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CHARTERED ACCOUNTANTS

Corporate Update

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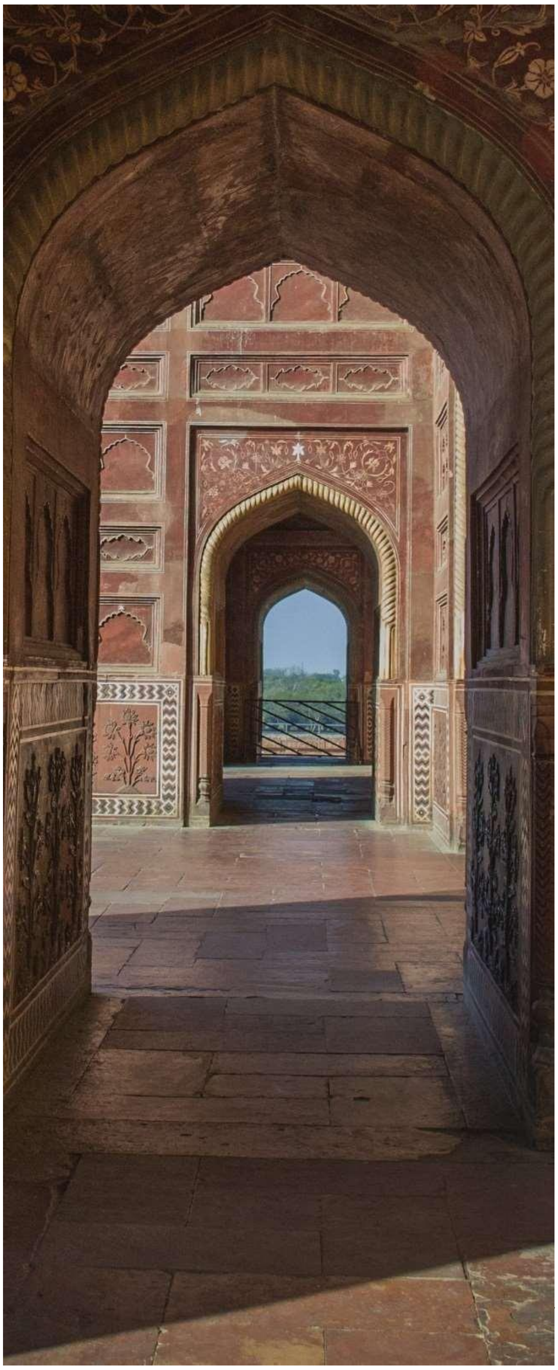

INTERNATIONAL TAX

DOMESTIC TAX

FOREWORD

Dear Reader,

The recent parliamentary elections saw a landslide victory for the Modi led National Democratic Alliance, which has already assumed charge for yet another five-year term. Various reforms are expected to be rolled out in this second term of the Government, which may be announced in the upcoming Union Budget on July 5, 2019.

One of the key reforms which may take center stage is the proposed Direct Tax Code, which is set to replace the existing, 58 years old Income-tax legislation. The Government plans to widen the tax base, while at the same easing compliance burden for tax payers. The task force set up for this purpose is expected to present its report on the proposed Direct Tax Code by end of July, 2019. Thereafter, this report may be put up for public and stakeholder comments.

On the international tax front, the new Union Cabinet of Ministers has recently approved the ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI'). The MLI will have the effect of modifying certain provisions of India's covered bilateral tax treaties, to incorporate certain anti abuse provisions.

India's active participation in the MLI is just a stepping stone for the Government to tighten the noose around tax avoidance. Earlier, the Government had withdrawn the capital gains exemptions clause in the tax treaties with Mauritius and Singapore, two jurisdictions which were widely used to route foreign investments into India. Moreover, the Government has already adopted other measures in their domestic tax law, such as introduction of tax on digital transactions, equalization levy etc., pursuant to the BEPS recommendations.

