1. **Investing (time) : (taxing) infrastructure project**

1.1. Feechu Ltd of Japan (Japco) is a leading contractor engaged in the execution of high rise infrastructure projects. In response to a tender of Government of India (GOI) for constructing natural gas repository, Japco, in association with Hydra Car’s Boon Infrastructure Ltd (HCB), an Indian Company, constituted a consortium to bid for the project. Consideration in respect of each of the components viz. offshore supply, offshore services, onshore supply and onshore services was mentioned separately in the bid document.

1.2. Japco and HCB entered into Joint Venture agreement prior to submission of the bid. This internal agreement was furnished to GOI as part of the bid.

1.3. The features governing relationship between the JV parties are broadly as under:

   - It is envisaged that while the work of offshore supply and offshore service is to be the sole responsibility of Japco, work of onshore supply and onshore service is to be shared by HCB and Japco.

   - In the JV agreement, there is clarity on the basis on which onshore supply/service work would be divided as also about the basis on which the consideration in respect of such shared/allocated work would be determined.

   - The agreement is clear on the point that the parties have collaborated with the sole object of fulfilling contractual obligations to the extent mandated by GOI and they have no other intention to carry on business in common with each other.

   - Role and responsibilities of each consortium member are separately and clearly identified. No one has the authority to bind the other except as specified.

   - Each party is to make independent arrangement for execution of its part of work; each is responsible for own cost, insurance, providing guarantee, etc.

   - While each one is jointly and severally liable to GOI in respect of the project, there is mutual indemnification covenant for ensuring that loss caused to the non-defaulting party is duly indemnified by the other.

   - In the event of bankruptcy or default by one, the other party has to complete the project by taking over the responsibility such that at any time GOI is able to proceed against any of the member.

   - Japco is appointed by JV as a Lead member for central contact point for correspondence, negotiation, etc. Japco, as a lead member, can sign all the documents on behalf of JV as per accepted norms and keep HCB informed through periodic meetings.

1.4. The consortium was declared as successful bidder. Having regard to the condition of bid document, joint bank account has been opened to receive the consideration. The banker is given standing instructions to immediately transfer respective share of consideration to the individual account of each party.
1.5. In respect of its own share of work, Japco operated as under:

(i) The work of sourcing offshore supply is retained by Japco to itself. In order to comprehend the exact specifications and to oversee installation, the personnel of Japco spent 30 mandays in India during F.Y.2010-11 and about 60 mandays are likely to be spent in the next year. Deliveries of the supplies are to be effected outside India on high seas basis. However, GOI has power of inspection and rejection till the facility becomes operational as guaranteed.

(ii) To provide offshore services, Japco assigned the responsibilities and rewards of the segment to its wholly owned subsidiary Theechu Ltd, a Thailand company, for no consideration. Theechu Ltd has adequate infrastructure and talent to execute the work. The assignment was consented to by GoI subject to a covenant that the ultimate responsibility will continue to vest with Japco should there be any breach or violation of the terms of the tender. Japco has retained a corresponding right of indemnification from Theechu in respect of damages, if any, incurred by Japco as a result of default of Theechu.

(iii) The portion of work related to onshore supply (to the extent it constituted responsibility of Japco) was assigned for a considerable fee to an Indian subsidiary (ICo1) floated by Japco just a day prior to the day of assignment. The consideration payable by the subsidiary was shown as capital contribution. Japco believes that the assignment consideration is not liable to tax in its hands and does also believe that it will constitute tax admissible expenditure in the hands of ICo1.

(iv) The portion of work related to onshore services (to the extent it constituted responsibility of Japco) was assigned to another Indian subsidiary (ICo2) which has a track record of handling small jobs of much a simpler nature. It is also expected that given the more specialized nature of services, a couple of key personnel of Japco will remain in India for a period of about two years not only to supervise work of ICo2, but also to provide adequate handholding and training to the personnel of ICo2. Japco does not propose to charge any amount in respect of services rendered by its personnel to ICo2. JapCo personnel have been provided with regular cabins in the work place of ICo2 and have been permitted to attend their continuing obligations in relation to other projects in and outside India.

1.6. Issues for consideration are as follows:

(i) Whether income received from GoI will be taxable in the hands of the JV or its members?

(ii) Assuming income is not taxable in the hands JV as a unit of assessment, determine taxability and tax implications in India with regard to the following transactions pertaining to Feechu Group.

