offshore fund on transfer of capital assets to an IFSC Fund would be exempt from tax, provided the consideration for such transfer is discharged in the form of share of unit or interest in the IFSC Fund.
 - Grandfathered shares held by an offshore fund (i.e., shares which are not chargeable to Indian capital gains tax) and transferred to an IFSC Fund in relocation would continue to be grandfathered in the hands of IFSC Fund, to the extent that the gains are attributable to units held by non-residents (not being a permanent establishment of the non-resident). In other words, capital gains arising to an IFSC Fund from sale (or any other form of transfer) of shares of

Indian companies which were received by such IFSC Fund from the offshore fund in relocation would not be subject to capital gains tax, if capital gains from those shares wouldn't be chargeable to tax in India if the relocation had not taken place.

Tax exemption to Sovereign Wealth Funds and Pension Funds

Pre-April 2021 position

The Finance Act, 2020 introduced tax exemptions for Sovereign Wealth Funds (SWFs) and Pension Funds (PFs) on their income arising (in the nature of dividend, interest and long-term capital gains) from investments made in infrastructure sector in India. The tax exemptions are available subject to satisfaction of certain prescribed conditions. The Finance Act, 2021 has relaxed some of these conditions as discussed below:

- Erstwhile condition: Investments made by SWFs/PFs in a Category-I or Category-II AIF would qualify for tax exemption provided the AIF invests 100 percent of its corpus in specified infrastructure entities.
- Amendment in Finance Act, 2021:
 - The investment threshold by AIFs in the specified infrastructure sector entities has been reduced from 100 percent to 50 percent.
 - Investments made by AIFs in Infrastructure Investment Trusts would also qualify for the tax exemption.
 - Investments made by AIFs in following companies would also qualify for the tax exemption (subject to certain conditions):
 - Domestic company set-up and registered after 1 April 2021, with at least 75 percent investment in one or more infrastructure companies
 - Non-Banking Financial Companies (registered as Infrastructure Finance Company / Infrastructure Debt Fund), having minimum 90 percent lending to infrastructure entities.
 - Where the investment by AIFs in the specified entities is less than 100 percent, tax exemption shall be available
 proportionately.
- Erstwhile condition: Investments made directly by SWFs / PFs qualify for tax exemption whereas investments made by the Investment holding companies of such SWFs / PFs don't qualify for tax exemption.
- Amendment in Finance Act, 2021: Investments made by SWF/PFs through holding companies / SPV would also qualify for tax exemption provided the SPV is a domestic Indian company set up and registered on or after 1 April 2021 and having minimum 75 percent investments in one or more infrastructure entities or in Infrastructure Investment Trusts. Further, tax exemption would be available to the extent of investments made by the SPV in infrastructure entities.
- Erstwhile condition: Investment by SWFs / PFs in a Non-banking finance company registered as an Infrastructure Finance Company and in Infrastructure debt fund do not qualify for the tax exemption.
- Amendment in Finance Act, 2021:
 - Investments by SWFs and PFs in Non-Banking Financial Companies (registered as Infrastructure Finance Company / Infrastructure Debt Fund) would qualify for tax exemption provided such companies lends at least 90 percent of its corpus to infrastructure entities.
 - If the aggregate lending of Non-Banking Financial Companies (registered as Infrastructure Finance Company / Infrastructure Debt Fund) in infrastructure entities is less than 100 percent, tax exemption under this clause shall be calculated proportionately.
- Erstwhile condition: The SWF/PF should not have raised any funds through loans or borrowings or deposit or investments.
- Amendment in Finance Act, 2021: Raising of funds by SWF / PF through the aforesaid means would not render the SWF / PF ineligible for tax exemption in India provided Indian investments are not funded by such loans or borrowings or deposits or investments.
- **Erstwhile condition:** The SWF / PF should not undertake any commercial activity whether within or outside India. However, the expression "commercial activity" had not been defined.
- Amendment in Finance Act, 2021: The above condition has been replaced with the condition that the SWF / PF shall not participate in the day-to-day operations of the investee entity in India. Further, the monitoring mechanism to protect the

investment with the investee, including the right to appoint directors or executive director shall not be considered as participation in the day-to-day operations of the investee entity.