C.S. Mathur
Partner

International Tax

Union Cabinet ratifies MLI

Press Release dated June 12, 2019

The Union Cabinet has approved ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) which was signed by India on June 07, 2017.

The MLI is the first multilateral treaty of its kind, allowing jurisdictions to transpose results from the OECD/G20 BEPS Project into their existing bilateral tax treaties, transforming the way tax treaties are modified. The Convention has been designed to strengthen existing tax treaties concluded among its parties without the need for burdensome and time-consuming bilateral renegotiations.

The MLI will modify India's bilateral treaties with other signatories to MLI in order to curb revenue loss through treaty abuse and base erosion and profit shifting strategies by ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created.

The Ministry of External Affairs has already sent a request for obtaining instrument of ratification from the Hon'ble President of India, which would thereafter be deposited with the OECD, being the depository of the MLI.

Till date, 26 jurisdictions including Australia, Austria, France, Japan, Netherlands, UK and Singapore have deposited instrument of ratification with the OECD.

For India, it is likely that the MLI provisions would become effective in year 2020.

High Court quashes tax officer's order rejecting nil withholding tax application by assessee in respect of capital gains under India-Mauritius tax treaty

Indostar Capital v ACIT [2019] 103 taxman.com 96 (Bombay)

Recently, the High Court of Bombay in the case of Indostar Capital, quashed the certificate passed by the Assessing Officer under section 197 of the Income-tax Act, wherein benefit under the Double Taxation Avoidance Agreement between India and Mauritius (the tax treaty) was denied to a Mauritius company, which sold shares of an Indian company, on the premise that the transaction was not genuine. The High Court held that in absence of prima facie evidence of tax avoidance, the tax authorities could not reject the application for issue of nil or lower withholding tax certificate under section 197 of the Act ("197 Certificate").

On facts of the instant case, the assessee, Indostar Capital, was a company incorporated in Mauritius in the year 2010 and held tax residency certificate (TRC) issued by Mauritius tax authorities. It held licence to act as an investment holding company and was formed to promote an Indian Non-Banking Financial Company named Indostar Capital Finance Limited ("ICFL"). It raised capital from various international institutional investors across the world over 4 years between years 2011 to 2015 to acquire approx. 97.3% of the total share capital of ICFL and these transactions were duly reported to the Reserve Bank of India. In 2018, the taxpayer decided to offload approx. 18.5 million ICFL shares through an IPO and expected to receive a consideration of INR 10586.8 million.

The assessee moved an application to its jurisdictional tax officer in India for grant of a 197 Certificate seeking a NIL withholding tax rate. In its application, the assessee contended that incidence of capital gains tax shall not arise in view of Article 13 (Capital

Gains) of the tax treaty. In this regard it may be noted that under Article 13 of the tax treaty, gain derived by the Mauritian resident from alienation of shares of an Indian resident, acquired before March 31, 2017 are not liable to capital gains tax in India.

The Assessing Officer rejected the application of taxpayer to issue Nil 197 Certificate and denied the benefit of tax treaty on the ground that transaction entered by the assessee was a tax avoidance scheme. This was based on the reasoning that the assessee had no commercial activities in Mauritius, no employees and administrative expense in Mauritius, and that the taxpayer had failed to produce TRCs of ultimate beneficiaries of the shares transferred. As such, the AO issued the 197 certificate authorizing the buyer of shares to remit the sale proceedings after appropriate deduction of tax.

Aggrieved, the taxpayer filed a writ petition before the Bombay High Court.

The High Court stated that all observations of its judgement would be prima-facie and would prejudice neither the taxpayer nor the tax department in the assessment yet to be done. The High Court considered para 4 of Article 13 of the tax treaty which states that gains arising to a Mauritius resident from the sale of shares of an Indian company acquired on or before March 31, 2017 would only be taxable in Mauritius and not in India. The High Court relied on Circular no. 789 of 2000 issued by the Central Board of Direct Taxes and various judicial precedents including the Supreme Court decision in the case of *UOI v Azadi Bachao Andolan [2003] 263 ITR 706* to state that the TRC would be sufficient proof of residency in Mauritius as well as for beneficial ownership of shares for obtaining treaty benefits. Accordingly, the High Court held that prima facie, the transaction is not liable to tax in India.

