INTERACTION BETWEEN INTERNATIONAL TAXATION AND PRIVATE INTERNATIONAL LAW

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ABSTRACT

International Taxation refers to an independent branch of law that has been roughly defined as a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions. Sovereign states with varied tax systems have independent tax regulations, which can sometimes coincide with methods of taxation of other jurisdictions leading to injustice. The most knowing international tax conflicts include double taxation, tax heavens, indirect transfers, transfer pricing, off-shore derivative instruments. Pith of international tax law lies in the relief to such conflicts provided for in the municipal tax law itself, cases decided by that country's judiciary, appropriate amendments to tax and other laws to deal with contemporary international tax issues etc. One way of interpreting international taxation is that it is the aggregation of those national law/rules triggered by conflict of tax laws occurring from each state's sovereignty due to diversity or duplication of law of each state's internal tax laws. Broader sense of the term shall include national as well as international tax laws dealing with problem of fiscal jurisdiction, i.e. law of conflict resolution arising from collision of various tax systems through international customary law, treaties etc.

This paper concentrates on former part of the interpretation of the term which inclines international taxation towards Private International Law rather than Public International Law as the governments usually limit their scope of taxation on the basis of territoriality, residency or exclusionary system or a hybrid system with such all or some of these characteristics. Private International Law determines which country law should be refers to in cases where there are international factors involved, in order to solve contradiction of the private law of each country. The relationship between these two branches of law has been established through the medium of conflicts

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like double taxation, tax heavens, undisclosed international assets etc., the attempted solution to which has been provided by municipal legislations, judgements and amendments to existing legislations. The paper attempts to take cognizance of and explains relevant legislations along with latest amendments and enactments (Including prospective enactments) for e.g. Black Money Act 2015, Finance Act 2015, GAAR etc.

1. INTRODUCTION

The concept of international tax law happened to have originated from conflict of tax laws of different nations. Sovereign states with varied tax systems have independent tax regulations which can sometimes coincide with methods of taxation of other jurisdictions leading to injustice. The most knowing international tax conflicts include double taxation, tax heavens, indirect transfers, transfer pricing, off-shore derivative instruments. Pith of international tax law asserts that the relief to such conflicts is provided for in the municipal tax law itself, cases decided by that country's judiciary, appropriate amendments to tax and other laws to deal with contemporary international tax issues etc. One way of interpreting international taxation is that it is the aggregation of those national law/rules triggered by conflict of tax laws occurring from each state's sovereignty due to diversity or duplication of law of each state's internal tax laws. Broader sense of the term shall include national as well as international tax laws dealing with problem of fiscal jurisdiction, i.e. law of conflict resolution arising from collision of various tax systems through international customary law, treaties etc.

This paper concentrates on former part of the interpretation of the term which inclines international taxation towards private international law rather than public international law. In the former international tax law identifies collision in national tax systems and attempts to rectify the same through municipal law itself. [1] These are rules established by national law relating to international finances for instance in India, Income Tax Act 1961 (IT Act) unequivocally provides for transactions having international ramifications say case concerning income earned by a resident abroad or by a NRI in India, the Act taxes both, former under the worldwide principle and the latter under source principle (Section 5). Other contemporary tax issues with international element are dealt with

[1] http://revcurentjur.ro/arhiva/attachments_201104/recjurid114_11F.pdf(last accessed on 8 September 2015).

by judicial decisions, amendments to IT or other Laws. Objectives of international taxation include contribution to local public services, prohibition of tax avoidance, and principle of burden sharing, prohibit harmful tax competition.

2. International Taxation and Private International Law

Private International Law determines *which country's law should be referred to in cases where there are international factors involved, in order to solve contradiction of the private law of each country.*[2] If a private transaction falls within the scope of legal orders of more than one state, Conflict of Law rules or Private International Law determines which law applies. Unlike Public International Law, there happens to be no uniform system of Conflict of Law, each State has its own rules. Ergo, imperfect legal relationships and consequential differing results are unavoidable. This Conflict of Law determine which law applies even when such question arises in tax matters (to the extent relationship is based on private law) e.g. when and whether a taxpayer has gained beneficial ownership of an asset, pricing between multinational associated enterprises, residence of an individual or a corporation etc.[3]Usually, states levy taxes only on the basis of their own tax laws but in certain circumstances recognition (not necessarily implementation) to foreign tax laws are given either through DTAA or providing foreign tax credit to the tax payer. As far as treaty rules are concerned, unlike rules of Private International Law. International Tax Law does not lead to application of foreign Law owing to the assumption that both the contracting states tax according to their own law. They are more in the nature of "*rules of limitation of law*" rather than "*conflict of law*". They have their independent origin and legal foundation separately from the domestic tax law (falling under the realm of Public International Law).

"International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions."[4] It is basically determination of tax liability of a "*Person*" subject to the tax laws of different countries or rather the international aspects of the individual country's taxation laws. The governments usually limit their scope of

[2] https://www.pwc.com/jp/en/taxnews-estate-taxation/assets/private-international-law-e.pdf(last accessed on 25 September 2015).

[3] http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1039&context=bjil (last accessed on 15 October 2015).