- **Erstwhile condition:** One of the conditions for a PF to be eligible for tax exemption is that the fund should not be liable to tax in the foreign country in which it is created or established.
- Amendment in Finance Act, 2021: The Finance Act, 2021 has clarified that even if a PF is liable to income-tax in its home country, it could still qualify for tax exemption in India provided its entire income is tax exempt in its home country.



Other amendments

Taxability of interest income from bonds

Income arising to FPIs from securities is generally taxable at the rate of 20 percent (plus applicable surcharge and cess). However, if the income is in the nature of interest arising on government securities or qualifying corporate bonds (i.e., those corporate bonds where the coupon rate does not exceed 500 bps of the applicable base rate of State Bank of India), then such income is currently taxable at a concessional tax rate of 5 percent (plus applicable surcharge and cess).

In September 2020, an amendment was made to the charging section (i.e., section 115AD of the ITA) that governs the taxation of FPIs to include funds set up in IFSC in this section. While doing so, the proviso which provides for reduced tax rate of 5 percent on interest income arising to FPIs from government securities and qualifying corporate bonds, was inadvertently deleted.

The Finance Act, 2021 has re-inserted the relevant proviso in the charging section (i.e., section 115AD) of the ITA whereby FPIs would continue to be taxed at the rate of 5 percent on interest income arising from government securities and qualifying corporate bonds.

Interest income from Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (INVITs)

Section 115AD of the ITA governs the taxability of income arising to FPIs from Indian securities as well as capital gains arising from transfer of such securities. Under this section, any income arising from securities (such as dividend, interest) is taxable at the rate of 20 percent except for interest from government securities and qualifying corporate bonds which is taxable at 5 percent. However, section 115AD does not provide for any carve out or special rate of tax for income arising to FPIs from REITs / INVITs.

Section 115A of the ITA governs taxability of income distributed by REITs and INVITs to non-residents. Under this section, interest income distributed by REITs and INVITs is taxable in the hands of non-resident investors at 5 percent.

Until 31 March 2021, units of REITs and INVITs were not included in the definition of the term "securities" and therefore, interest income arising to an FPI from such REITs and INVITs could be taxed under section 115A at the concessional tax rate of 5 percent.

The Finance Act, 2021 has amended the definition of the term "securities" to include units of REITs and INVITs under its ambit. With this amendment, interest income arising to an FPI from REITs and INVITs would be taxable as "income from securities" under section 115AD discussed above. In the absence of any carve out or special tax rate in section 115AD, such interest income could now be taxable at 20 percent under section 115AD.

"Liable to tax" defined

The Finance Act, 2021 has introduced the definition of the term "liable to tax" in the Indian tax law. It is defined to mean that there is income-tax liability on a person under any law for the time being in force in its home country and shall include a person who has subsequently been exempted from such liability under that country's law.

Given the newly added definition, it appears that the intention is to consider such persons as "liable to tax" who are within the ambit of tax law of a country but may be exempted from tax payment.

Recent tax rulings



Withholding tax on dividend applicable at 5 percent for Netherlands tax resident Concentrix Services Netherlands B.V. and Optum Global Solutions International BV [TS-286-HC-2021 (Delhi High Court)

The taxpayers (two of them) were residents of Netherlands and held 99.99 percent shares in their Indian subsidiaries. They made an application to Indian tax authorities to confirm that the dividends received by them from Indian companies should be taxable at 5 percent as per India-Netherlands tax treaty, read with the Protocol thereto.

Under the India-Netherlands tax treaty, the tax rate on dividend income arising to a tax resident of Netherlands should not exceed 10 percent. Additionally, under the protocol signed between the two countries, if India was to enter into a tax treaty with another OECD country (post signing the tax treaty with Netherlands) wherein inter-alia the tax rate on dividend and certain other types of income was lower than the tax rate in India-Netherlands tax treaty, then such lower tax rate shall also apply to the relevant income arising to tax residents of Netherlands. This clause is referred to as most-favored-nation (MFN) clause. Post signing of the tax treaty with Netherlands, India entered into tax treaties with other OECD countries such as Slovenia and Colombia. In these treaties, dividends received from subsidiaries are taxable at 5 percent.