The High Court discussed the decision of Hon'ble Supreme Court in the case of *Vodafone International Holdings B.V. v UOI [2012] 341 ITR 1*, wherein it was held that the tax authorities may invoke the principle of "substance over form" or "piercing the corporate veil" and deny the benefits of tax treaty if it is established that a transaction is a sham or is designed for tax avoidance.

The Court stated that the Assessing Officer could reject the application under section 197 despite existence of tax treaty and availability of TRC if he could prima facie demonstrate that the entire transaction from the inception was a sham and a colourable device to avoid tax. However, the Court observed that merely because the Taxpayer had not transacted any other business, had no administrative expenditure or employment structure, it would not be sufficient by itself to create a prima facie case of a fraudulent transaction, although such factors may be used to establish that the transaction was a sham in the assessment proceedings. The High Court held that all these aspects must be looked into during assessment proceedings, as the proceedings under section 197 are provisional in nature.

0Accordingly, the High Court quashed the 197 order and directed the tax authorities to release the taxes withheld along with interest subject to certain conditions and to issue Nil 197 Certificate to the taxpayer. To protect the interest of the tax department, the Court directed the taxpayer to maintain certain shareholding in the Indian company as security and to file its income tax return within the due date.

Delhi Tribunal deviates from its earlier ruling in assessee's own case, holds grouting work as not falling under 'construction' activity to constitute PE, and holds equipment on main contractor's vessel constitutes Fixed Place PE

ULO Systems LLC v DCIT [2019] 105 taxmann.com 259 (Delhi-Trib.)

Recently, the Hon'ble Tax Tribunal, Delhi bench, disagreeing with view expressed by its

Coordinate bench in assessee's own case for another assessment year, held that grouting work did not fall under 'construction' activity to constitute permanent establishment (PE) in India. The Tax Tribunal further held that the assessee had a fixed place PE in India in the form of equipment stationed on the customer's vessel.

On the facts of the case, the Assessee company is a UAE tax resident and engaged in grouting work (laying layer of cement on an underwater structure) for companies in oil and gas industry. The Assessee contended that grouting activities carried out by it fall within construction activity and no PE was constituted under Article 5(2)(h) of India-UAE tax treaty as the number of days spent in India was less than 9 months. In this regard, the Assessee relied on order dated December 21, 2018 of the Coordinate Bench of Tax Tribunal, Delhi in assessee's own case of *ULO Systems LLC v Asstt. DIT [2019] 101 taxmann.com 490*, wherein it was held that work carried out by the assessee fell under 'construction' activity and since the duration test was not met, assessee did not have a Construction PE in India. In its said decision of the Coordinate Bench, it was also held that the concept of 'Equipment PE' was nowhere mentioned in the India-UAE tax treaty.

The Tribunal analysed the scope of activities carried out by assessee in India under various contracts and held that the activities of pipelines and cable crossing, pipeline and cable stabilisation, pipeline cable protection, stabilisation and protection of various subsea structures, anti-scour protection etc., cannot be held to be 'Construction' under Article 5(2)(h) of India-UAE tax treaty. In this regard, the Tribunal also relied on the commentary of noted author, Klaus Vogel on Double Taxation Convention which opined that subsea activities that could be treated as 'Construction" are "laying of pipe-lines and excavating and dredging".