- Offshore supply
- Offshore services
- Onshore supply
- Onshore services

PS: Participants need not discuss tax implications for HCB or employee of JapCo.
1.7. Reference material:

- Section 5, 9, 28, 44DA, 92, 115A etc of Income-tax Act, 1961
- Article 5, 7 and 12 of India-Japan Treaty
- Article 5 & 7 of India-Thailand treaty
- Illustrative references:
  - *Ishikawajima Harima Heavy Industries v. DIT* [288 ITR 408](SC)
  - *CIT v. Hyundai Heavy Industries Co Ltd* [291 ITR 482](SC)
  - Hyosung Corporation, In Re [314 ITR 343](AAR)
  - *Ansaldo Energia SPA v. ITAT* [310 ITR 237](Mad)
  - Hyundai Rotem Co [323 ITR 777](AAR)
  - Instruction No 1829 of CBDT [since withdrawn in 2009]

2. Reining the Remittances: Health check ahead?

2.1. Shoppers Paradise Ltd (SPL) is engaged in the business of telemarketing of various health products. It has a chain of retail outlets. SPL has obligation to effect certain foreign remittances. All such contracts of SPL with the payees are on net of tax basis i.e. the payees are tax protected. Till today, SPL has adopted conservative stand of deducting tax after suitable grossing up, at rates advised by their adviser in respect of all the remittances discussed in para 2.3 herein.

2.2. SPL’s new accountant is worried about implications of section 206AA of the Act as also about growing hazards and is of the view that SPL should have a relook at tax withholding compliances. Out of caution, the accountant had approached all the payees requesting them to furnish their PAN in India. As expected, each of them not only declined to accede to the request but also indicate their unwillingness to continue their relations if the insistence endured.

2.3. In this background, the accountant has requested for your cool and calm thoughts on the applicable withholding tax compliance in respect of each of the following remittances:

(a) SPL has signed an agreement with an Indian agent of Sab Se Set Inc, a channel company from Singapore for placement of advertisements on TV channels which have large footprint area in India. SPL has not been deducting tax at source on the basis of representation of the agent that he works as an independent agent on behalf of multiple channels and that his role in India is limited to co-ordinate and liaise with advertisers like SPL. The Indian agent has made available a certificate from the channel company to confirm that the company has no PE in India. The Indian agent (who holds PAN) has agreed that tax can be deducted @1% in terms of section 194C of the Act while making payment to him.

(b) SPL has a non-executive director who is tax resident of Malaysia. The non-executive director is being paid directors’ fees for attending various Board meetings in and outside India. Tax @10% has been deducted at source under section 194-J of the Act.

(c) In order to equip newly recruited employees with various soft skills and other techniques of relevance to SPL’s business, SPL sends the employees for training workshops conducted by a reputed company which owns business training institute. The Institute is
headquartered in Hong Kong but conducts the courses in Netherlands. The remittance is made to Netherlands.

(d) Business guru of renowned fame from USA comes to India once a year and gives training to top cadre personnel of SPL for a day to equip company leadership to face challenges of the business. This is done after his understanding specific needs of SPL.

(e) SPL procured from eRetail Empowerment Inc of Singapore, software which would help SPL manage and control its supply chain and inventory. The software is, as such, an off the shelf software. Employees of the supplier would be in India to install the software on the server of SPL and on the individual machines of various employees of SPL after introducing various security measures such as password protection, firewalls, default back-up system, etc. Two training sessions would be held in India. In all, about 10 professionals would be present in India for about a week.

(f) For designing of its one of the state-of-the-art outlets which SPL is planning to set up, SPL is in active negotiations with a renowned architecture firm primarily based at USA and has been organized as a firm in USA. The engagement will involve understanding of the specific requirements of SPL and will involve tailor made designs. The work is to be performed largely outside India. USA firm is assessed as a ‘transparent entity’ and its income is taxed in the hands of its partners.

The service provider has indicated that the job engagement can be contracted with any of their affiliates in EU since each affiliate is as equally placed. The service provider has indicated that SPL can think of contracting with its affiliate from Finland, France, Netherlands, etc having regard to more beneficial treaty provisions read with MFN protocols and has left the choice to SPL.

2.4. In the background aforesaid, following issues may be addressed:

(a) Tax implications of each of the remittances under the Act and under the applicable treaty, if any.

(b) Impact of section 206AA – particularly, when payee has the benefit of concessional tax rate of the treaty

(c) Tax rate which needs to be adopted if section 206AA is held applicable – in particular, to examine if such rate needs to be increased by surcharge and/ or requires grossing up in terms of section195A of the Act.

(d) How best to mitigate/soften rigor of section 206AA.

2.5. To mitigate incidence of S.206AA, the accountant is seriously considering the option of filing application under section 197 of the Act by making use of SPL’s PAN and by claiming that the application is filed as an agent of non-resident payees in terms of section 163 of the Act.