[4] https://www.icsi.edu/docs/webmodules/Publications/4.%20Tax%20Laws%20and %20Practice.pdf(last accessed on 12 September 2015).

taxation on the basis of territoriality, residency or exclusionary system or a hybrid system with such all or some of these characteristics. Such systems of taxation can lead to double taxation, no taxation, re-characterizing of income by the tax-payer to favourable jurisdiction in a manner that can reduce his tax liability (transfer pricing), taxing/ no taxing of world-wide income etc. Most countries provide for rules within its own municipal law to resolve such conflict of law issues, which can, in a way be referred to as Private International Law Rules.

For instance, as mentioned above, it contains provisions to deal with transactions having extra-jurisdictional ramifications. For e.g. taxing of incomes earned abroad by resident tax-payers or income earned by Non- Residents in India under Section 5 of the Act.

3. MOST COMMON CONFLICTS OF THE INTERNATIONAL TAXATION

3.1. Double taxation

National tax law establishes connecting factors between taxpayer and the taxing state such as residence, habitual residence, citizenship, family ties (personal factors) or source of income, place of activity, location of property (economic factors). Overlapping in the multiple jurisdictions can occur when different connecting factors determine the tax liability for the same subject leading to double taxation. If the states have DTAA, naturally that will apply but in case it doesn't exist, the municipal law shall come to the rescue. Now the difference in approach of different legal systems in taxing any income under its sovereign authority can be noticed under the following examples:[5]

i. Cayman Islands, Maldives, Kuwait, Bahrain etc. - No Personal Income Tax whatsoever.
ii. Costa Rica, Lebanon, Botswana, Singapore etc. - Territorial Taxation only i.e. no Foreign Income of resident assessees chargeable to tax under the domestic law.
iii. Australia, Canada, France, Germany, India etc. – Residential Taxation.
iv. United States and Eritrea - Citizenship based taxation along with residential taxation i.e. Citizens are taxed same as residents.

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[5] http://www.ey.com/Publication/vwLUAssets/Global_Executive_2011/$FILE/GE 2011_Global_Executive.pdf(last accessed on 1 September 2015).

Territorial systems usually tax local income irrespective of the taxpayer worldwide income which leads to potential avoidance of taxation on portable income by moving it outside his home country. Residential systems like India have to undertake the daunting tasks of defining '*resident*' and characterizing the non-residents' income, which varies from country to country. The test for residence acting as one of the connecting factors to determine tax liability of an individual for an individual has been mentioned under section 6 of the IT Act (Residents, Non- Residents, and Not Ordinarily Residents). It is based on the number of days a person has been residing in India in the previous year or years before. For corporations the test of residence has been recently changed by the Finance Act, 2015. From this year onwards, a company will be considered to be resident if it is incorporated in India or if it's Place of Effective Management (POEM) is in India. Earlier, test of control and management wholly in India was used. Thus if part of control was outside India even though it was largely controlled from India, it would not be considered a resident of India which led to avoidance of tax on global income by such companies under the IT Act. This could be achieved simply, by say, having one or more foreign directors and board meetings outside India. Various judicial pronouncements have laid down that this control and management refer to de-facto control and management and not the rights to control and manage.[6] Now, place where key management and commercial decisions necessary for the conduct of business of an entity as a whole are made in substance will be considered the place of residence for that company for the purposes of Indian IT Act.[7] Also, section of the IT Act categorically mentions that if a person is resident in India in a previous year relevant to an assessment year in respect of nay source of income, he shall deemed to be resident in India in the relevant assessment year in respect of each of his other sources of income i.e. not only his India sourced income but also his worldwide becomes taxable in India. Under the IT Act, they will have to file their tax return and disclose assets. Indian IT Act also provides for taxing of any payment that has to be made to a non- resident, the resident tax payer is obliged to deduct tax at source and pay under section 195 of IT Act at the rates as specified by the CBDT. For e.g. dividends paid by domestic countries – NIL, for royalties and technical services- 10% etc. It does not apply to non-resident tax payer or to payments made outside India by one foreigner

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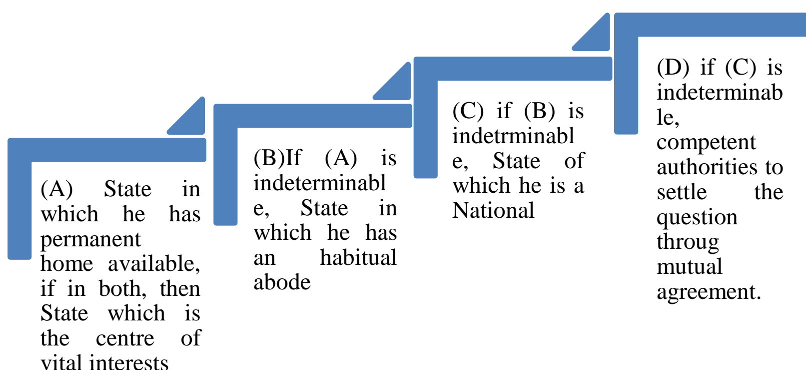
[6]CIT v. Bank of China,(154 ITR 617) (1985).

[7] http://www.rashminsanghvi.com/downloads/taxation/internationaltaxation/Budget 2015_Direct_Tax_and_FE MA.htm(last accessed on 14October 2015).

to another even if the other has rendered services in India this is because a country does not recognize or enforce revenue laws of another unless they have agreement of such nature[8].