Regarding existence of fixed place PE, the Tribunal observed that assessee's equipment as well as personnel, were stationed on the vessel of Main Contractor, for carrying out grouting and that the equipment was the main place of business of assessee. The Tribunal held that the 'vessel' on which equipment's were placed and personnel was stationed was fixed place PE of assessee in India under Article 5(1) of India-UAE tax treaty and that the assessee had fair amount of permanence through its personnel and its equipment within India to perform its business activity for its contractors. In this regard, the Tribunal placed reliance on OECD commentary, Klaus Vogel's commentary and on the decision of Hon'ble Supreme Court in case of *Formula One World Championship Ltd. v. CIT [2017] 394 ITR 89*. The Tribunal observed that the order passed by Coordinate bench in assessee's own case for earlier assessment year was not in accordance with decision of Hon'ble Supreme Court in case of Formula One World Championship Ltd.

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Domestic Tax

Speculative business loss from trading in shares cannot be set-off against the profits from transactions in derivates prior to amendment in Section 73 of the Income-tax Act

Snowtex Investment Ltd. v. PCIT [2019] 105 taxmann.com 282 (SC)

In the instant case, the assessee was a registered Non-Banking Finance Company (NBFC) and its principal business was trading in shares and securities. During AY 2008-09, the assessee filed income tax return claiming a set off of losses arising from trading in shares against the profits from derivatives business.

During assessment proceedings, the assessing officer held that the loss incurred by assessee from trading in shares was speculation loss, whereas the activities pertaining to derivatives could not be treated as speculative business, in view of provisions of Section 43(5)(d) of the Income-Tax Act as amended by Finance Act, 2005. Hence, loss arising from trading in shares cannot be set-off against the profits from derivatives business. CIT(A) also upheld the order of assessing officer.

On appeal, the Tax Tribunal allowed the claim of the assessee for setting off the loss from share trading against the profits from transactions in derivatives since the character of the activities was similar. The Tribunal also held that the assessee had treated the entire activity of the purchase and sale of shares which comprised both the delivery based and non-delivery based trading, as one composite.

Before the High Court, the assessee, contended that its principal business was granting of loans and advances and not trading in shares. It was also contended that profits alone should not be taken into account for determining its principal business. In this regard, the High Court noted that assessee itself made an admission before the assessing officer that its principal business was trading in shares. Hence, this should be treated as binding on them. Hence, as per the provisions of section 73 of the Act, the assessee should not be deemed to be carrying speculative business. The High Court held that the profits which had arisen from trading in derivatives were not profits from a speculative business. Hence, loss on trading in shares could not be set off against the profits arising from the business of derivatives.

The assessee filed appeal before the Hon'ble Supreme Court which observed that Section 43(5) of the Act was amended with effect from April 1, 2006 as a result of which the business of trading in derivatives carried out on a recognized stock exchange fell outside the purview of business of speculation. Further, a specific amendment was made in Explanation to Section 73 with effect from April 1, 2015 that where the principal business of the company is trading in shares, such activities would be treated as non-speculative in nature. The latter amendment was intended to take effect from the aforesaid date and it cannot be held that it was clarificatory or that the intent was to give it retrospective effect. Hon'ble Supreme Court also relied on various judgements to hold that the provisions introduced in Section 73 with effect from April 1, 2015 could not be regarded as clarificatory in nature since it was made with prospective effect.

Hon'ble Supreme Court upheld the order of High Court that the assessee's principal business was trading in shares as stated by assessee before the assessing officer.

Consequently, it was held that in AY 2008-09, the loss from trading in shares was not capable of being set off against the profits from business of derivatives, since it did not constitute profits and gains of a speculative business.

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Important dates to remember

Particulars	Date
Deposit of TDS for the month of June 2019	07.07.2019
Filing of GSTR I for the month of June 2019	11.07.2019
Filing of GSTR 3B for the month of June 2019	20.07.2019

For further information, please contact:

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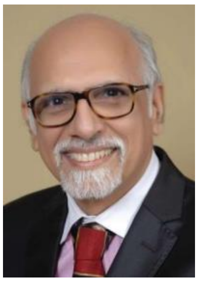

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