The tax authorities did not agree with the contention of the taxpayers to apply 5 percent tax rate and instead issued a certificate confirming that the taxes should be withheld at 10 percent as per the India-Netherlands tax treaty. The basis of such action by tax authorities was that there was no separate notification issued, which entailed importing the benefit of the MFN from the tax treaties executed with countries such as Slovenia, Lithuania and Colombia, into the India-Netherlands tax treaty.

In appeal, the matter reached Delhi High Court (HC) which ruled in favor of the taxpayers and held that the Protocol to the India-Netherlands tax treaty formed an integral part of the tax treaty and no separate notification was required to apply the Protocol's provisions. The HC also placed reliance on the decree issued by the Kingdom of Netherlands wherein it was interpreted that the lower rate of tax set forth in the India-Slovenia tax treaty was applicable on the date when Slovenia became member of the OECD i.e. from 21 August 2010, although, the India-Slovenia tax treaty came into force on 17 February 2005.

Carry forward of capital losses 'exempt' under a tax treaty allowed

Goldman Sachs India Investments (Singapore) PTE Limited [TS-294-ITAT-2021(Mum)]

A Singapore Company (taxpayer) was registered as a Foreign Institutional Investor (FII) in India. During the Financial Year (FY) 2011-12, it incurred short term capital losses on sale of its Indian investments and carried forward the same to subsequent years. During audit proceedings, the Assessing Officer (AO) denied the carry forward of capital losses on the grounds that since capital gains earned by the taxpayer are exempt under the India-Singapore tax treaty, the capital losses should also be ignored. The taxpayer filed objections against the AO's order with the Dispute Resolution Panel (DRP) wherein AO's order was upheld.

Aggrieved, the taxpayer filed an appeal before the Mumbai Income Tax Appellate Tribunal (ITAT). The ITAT relied on a previous ruling¹ passed in the case of taxpayer's sister concern company and ruled in favor of the taxpayer. The following observations of the ITAT are noteworthy:

- In determining taxability of the income, if provisions of the ITA are more beneficial as compared to the tax treaty then the beneficial provisions of the ITA will apply over tax treaty.
- In any case, a tax treaty cannot be thrust upon a taxpayer. In case the taxpayer does not opt for the tax treaty in a particular year, it would not be precluded from availing the benefits of the said treaty in the subsequent years
- Once the amount of capital losses to be carried forward are quantified (and not disputed by the AO), then such losses would be permitted to be carried forward and be available for set off against taxable income of subsequent years.
- While the set- off of such losses in any subsequent year under audit proceeding may be examined, it is not open to the AO to deny the carry forward of losses so determined and quantified in a prior year.

Accordingly, the ITAT held that the losses will be governed by the provisions of ITA as it is more beneficial to assessee and shall be allowed to be carried forward to future years.

Capital gains arising on sale of Indian company shares not taxable in India on satisfaction of conditions under India-Singapore tax treaty

BG Asia Pacific Holding Pte. Ltd. [2021] AAR/1376/2012

A Singapore-based investment company (taxpayer) was a wholly owned subsidiary (WOS) of a UK company and functioned as the regional headquarters of its business group in Singapore. The taxpayer had acquired 65.122 percent stake in an Indian listed company (I co.) in the 1990s. As a part of a global restructuring exercise, it proposed to undertake an off-market transfer of its holding in I co. to another Indian company in 2012. In this regard, the taxpayer sought an advance ruling from the Authority for Advance Ruling (AAR) to determine whether it was liable to capital gains tax under the ITA and if it was entitled to the benefits under the India-Singapore tax treaty.

The taxpayer contended that the capital gains on the sale of I co. shall be taxable only in Singapore under Article 13(4) of the tax treaty. It held a valid TRC issued by the Singapore tax authorities and fulfilled the limitation of benefit (LOB) conditions as provided in the tax treaty, by bringing on record evidence to prove commercial substance in Singapore in terms of operations, investments, personnel, board meetings, decision making, etc. Further, the TRC obtained by the taxpayer had an explicit declaration from the Singapore revenue authorities that - (i) the taxpayer conducts its business activities of investment holding in Singapore, and (ii) the taxpayer satisfies LOB conditions as prescribed in the tax treaty.