To mitigate the double taxation of income the provisions were made which extend relief in two ways- unilateral and bilateral (section 90[9] - through treaty). In case where an individual happens to be a resident of both the contracting states based on their domestic tax law, double taxation avoidance agreements actuate which country's tax law shall apply by ascertaining the actual residential status of a person in the following manner[10]:

Person shall be *Resident* of only that State[11]-



And in case of person other than individual, determination shall be made based on situation of POEM. These rules are referred to as '*tie breaking clause*' which apply when the concerned person is resident of more than one state. But, the treaty provisions are also applicable when a person is resident in one country but has a source of income situated

[8] http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Articles/Groping%20in%20the%20Dark%20%20The%20Extending%20Arms%20of%20the%20Indian%20International%20Withholding%20Tax.pdf(last accessed on 30August 2015).

[9] The Central Government can enter into an agreement with Government of any other Country for granting relief to the assessee having to pay tax under Tax laws of both the Countries to avoid double Taxation, exchange of information for the prevention of evasion or avoidance of income tax chargeable under Tax Laws of the contracting States.

[10] https://www.icsi.edu/docs/webmodules/Publications/4.%20Tax%20Laws%20and%20Practice.pdf(last accessed on 11 September 2015).

[11] Based on OECD guidelines

in another country, leading to a situation at hand where his income is taxed in both countries i.e. double taxation occurs. For example, Article 1 of India- US DTAA mentions that it is applicable to persons who are residents of one or both of the contracting states.

Section 91 applieswherethereis no agreementunderSection 90 forrelieforavoidance of doubletaxation of incomewhereinbydeductionorotherwise, he shall be givenreliefundertheIndian IT Actitself i.e. domesticlaw of the country willapply. He isentitledtoclaimdeductionfromthetaxpayablebyhimonsuchdoublytaxedincome at ratelower of eitherthe actual taxpaid in theforeign country oramountcomputedundertheIndian IT Act. Thisreliefisavailableto non-residentassesses, butonly in respect of theirincomefrom a firmregistered in India and resident in India. As far as DTAA withtaxheavensisconcerned[12]. India's DTAA withTaxHeavenslikeMauritius, Cyprus, havefacedcriticismespeciallythe capital gainsreliefprovision. Itispivotaltomentionherethat in 2013, CBDT issued a pressrelease[13] notifyingCyprus as a non-cooperativejurisdictionforfailuretoprovideinformationwhichwasrequestedforunderthe Exchange of Information ("EoI") provisionsunderthetaxtreatybetween India and Cyprus. Followingthenotification, itwasclarifiedthatthoughthe DTAA has notbeenterminated, itsbenefitshavebeen, to a largeextent, done awaywithincluding no deductionsforanypaymentmadetofinancialinstitution in Cyprusorforanyexpenditurearisingfrom a transactionwith a personlocated in Cyprusunlessthetaxpayerfurnishestherequisiteinformation.Singaporethoughpermitsforeignersto set up companiesthere, levies no capital gains and incometaxonforeignprofitsdespite anti abuse rules in the India-SingaporeTreaty. ThemostinfamousisIndia's DTAA with UAE whereinthereis no incometaxwhatsoeverforindividuals, subjecttoconditions, which can possibly lead tostashingaway of unaccountedmoneyfrom India.[14]Thoughgovernmentisundertalksforrenegotiation of suchtreaties. Fore.g. Mauritiustopreventthe abuse of the beneficial provisions of DTAA and facilitatetheexchange of informationbetweentheparties. In

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[12]Has been explained later in the paper.
[13]Notification No. 86/2013 dated November 1, 2013
[14]www.rashminsanghvi.com. Presentation on Tax Haven

thepastfewyears, enteredintoseveralEoIagreementswithothercountries, especiallythetaxheavens, tocheckevasion. Recently, thegovernment has alsosigned multilateral automaticexchange of information (AEOI) forsharing of tax data and has enteredanagreementwiththe US undertheForeignAccountTaxComplianc eAct (FATCA) which willenable India togetinformationaboutfinancialtransactions done byIndianpersons in othercountries.[15]

Theintroduction of many anti- abuse provisions in thenationallaw as well as treatyprovisions has rootedfromthe case of AzadiBachaoAndolan [16] in whichtreaty shopping [17] wasthekeyissue. TheSupremeCourtwhileobservingthatthe central governmentunderSection 90 can tax/grantexemptions, upheldthevalidity of Circular No. 682 providingfortaxing of capital gains of anyresident of Mauritiusbyalienation of shares of anIndiancompany in Mauritiusonly. ItfurtherheldthatLimitationonBenefits ("LOB") clauseismustiftheintentionistopreventtreaty shopping. Pursuanttothisjudgement, theIndianTaxauthoritieshavetaken up toensurethat bilateral taxtreaties are notusedforabusivebusinessarrangements. In 2015, India-Mauritius DTAA has beenrevisedtoincludean LOB clause. Presently, India has comprehensiveTaxTreatieswitharound 88 countriesout of whichonethirdhaveArticleon LOB afterthereportaddressing BEPS (Base Erosion and ProfitShifting) wasissued in February 2013. LOB provisions are aimed at denyingtreatybenefitsfor a transactionifitsmainpurposewastoobtainbenefitsundertherespectivetaxtre aties. Thisisusuallyexaminedbasedonallfacts and circumstances, of whether in theabsence of suchtaxadvantages, a reasonabletaxpayerwouldhaveenteredintothesametransactions/ arrangements. Suchclausesalsoindicatethatdomesticlawwouldoverridethe Treatytopreven ttaxavoidance.