2.6. **Reference Material**

- Section 5, 9, 115A, 163, relevant provisions of Chapter XVII-B etc.
- Circular No 714 dated 3 August 1995
- Provisions of applicable DTAA
- Illustrative references:
- *BBC Worldwide Ltd v. DDIT (37 SOT 253)(Del)*
3. **Fun Group : Hiving off stake in an Indian company**

3.1. Fun Group, a renowned business group in the field of entertainment headed by Fun Inc. of USA, has the following business structure for its international operations.

3.2. The structure comprises of Fun Singapore (heading the Asia Pacific region), Fun UK, (heading the European region) and Fun Africa (heading the African region).

3.3. Fun Singapore has an independent Board comprised of people who are employees of Fun US, apart from a couple of professionals at Singapore. The details of expenditure incurred by Fun Singapore in the recent years are as under:

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<th>31.03.09</th>
<th>31.03.10</th>
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<td>75</td>
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<tr>
<td><strong>Directors’ fees</strong></td>
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<td>50</td>
<td>50</td>
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<tr>
<td><strong>Executive, General and Administration Expenses</strong></td>
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<td>200</td>
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<tr>
<td><strong>Cost sharing contribution as per Global Policy to USCo</strong></td>
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<tr>
<td><strong>Total</strong></td>
<td>275</td>
<td>300</td>
<td>375</td>
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</table>
3.4. Fun Singapore acquired stake in Indian Company from another Singapore Company before 31 March 2007. The seller had held the stake through MauCo and Fun Singapore acquired shares of MauCo for cost of 100 MioS $.

3.5. In order to be a world leader in the field of entertainment, Fun group believes that it should hold 100% interest in any company within the group. After various rounds of negotiations, the group was unsuccessful in striking a deal of acquiring shares from the other shareholder of ICo. Hence, Fun Group decided to exit. Fun Singapore thereupon agreed to transfer shares of MauCo to another Mauritius Company, Mickey Co Ltd, which holds 60% interest in the Indian company. The consideration payable was inclusive of control premium, which Mickey Co, was willing to pay.

3.6. The news of transfer was well advertised in diverse public media. Decision to transfer was taken at a Board meeting in Hong Kong, but was approved by President operations in US. The news also featured on the website of Fun Group and in the regulatory filing that Fun US did in the US. The transfer was accompanied by non-compete covenant on the part of Fun Mauritius, Fun Singapore and Fun US agreeing not to compete in the same line of business in the territory of India for a period of 2 years. No separate consideration was specified in respect of non-compete covenants.

3.7. Based on the above facts, kindly determine the tax liability, if any, incurred in India in relation to impugned transfer of shares by:

   - Fun Singapore
   - MauCo
   - Fun US

Kindly also advise whether the Mikey Co incurred any tax liability or tax risk, as it did not withhold any tax. Also, as per advice received from participants of RRC 2007, Fun Singapore had refrained from withholding any tax at the time of its purchase.

3.8. Reference material:

   - Section 5 read with Section 9 of the Income-tax Act, 1961
   - Section 195 of the Income-tax Act, 1961
   - Article 13 (capital gains) of India’s treaties with Singapore, Mauritius, USA.
   - Article 3 (LOB clause) of India Singapore treaty as introduced vide protocol of 1994
   - Section 5(4)(g) & 5(6) as proposed by DTC 2010
   - Vodafone International Holdings B.V v. UOI (329 ITR 126)(Bom)

Roadmap to DTC 2010

DTC 2010 Bill has introduced CFC regulations in the form of Schedule XX to the Code. The regulation may have significant impact on the way in which Indian Companies have organized their overseas operations. The concept of ‘place of effective management’ as a test of residence as proposed in section 4(3)(b) of DTC 2010 will also have significant impact on the taxation of overseas entities in India. It is possible that the Indian companies may need to reorganize themselves well in time to face the challenges of the revised legal framework. It is hence that the case studies have been designed while being conscious that they do not deal with provisions of present law. The participants are requested to attend to these case studies on
the basis that provisions as proposed in DTC 2010 Bill have been introduced and are applicable to the years under examination.

4. **Place of Effective Management : Tuning to Poem**
   4.1. The family of Azzummal Golmal (A), an Indian resident, is in the business of trading in and manufacture of medical equipments. For the purpose, they have formed a company in India (Ind Co). The shares are held equally by A and by his brother’s wife.

   4.2. With a view to explore overseas market, 100% shares of a South African Company (SA Co) were acquired within the fold of Mauritius Co (Mau Co) which was set up as a step down subsidiary of Ind Co. Mr. A is the CEO of Ind Co and is also a director of Mau Co and SA Co. Mr. A resides in India for most part of the year.