The Indian tax authorities argued that the taxpayer was an investment holding company without having any bonafide business activities and thus, it did not comply with the LOB clause stipulated in the India-Singapore tax treaty.

The AAR examined all the conditions of the LOB clause against the facts of the case and ruled taxpayer's favor by allowing treaty benefits. Some of the key observations of the AAR are summarised as under:

• The shares of I Co were acquired 6 years prior to the introduction of tax exemption in the India Singapore tax treaty and therefore, it cannot be said that I Co shares were acquired by the taxpayer only for the purpose of availing benefits under the tax treaty. The shares of I Co were sold in 2012 under a general business policy decision to divest non-core business interest in respect of taxpayer's group all over the world and it was not specific for India. Similar sale of shares of non-core holding was made in other countries as well pursuant to a bonafide restructuring. Considering these facts, the AAR held

¹ Goldman Sachs Investments (Mauritius) Ltd. Vs. DCIT (2020) 120 taxmann.com 23 (Mum-Trib.),

that the affairs of the taxpayer were not arranged with a primary purpose of availing tax treaty benefits.

- Basis past judicial precedents², it was held that holding companies are essential for management of MNC's worldwide business interest and that the activity of such an investment holding company will be considered as a bonafide business activity so as to satisfy the condition mentioned in the LOB clause. Further, the business of 'investment activities' also has a separate code for describing the nature of business in Indian income tax return forms. The tax treaty and the protocol thereto could not be read beyond what was provided therein and there is no provision in the India-Singapore treaty which states that treaty benefit will be denied if a company is a mere investment holding company.
- Taxpayer was set-up in 1995 in Singapore and since then, it was continuously engaged in the business activity of holding investments. The Andhra Pradesh HC in an earlier case had held that investment is itself a legitimate, established and globally well recognised business/commercial avocation. The business activity carried out by the taxpayer was not only continuous but also real. Based on the audited accounts (for the financial year ended 31 December 2004 onwards) the taxpayer had disclosed considerable amount of dividend on a regular basis in all the years. Therefore, the taxpayer could not be regarded as a shell / conduit company as prescribed in the LOB conditions in the India-Singapore tax treaty.
- The TRC in respect of 'certificates of residence' cannot not be questioned. However, the position may not be the same in respect of a certificate that requires interpretation of any clause of the tax treaty. Accordingly, the certificate (in respect of annual expenditure) issued by the Singapore tax authority was in the realm of interpretation of the clause of the tax treaty and could not be taken as conclusive and the tax department was entitled to rebut the same on facts. However, the tax authorities could not bring any material on record to rebut the taxpayer's claim that it had indeed incurred annual operational expenditure of more than SG\$200,000, for 24 months preceding the month in which capital gain arose to the taxpayer. In this context, it was also held that expenditure incurred on statutory compliances would not be regarded as operational expenditure but employee cost recharged by the taxpayer's group company to it would fall within the ambit of administrative expense and therefore, should be regarded as operational expenditure.
- Based on the above and on facts of the case, the AAR held that the prescribed LOB conditions were satisfied, and the taxpayer was eligible to avail exemption under the tax treaty. As the taxpayer was a resident of Singapore, capital gains arising on sale of I Co shares was liable to tax in Singapore only and thus, the same could not be taxed in India.

Transfer of Indian company shares sans consideration subject to capital gains tax, transfer pricing (TP) provisions applicable

Mettler Toledo GmbH, In re [2021] 123 taxmann.com 253 (AAR- Mumbai)

A Switzerland company (S Co) proposed to contribute (by transferring) equity shares held in an Indian company (I Co) to another Swiss company (taxpayer) without any consideration as a part of internal restructuring exercise. The taxpayer sought an advance ruling from the AAR in respect of - (i) taxability of the proposed receipt of I Co. shares under the India-Switzerland tax treaty, (ii) whether S Co. (transferor of I Co. shares) was required to deduct any tax at source under the ITA in relation to the proposed contribution of I Co shares to the taxpayer, and (iii) whether the taxpayer (being recipient of I Co shares) was required to withhold any tax under the ITA.