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[15] Jayant Sinha, *Black Money Finance*, The Economic Times, availaible at http://articles.economictimes.indiatimes.com/2015-07-0/news/65036832_1_blackmoney-finance-jayant-sinha-tax-information-exchange-agreements (last accessed on 12 October 2015).

[16] Union of India v. AzadiBachaoAndolan,(2003) 132 TAXMAN 373 (SC).

[17] Re- routing of funds from non- contracting State through one of the contracting States to benefit from the Tax Treaty provisions between the two contracting States.

3.2. Tax heaven

OECD very well recognizes that every sovereign jurisdiction has a right to determine whether to impose direct taxes on income and if so then to determine the appropriate tax rate[18]. Also, countries are usually not obligated to provide customer information to tax authorities abroad. In simplest of terms, a tax heaven country is a place where income is taxed at a lower rate or there is no tax at all because of which '*persons*' move from jurisdiction of high rates of taxes to a region where tax liability is lower. This has perpetrated aggressive competition amongst various nations to lure international investments in their country, especially amongst small countries, thereby making '*tax heaven shopping*' available to multinationals. Obviously, this adversely affects the tax revenue of the Country from where such '*persons*' transfer their business. Switzerland is the most infamous tax heaven followed by certain Caribbean countries. They also tend to facilitate domestic tax evasion[19] and money laundering through strict financial secrecy laws. [20] Other Factors determining whether a jurisdiction is a tax heaven – lack of transparency, prevention of effective exchange of tax related information etc.

Tax heavens may have reputable banks to attract business and customers' accounts therein are required to pay taxes in that region even though they are not the citizens/residents of such countries. The taxes paid here are much lower than they would have had to pay in their home country which can lead to considerable amount of saving in the long term. People use these tax heavens to hide their income generating investments, due to non- disclosure, they can avoid paying taxes on that income. It is imperative to mention here that this idea of low taxes, high privacy is not illegal. What is illegal is the failure to report income from foreign accounts to the tax authorities back home in accordance with domestic tax law. Indian jurisprudence deal with unaccounted money and illegal income through legislations covering following transactions with foreign element having repercussions on Indian taxation (with recent updates brought by Finance Act, 2015):

[18] http://www.igidr.ac.in/money/mfc-12/Manish_Shashank.pdf(last accessed on 18 September 2015).

[19]Avoidance of taxes which otherwise have to be paid to home Country by allowing taxpayers to reallocate taxable income from high to low tax jurisdiction.

[20] Richard A. Johnson, *Why Harmful Tax Practices Will Continue After Developing Nations Pay: A Critique of the OECD's initiatives against harmful tax competition*, 26 Boston College Third World Law Journal 351 (Spring 2006).

3.2.1. Undisclosed foreign income and assets

Before 2012, there existed a clear void in Indian law as disclose of foreign assets was not a requirement under Income Tax Returns filed by the Assessee. Also, Wealth Tax Act did not cover within its ambit disclosure and taxation of productive financial assets which could have possibly perpetrated stashing away of black money in the form of shares in foreign company, foreign bank account, international securities etc. undisclosed and unaccounted for especially in tax heavens. Finance Act 2012 changed this scenario following numerous leaks of tentative figures of the amount of black money stashed abroad by Indian Residents by mandating the residents to file return of their foreign assets under Schedule FA whether or not they had taxable income under the Act. After years of lackadaisical approach of the previous Government, the new government finally came up with much controversial Black Money (Disclosure of Foreign Income and Assets) Act, 2015.

The Act shall apply to all persons who qualify to be a '*resident and ordinarily resident*' as under Section 6 of the IT Act. It proposes to levy a tax of 30% on the total undisclosed foreign income and Assets of a person in a year. The total undisclosed foreign income and asset in a year is the income from a source outside located India that has not been disclosed in the return or where the Indian tax return is not filed and the value of undisclosed asset (held by assessee in his name/beneficial owner/beneficiary). These undisclosed assets are to be taxed on their Fair Market Value in the previous year in which the Asset came to the notice of the tax authorities. The penalty can be levied upto 3 times on the tax amount i.e. 120% alongwith the risk of prosecution which can be rigorous imprisonment from six months to seven years for failure to furnish returns in respect of Foreign Assets/income. The punishment for wilful attempt to evade tax w.r.t. foreign income/asset will be rigorous imprisonment from three to ten years in addition to fine.[21]

3.2.2. Money laundering

Money laundering is concealing of the proceeds generated out of a criminal activity in order to disguise its origin and make it seem like it was generated through legit means. Offshore tax heavens have long been associated with money laundering owing to their stringent financial

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[21] http://pib.nic.in/newsite/PrintRelease.aspx?relid=117477(last accessed on 4 September 2015).

secrecy laws which prohibit disclosure of anonymous accounts to tax authorities abroad. A hypothetical situation can be considered to understand how tax heavens in a way promote and protect money laundering. If a high stature government employee is taking bribe or steals substantial wealth from government funds, obviously, he will not be able to hold this huge amount in his name in his domestic bank account. So he might open an offshore company in tax heavens, the payers of illegal monies will directly transfer the sum to the company's account without payee's name appearing on any of the financial document/ instrument. The company will become a veil covering his name. Tax heavens laws provide for secrecy which along with the system of '*Bearer Shares*' [22] prevent leaking of account holder's information.