The taxpayer's contentions were as follows:

- a) Under the ITA, receipt of shares by the taxpayer would be taxable as 'Income from Other Sources'. However, since the tax treaty grants the taxation rights on other income to Switzerland, such income should not be taxable in India.
- b) Also, given that the proposed receipt of shares would not be taxable under the tax treaty, there was no requirement for S Co to withhold tax on transfer of shares to the taxpayer.
- c) No capital gains liability arose in the hands of S Co (i.e., transferor) since it did not receive any consideration from the taxpayer for transfer of shares. Additionally, in absence of any consideration, capital gains computation mechanism provided in the ITA also failed.
- d) Given that the shares were transferred by way of gift, no income arose to the taxpayer (i.e., recipient of shares) and hence, the transaction was not subject to Indian TP provisions.

² Vodafone International Holdings BV vs. UOI [2012] 204 Taxman 408 (SC)

The AAR ruled that absence of consideration was not a decisive factor for application of TP provisions since TP provisions would apply even if the transactions were exempt under treaty provisions. Under the TP provisions, transactions between the associated enterprises need to be executed at arm's length price (ALP). The AAR thus held that in the current case, TP provisions were attracted, and that ALP had to be determined. Once ALP was determined, capital gains tax liability arose in the hands of S Co (i.e., transferor of I Co shares) and consequently the taxpayer (i.e., recipient of I Co shares) was required to deduct tax under the ITA.

On the issue of the transaction being designed prima facie for avoidance of tax, the AAR agreed with the arguments of the tax authorities and held that the proposed transaction was prima facie without any commercial logic or substance and thus, fell under scheme of tax avoidance. Accordingly, it was held that - (i) capital gains tax was exigible in the hands of S Co (i.e., transferor of I Co shares), (ii) the taxpayer (i.e., recipient of I Co shares) was liable to withhold tax at source under the ITA on capital gains arising to S Co., and (iii) the proposed share transfer transaction was a tax avoidance arrangement and thereby could not be allowed by the AAR.

Non-voluntary gift of shares is liable to capital gains tax

PCIT vs. M/s. Redington (India) Limited T.C.A Nos. 590 & 591 of 2019

An Indian company (taxpayer) carried out its Middle East overseas operations, by way of a WOS and further step-down subsidiaries. A private equity (PE) fund had evinced interest in taxpayer's Middle East operations. However, due to local restrictions, the PE fund could not invest directly in the taxpayer WOS in Middle East. In July 2008, the taxpayer set up another WOS in Mauritius (M Co). M Co in turn set-up a WOS in Cayman Island (C Co). Consequently, C Co became a step-down subsidiary of the taxpayer. Subsequently, in November 2008, the taxpayer gifted its holding in the Middle East WOS (i.e., transferred its shares without consideration) to C Co. Within about a week, the PE fund invested in C Co thereby, achieving its commercial objective of investing in taxpayer's Middle East operations.

During the audit proceedings the tax officer held that the transfer of Middle East WOS shares by the taxpayer to C Co. without any consideration was liable to capital gains tax in India. On further appeal proceedings, the matter reached before the HC which held as follows:

- Corporate gifting is not prohibited and therefore, a company is entitled to execute a gift. However, the essential elements of gift are (i) absence of consideration, (ii) the donor, (iii) the donee, (iv) should be voluntary, (v) the subject matter, (vi) transfer, and (vii) acceptance.
- Since the resolution passed by the Board of Directors did not state that the transfer was by way of gift (the words used in the resolution were "with or without consideration"), it did not consider it to be a gratuitous transfer. The voluntary consent of the donor (i.e., taxpayer) was missing because the physical act in proving the transfer of shares and executing the deed of share transfer should coincide with the mental act that it was the intention to execute the gift. If the intention of the donor / taxpayer was to effect transfer without consideration, the resolution would have spelt out the same in no uncertain terms.
- The decision of the taxpayer's Board in resolving to approve the transfer of shares with or without consideration was a clear indicator to show that the transaction was not voluntary. This was so because, within less than a week after effecting the transfer, the PE fund invested in C Co and when the transfer took place, C Co had no other assets or income except the investment in shares of the Middle East WOS.
- Thus, the facts clearly demonstrated that much prior to effecting the transfer of shares, there were other transactions, which were in the pipeline. The sole intention of the taxpayer was corporate restructuring. Therefore, the voluntariness in the transfer of shares stood excluded.
- Based on the chain of events, it was evidently clear that the incorporation of companies in Mauritius and Cayman Island just before the transfer of shares was undoubtedly a means to avoid taxation in India and the said two companies were used as conduits to avoid income-tax. The asset owned by the taxpayer (i.e., shares in the Middle east WOS), which were hitherto within the network of the Indian tax laws, stood shifted to Cayman Island which was a tax haven. Therefore, the entire transaction was structured to accommodate the third-party investor.