In India, Prevention of Money Laundering Act, 2002 (PMLA) attempts to curb money laundering and provides for seizure, confiscation and freezing of the proceeds of the criminal activity. The Act also empowers the Enforcement Directorate to confiscate the Indian property of equivalent value of foreign assets in case it finds it difficult to bring the funds back to India. Also, Finance Act, 2015 has made tax evasion relating to foreign assets and income a predicate offence under the Act i.e. unaccounted money or undisclosed assets abroad will now be considered a main and serious criminal offence under PMLA along with the penalty under the IT Act. [23]

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[22] *Ibid.*

[23] http://www.rashminsanghvi.com/downloads/taxation/internationaltaxation/Budget_2015_Direct_Tax_and_FEMA.htm(last accessed on 26 September 2015).

3.2.3. FEMA provisions

Finance Act 2015 has also inserted Section 37A in FEMA which that if any person holds any property, security of foreign exchange abroad contravening Section 4 of FEMA, an equivalent value of Indian Property can be seized by the Enforcement Directorate without any notice or opportunity of proving to the tax payer. This is because in case a person holds assets in a tax heaven in violation of Section 4 and when the ED wants to confiscate his foreign assets, the government or its banks may refuse to cooperate owing to their secrecy rules, ergo, ED is given power to go after his domestic assets. It will deemed to be black money. Also the order will be non-appealable under FEMA, only Writ jurisdiction to the High Court.

3.2.4. Transfer pricing

As mentioned earlier, tax heavens help people to hold wealth safely and incognito. Tax planners are concerned about how to transfer the funds outside their home country to a tax heaven to hold and own the same safely and utilize it without actually breaking the law. Shifting of trading profits can be done through transfer pricing. Transfer pricing is undertaken between associated enterprises or related enterprises associated by reason of common ownership, control or interest wherein an entity in a high tax jurisdiction like India under invoices its incomes and over invoices its expenses and shifts the resulting profits to a tax heaven where its associated enterprise is located. Pricing of products is the key in the scenario to transfer taxable profits from taxing country to a tax heaven.

Example: A U.S. Co. gets its raw material from other countries where it has subsidiaries. Also the company has subsidiaries in tax heavens like Malaysia, Panama etc. Now, the subsidiaries will sell their finished products (to be used by the US Co. as raw material) to group's tax heavens at the lowest profit margin. Tax heavens will sell the same goods to the US Company at highest profit margin. US Co. will have to pay several other expenses like interest, royalty etc. to group's tax heavens. That way, substantial profits of the group can be retained in tax heavens. Profits will remain same for the group as a whole, it's just the group reduces its overall tax liability.

In India too, there was a need to develop a mechanism to determine fair and equitable profits and taxing them in India. So, Finance Act 2001

brought detailed transfer pricing provisions in India through Section 92 to 92F of the IT Act. These provisions provide for determination of transfer price and documentation procedure. Finance Act 2012 extended the applicability of transfer pricing to certain domestic transactions (Section 92BA) [24] . The aim of these provisions is that price of goods/services transferred between the related enterprises (transfer price) should be at arm's length price.[25] Price more or less than the arm's length price can result into uncompetitiveness of the product due to high cost or loss at an entity level respectively. The term associated enterprises has been defined under Section 92A of the IT Act, the pith of the section is that Associate Enterprise can be determined on the basis of control, capital or participation in management of one entity over the other. It is to be noted that the participation can be direct or indirect. Section 92(2) elucidates instances of Deemed Associated Enterprises. International transaction has been defined as transaction between two or more associated enterprises, at least one of whom is a NR having bearing on their profits, losses, income, assets etc. including their mutual agreement for contribution, allocation or apportionment of any cost or expense w.r.t. any benefit/service provided to any of such enterprises. Transactions can also deemed to be International between such Associate Enterprise looking at the substance of their relationship. Section 92CA calls for reference to the Transfer Pricing Officer by the AO for the computation of ALP in an international transaction. He can call for information from the Assesse, can proceed *suomoto*, discover, inspect, call for attendance, etc.

It is pivotal to mention here that transfer pricing continues to remain as one of the significant challenges faced by the foreign investors.[26] Off late, more complex issues that are debated include cost sharing for market intangibles, share valuation etc.[27]

i. Market Intangible: An increasing number of MNEs tap the Indian markets by offering their products through Local affiliates/distributors. Owing to strong market competition, there

[24]E.g. Transactions between related parties, other parties having substantial interest.

[25] ALP- Fair price of goods/ services chargeable from an independent party in uncontrolled conditions

[26] http://www.pwc.in/services/tax/news_alert/2013/pwc_news_alert_5_july_2013_transfer_pricing_perspectives_recent_judicial_developments_on_significant_issues.pdf(last accessed on 20 September 2015).

[27] http://puneicai.org/wp-content/uploads/HDG-ICAI-Pune-Transfer-Pricing-Latest-Developments-4-July-2015.pdf(last accessed on 5October 2015).

has been substantial increase in AMP (Advertising, Marketing and Promotion) expenditure incurred by the Indian licensee on behalf of its foreign AE which has brought key transfer pricing issue in intra group transactions relating to the creation of market intangible and the taxability of associated income [28]. In LG Electronics case [29], Delhi SB ruled that tax payer's use of brand/logo of its AE outside India coupled with AMP expenditure higher than industry average is basically a tacit agreement between the parties for promoting the foreign brand and same can be considered as provision of service to AE by the tax payer [30]. The same was to be treated as an international transaction, calling for applicability of Transfer Pricing Regulations. This position led to a lot of ambiguity which was finally clarified last year in the case of Sony Ericsson[31] wherein the Delhi High Court held that AMP expenses can be characterized as International Transaction subject to transfer pricing but it rejected the concept of bright line test suggested in LG test and that non-routine AMP may not necessarily be considered a separate transaction. Marketing and distribution expenses can be clubbed for ALP determination as they are closely linked. High Court said brand building is not equivalent to advertisement even though latter is exorbitant [32]. The Court stated that transfer pricing provisions are anti- avoidance provisions, should be appointed selectively so as to they don't lead to double taxation.

ii. Share Valuation: Recently Bombay High Court in Shell India Markets case [33] following its decision in Vodafone [34] held that transfer pricing provisions do not apply to capital amounts received or arising on account of issue of shares by an entity to a

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[28] http://www.tp.taxsutra.com/microsite/AMP#content-bottom(last accessed on 11 October 2015).

[29] LG Electronics India Pvt Ltd v. ACIT, [2013] 29 taxmann.com 300 (Delhi-Tribunal)(SB).

[30] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/tp-india-march19-2015.pdf(last accessed on 28 September 2015).

[31] Sony Ericsson Mobile Communication India Pvt. Ltd. v. CIT, (ITA No. 16/2014)-Taxsutra.

[32] http://www.pwc.in/assets/pdfs/news-alert-tax/2015/pwc-news-alert-18-march-2015-delhi-high-court-on-marketing-intangibles.pdf(last accessed on 21 August 2015).

[33] Shell India Markets Pvt. Ltd. v. ACIT LTU and ors (Writ Petition No. 1205 of 2013 – Bombay High Court).

[34] Vodafone India Services Pvt. Ltd. v. UOI, (2014) 368 ITR 1 (Bom)

non-resident entity. This is because 'income' should arise out of International Transaction which is chargeable to tax and Income does not include capital account transaction. Thus, there is no charge on transaction of issue of share at a premium (capital in nature). Moreover, Chapter X is a not charging provision but a machinery to arrive at ALP between AE. Mere non reporting of transaction in form 3CEB would not give jurisdiction to tax department to tax a non- taxable transaction.[35]

3.2.5. Offshore transfers comprising Indian assets

The mechanism followed to shift Capital gains from indirect transfer of Assets in India away from India is that the Parent Co. /Individual holds assets in the Host country through a subsidiary Company/SPV (ABC). These shares in SPV are held through a tax heaven entity (EFG). Whenever transfer of interest in ABC is desired may be due to substantial increase in the value of business, the same is achieved through EFG i.e. Transfer of shares of EFG. No tax will be payable in India as no transaction has been directly occurred or recorded in India In simple terms, situs of the title documents is shifted outside the host country to avoid taxes in the host country as judiciary goes by form and not substance as in case of Vodafone International. The Supreme Court in this a case put an end to a long dragged controversy surrounding the taxability in India of offshore transfer of shares of a company (in Cayman Islands) by the Hutchison group to Vodafone.[36] The Court came to a conclusion that there existed no tax liability on Vodafone as Indian tax authorities do not possess territorial jurisdiction to tax the off- shore transaction in the stated facts. Tax department was directed to return INR 25000 collected by it as tax earlier. While interpreting Section 9(1) (i) of the IT Act[37], the Court observed section does not cover indirect transfers of capital asset which can also be noticed from perusal of Direct Taxes Code Bill 2010 proposals. As for the applicability of Section 195 (Withholding tax), the Court held that TDS would not arise as the case involves offshore transfer between two non-

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[35] https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/india-dec-8-2014.pdf(last accessed on 17 September 2015).

[36] https://www.kpmg.com/in/en/services/tax/flashnews/kpmg-flash-news-vodafone-international-holdings-bv.pdf(last accessed on 8 September 2015).

[37] Section inter alia says that income accruing/arising directly or indirectly from transfer of a capital in situated in India is deemed to arise/ accrue in India in the hands of the transferring non- resident.

residents, thus no liability to pay capital gains tax in India. Also Vodafone cannot be treated as representative assessee of HTIL. The Court asserted if NR, through abuse of organizational form makes indirect transfer to avoid tax/ withholding tax, the tax authorities can disregard this form of arrangement and characterize the equity transfer according to its economic substance and impose tax.

It is pivotal to mention here that this impugned judgement was in a way held to be moot by insertion of explanation 2 to Section 2(47) with retrospective effect from 1962 by Finance Act 2012 which clarified that '*transfer*' included parting with/creation of asset in India directly/indirectly through a Share Purchase Agreement or otherwise, notwithstanding that such transfer has been effected through transfer of shares of a Company registered/incorporated outside India and shall be subjected to tax in India. The amended provisions (Explanation 5 to Section 9(1)(i) provides that capital asset (share/interest in foreign entity) shall be deemed to be situated in India if the share derives directly/indirectly, its value substantially from assets located in India. Finance Act 2015 has extended clarification to the term '*substantial*' as the value of Indian assets (tangible/intangible) exceeding INR 100 million and representing at least 50% of the value of all the assets held by the foreign entity. If all the assets of foreign entity are not located in India then capital gains tax is proposed to apply to only such part of income as is reasonably attributable to the Indian assets. The Act also mentions case where indirect transfer provisions would not apply.