Accordingly, the HC held that the transfer of the Middle East WOS shares by the taxpayer would be chargeable as capital gains under the ITA.

Payment to non-residents for imported software cannot be characterised as 'royalty' as it amounts to simplicitor purchase of goods, not taxable in India, hence no tax withholding required

Engineering Analysis Centre of Excellence Private Limited vs. The Commissioner of Income Tax & ANR (CIVIL APPEAL NOS. 8733-8734 OF 2018)

In this landmark ruling, the Supreme Court of India (SC) has held that the amount paid by resident Indian end users/ distributors to non-resident computer software manufacturers / suppliers, as consideration for resale / use of computer software, cannot be characterised as 'royalty' (i.e. use of copyright in the computer software) under Article 12 of the tax treaties, as the same amounts to simplicitor purchase of goods and therefore, does not give rise to a liability to deduct any taxes under the ITA.

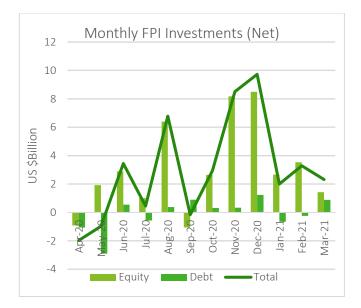
In the past, there have been divergent rulings by various courts on this issue which has been finally put to rest. The following observations of the SC are noteworthy in this respect:

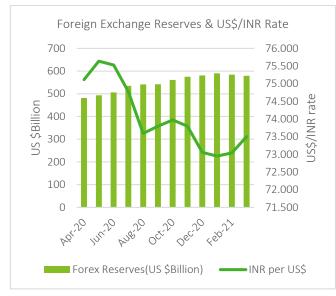
- The SC upheld the principle laid down in a past ruling³ that tax treaties must be interpreted liberally with a view to implement the true intention of the parties.
- Once a tax treaty applies, the provisions of the ITA can only apply to the extent that they are more beneficial to the taxpayer and not otherwise. Further, where any term is defined under the tax treaty, the definition contained in the tax treaty itself has to be looked at.
- The withholding tax provisions are machinery provisions which are inextricably linked with the charging provisions, as a result of which, the withholding tax obligation arises only when the sum is chargeable to tax under the provisions of the ITA, read with the tax treaty. Basis a circular⁴, it has been clarified that the tax deductor must take into consideration the effect of the tax treaty provisions in respect of payment of royalties and technical fees while deducting taxes at source.

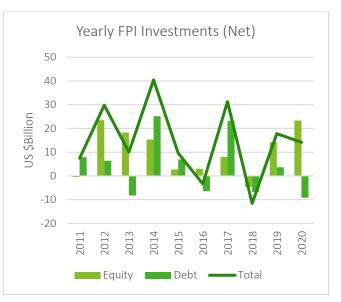
³ Azadi Bachao Andolan (2004) 10 SCC 1

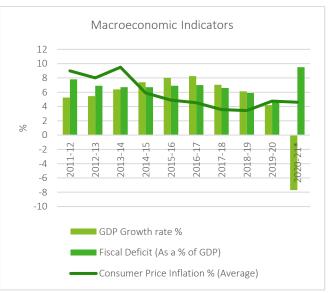
⁴ Central Board of Direct Taxes Circular No 728 dated 30 October 1995

Key trends at a glance











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