The Indian government has attempted to curb the tax evasion by residents through tax heavens by enacting plethora of national laws some of which have been mentioned above in brevity and by entering into bilateral tax agreements containing anti abuse provisions with such nations respectively. One classic example, which can be illustrated, would be of India-Singapore DTAA. Singapore was considered to be a downright Tax Heaven owing to its territorial system of taxation and even because the Limitation of relief – article 24 of the India- Singapore DTAA exempted from its purview capital gains which led to tax evasion from India. The position changed after the treaty was amended in 2005 which made it taxable under Singapore tax law and exclusion of the benefits to shell/conduit companies which have been elaborately defined under the DTAA and also LOB clause was included in the revised bilateral agreement. Thus, the Indian government is continually on a look out and attempts to plug loop-holes in domestic tax laws as

well as international treaties to curb non-disclosure of income and erosion of tax payable in India.

4. TAXABILITY OF OFFSHORE DERIVATIVE INSTRUMENTS (ODIs)

Sometimes, it is difficult to ascertain the actual owner of the underlying asset, the actual possessor of the real entitlements/ benefits/ benefits accruing from such ownership though he does not hold legal title to the same (substance over form approach). This usually happens in the case of Offshore Derivative instruments leading to deferral of taxes in the resident country. Tax Authorities aim to prevent the tax avoidance by looking at the beneficial owners under the garb of conduit structures. ODIs have been defined under SEBI (Foreign Institutional Investor) Regulations, 1995 as instruments, which are issued outside India by a FII against underlying securities held by it (listed/proposed to be listed in Indian Stock Exchange). E.g. Participatory Notes, swaps, options, contracts for difference etc. In the absence of unequivocal tax provisions, it becomes difficult to determine who is the beneficial owner whether the issuer long party holding the securities situated in the source country and has hedged his position by issuing derivative instruments against such securities/assets or the recipient party i.e. holder of the derivative instrument. Holder of an ODI is only entitled to the returns on the underlying securities with no rights in such securities because their ownership and other similar attributes vest with the FII. Unlike in few international precedents, Law in India is not very clear to make such holders, beneficial owners of such securities taxable under the Income Tax Act as it is not mandatory for FII to hedge his position, no voting right to the holder, holder cannot instruct FII to sell the underlying securities etc. The value of ODI can be linked to an asset in India (security from which swap derives its value), it is a nonetheless a contract that does not really obligate FII to acquire/dispose such security i.e. he may not fully hedge its position vis a vis the counterparties. On redemption of ODI by FII, holder is entitled market price plus dividend (no requirement to sell securities by FII). Holder having no control on securities should not be perceived as share/interest deemed to be situated in India under Explanation 7 to Section 9(1) (a). Thus, there exists a clear void in Indian tax law as far as taxability of offshore derivative instruments is concerned despite capital gain tax amendments brought by Finance Act 2012.

5. NEED FOR MAT (MINIMUM ALTERNATE TAX)

A company is supposed to pay tax in accordance with IT Act provisions but its Profit & Loss Account is prepared as per the Companies Act provisions. Certain companies show book profits, declare dividend but shows nil income under the IT Act and thus referred to as zero tax companies due to large number of exemptions deductions under the Act. Section 115JA states companies paying normal income tax less than 18.5% of book profits on account of various deductions/exemptions under the Act, it has to pay MAT at 18.5%. Controversy relating to applicability of MAT on foreign companies especially FII/FPI has been settled by Finance Act 2015 which clarifies that MAT provisions would not apply to income accruing to foreign companies (including FII/ FPI) from capital gains from transaction in securities/interest/royalty/FTS FY 2015- 16 onwards. Also, pending cases prior to April 1, continued to be under the tax radar till it was subsequently clarified by the government that such transactions shall also not be taxed. Also, the Finance Act 2015 has settled the long dragged controversy of taxability of AOP under MAT provisions. There was conflict of Company Law and Income Tax Law, former stated that AOP members are not taxable on share of their profit in AOP but the latter included this share of profit in book profits leading to a situation had to pay MAT after AOP has already paid the tax which has been negated by the 2015 Act. For FIIs also MAT has been removed. Though it seems both these amendments have been given prospective effect, though the amendments are clarificatory in nature.

6. GENERAL ANTI AVOIDANCE RULES (GAAR)

GAAR is an anti- tax avoidance rule introduced in 2012 Budget by the then Finance Minister to counter aggressive tax avoidance schemes. Enactment of these rules shows how India is moving slowly though surely towards substance over form taxation and legitimate business planning.

i. Transaction/arrangement having no commercial substance other than evading tax can be denied tax benefits by the empowered officials.
ii. Target Participatory Notes (hedging of funds not registered with SEBI, Investment I Indian securities by anonymous foreign holder of derivative. So far, tax would only be imposed on the holder of securities (registered financial firm) who buys securities

on behalf of the client.[38] The investor has to prove that the respective Participatory Note is not undertaken to avoid taxes.

iii. Tax Department could deny double taxation treaty benefits to foreign funds if deals are made in tax heavens like Mauritius to avoid taxes.

These rules signify tough stand the government is willing to undertake to crack down tax evasion. The domestic Law expressly provides that GAAR provisions would override all tax treaties so as to give wide powers to the tax authorities to look through/disregard/re-characterize transactions having tainted elements like- not at ALP, abuse of tax provisions, not in an ordinary employed bona fide manner etc. Invocation of GAAR can have far reaching ramifications for foreign investors in India. But the guidelines explaining aspects of GAAR, circumstances in which it can be invoked, its application etc. is awaited[39]. The rules were introduced in 2012 but the announcement spooked foreign Investors and the rules were widely criticized, due to its negative publicity, its implementation was postponed till 2013. In September 2012, the reports postponed its implementation for another 3 years. In Budget Speech 2015, the new government indicated that it has been striving to foster a stable and predictable taxation policy and a non-adversarial tax administration as over the past few years. India has been increasingly losing favour with foreign investors as a result of its unpredictable tax regime, to the extent of being termed as the world's most draconian tax regime. Ergo, a series of step has been taken in this regard for the creation of a stable and predictable tax regime in India- deferral of GAAR by 2 years, shelving of Direct Tax Code [40] permanently, and proposed reduction of corporate tax to 25% over the period of next four years, phased removal of all exemptions available to corporate entities etc.

7. BASE EROSION AND PROFIT SHIFTING (BEPS)

Profit shifting is one of the ways in which erosion of national tax bases occur. Multinational companies use 3 mechanisms to shift profits across

[38] http://profit.ndtv.com/news/corporates/article-5-facts-about-the-general-anti-avoidance-rule-gaar-300693(last accessed on 25August 2015).

[39] http://www.ey.com/IN/en/Services/Tax/EY-how-will-doing-business-in-india-change-with-gaar-pranav-sayta(last accessed on 3 September 2015).

[40] Code to replace Indian IT Act thereby consolidating and amending law relating to income/dividend/wealth/fringe- benefit taxes so establish equitable direct tax system to improve tax- GDP ratio(last accessed on 28August 2015).

borders viz*hybrid mismatch arrangement* to take advantage of lower tax rates as same money or transaction is treated differently by different countries, *Special Purpose Entities (SPEs)* with little or no presence in the host economy to avail the benefits of tax agreement of the contracting States, *Transfer Pricing* used to decide how profits should be allocated among the different parts of the company in different countries and how much tax the MNC has to pay and to which tax administration. BEPS concerns fairness and equity in payment of taxes by MNCs for which national level solutions don't suffice.

International tax rules are generally efficient in ensuring that companies are not subject to double taxation, but BEPS takes advantage of gaps in the rules to avoid paying tax completely, so-called "double non taxation" or to pay a sum across two or more countries that is less than what they would pay in a single country.[41]

On this issue of BEPS, OECD published a Report on October 5, 2015 wherein Action Plan 6 elucidates preventing the grant of Treaty benefits in 'Inappropriate Circumstances' i.e. where the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and treatment. For this purpose, the Report proposes insertion of "Principal Purposes Test" (PPT) to address such cases. The Action Plan will also for example stop the abuse of transfer pricing by ensuring that taxable profits can't be artificially shifted through the transfer of patents, copyright or other intangibles away from countries where the value is created, and it will oblige taxpayers to report their aggressive tax planning arrangements.

The Report also provides clarity on conflict resolution between provisions of Tax treaties and applicability of domestic GAAR through guiding principle of BEPS. BEPS Action Plan also asserts that considering nature and high impact disputes involving implementation of GAAR, an administrative/approval process has to be brought in order to ensure consistency and avoid its unscrupulous application.[42] Thus, under BEPS Action Plan, there is an apparent interaction between Public International Law and Private International Law.

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[41] http://oecdinsights.org/2013/07/19/what-is-beps-how-can-you-stop-it/ (last accessed on 11 September 2015).

[42] http://www.itraf.org/document/OccasionalPaper-5.pdf(last accessed on 23 September 2015).

8. CONCLUSION

The Premise of the Paper lies in elucidating that how International Tax Law though an independent branch of Law is more inclined towards or follows the principles of Private International Law rather than Public International Law. *"International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions*. In the Indian context- IT Act, others laws like PMLA, FEMA, GAAR, Black Money Act, judicial decisions (e.g. Vodafone for indirect transfers, Sony for Transfer Pricing (market intangibles) etc.), various upcoming legislations and amendments form the aggregation of those national law/rules which triggered by conflict of tax laws (occurring from each State's sovereignty) due to diversity or duplication of law of each State's internal tax laws. Even though Bilateral DTAAs do exist but the conflict of law situation is resolved by the municipal law itself as In case of conflict between the two, IT Act is applicable (or the more beneficial provision) and also the recent GAAR clearly and unequivocally gives precedence to municipal law over these DTAAs in dealing with cross border transactions tainted with elements like not at ALP, abuse of tax provisions, not in an ordinary employed bonafide manner etc. The 2015 Black Money Act appears to be colour-coding black according to location. The Act does not claim to be noble, equitable or consistent rather fathoms the government's desperation to not lose its tax revenue to any other Country under the garb of insufficiency of statutory provisions dealing with the problem. The Act also provides for entering into agreements by the government with other countries for information exchange regarding resident's money/assets/accounts abroad (like FATCA in US).Thus it can be asserted the International Taxation in fact resembles Private International Law approach rather than Public International law as the solutions to most of the if not all the international conflicts in the matters of taxation lie in the local law (legislations and judicial precedents) itself. Cross Border Tax agreements do exist but they originate from the municipal law itself and in case of any conflict between the two, the latter prevails, though not always.