   4.3. SA Co is in the business of sale and purchase of medical equipments globally. Mau Co is a pure holding company organized as GBLC1 Company in Mauritius and presently holds SA Co as its only investment. Mau Co has obtained a tax residency certificate (TRC) from the Mauritius tax authorities confirming that it is a tax resident of Mauritius under the Mauritius domestic tax law for calendar years 2009 and 2010 and is confident of obtaining the same for calendar year 2011 as well.

   4.4. In December 2010, Mau Co. received dividends from SA Co and has also earned significant profits from resale of products procured from Ind Co and reselling to SA Co.

   4.5. Mr. A believes that he is most diligent in complying with his tax obligations in India and overseas. He has declined the request of his tax advisor to review tax affairs of SA Co and Mau Co on the ground that these are foreign companies and can have no tax implications in India.

   4.6. On being promised free advice, Mr. A has since disclosed following pointers, based on which he has solicited views on residential status of the two overseas companies as per current tax law provisions and as per DTC 2010:
      - Mr. A actively participates in the decision making process of Mau Co / SA Co while being in India.
      - At least one meeting of the BOD of Mau Co / SA Co takes place in India. However, the minutes of the meeting are signed in the respective jurisdiction.
      - Fund requirements of Mau Co / SA Co are primarily sourced and solicited with the assistance of employees of Ind Co.
      - Key agreements with the customers are agreed to in India, but, are formally executed outside India.
      - Mauco/ SA Co did always have two employees to manage compliances.

4.7. **Reference Material**
   - Section 6 of the Income-tax Act 1961
   - Section 4(3)(b) as proposed in DTC, 2010
   - Article 4 of tax treaties of India with Mauritius and South Africa
   - OECD/ UN Commentary on Article 4
Illustrative References:

- De Beers Consolidated Mines v. Howe [(1906) 5 TC 198]
- Smallwood v. Revenue and Customs Comrs (2010) EWCA Civ 778 (Court of Appeals)
- Integrated Container Feeder Service v. JCIT (96 ITD 371)(Mum)
- Saraswati Holding Corporation Ltd. v. DDIT, 16 SOT 535 (Del)
- SMR Investments Ltd. v. DDIT (2010-TII-66-ITAT-DEL-INTL)
- Radha Rani Holdings (P) Ltd v. ACIT (16 SOT 495) (Del)

5. **CFC : Controlling the challenge**

5.1. **Fact Pattern**

![Diagram of CFC structure]

5.2. Till date, the group has been advised to channelize all their overseas acquisitions/ventures through Mauritius Company (Holdco) which has been organized as an ordinary company in Mauritius. Over years, Holdco has also acted as a trader for procuring goods from India and exporting to South African countries. This business segment involves Mauco’s dealings with unrelated parties.

Mauco has huge borrowings and till date has incurred accumulated losses.

5.3. The details of relevance in respect of downstream investments held through Holdco are as under:

(i) Company P owns IPR in respect of a patent owned by P which can be used for manufacture of drugs and pharmaceuticals. P is likely to earn licence fee of $ 100,000
from international customers in the financial year (FY) 2011-2012. From profit for FY 2011-12, it would declare interim dividend of $ 75,000 to A. In respect of such dividend income, A is not likely to pay any tax in its home country in view of benefit of participation exemption available to A in its home country. A is an operating company and for FY 2011-12, it is likely to have turnover of about $10M and net profit (including expected dividend from P) of about $100,000.

(ii) The acquisition of Q by B was a highly leveraged acquisition. Q is an operating company engaged in the trading business in Belgium. Q is likely to earn income of $ 300,000 for FY 2011-12. Q is likely to plough back profits for meeting its expansion needs. B is also located in Belgium. Belgium permits furnishing of annual return on a fiscal unity basis i.e B will file consolidated tax return wherein Q's income will also be offered to tax. Accordingly, B is likely to report income of $ 100,000 (after setting off its interest expenditure of $ 200,000 against income of $ 300,000 of Q). On such taxable income of $ 100,000, tax will be paid by B at the rate of 30%.

(iii) Equity shares of C are listed in a recognized stock exchange in Singapore. Preference shares of C are not listed. R (subsidiary of C and a company registered in Cayman Island) is engaged in the business of owning shipping containers and hiring out the same on rental basis. Considering that R is ‘cash cow’ of the group, business model adopted till date (and as desired to be followed in the future) is that income of R is upstreamed to C and from C to Holdco at the earliest possible opportunity. Listed company C has no other meaningful activity.

(iv) Holdco in Mauritius earned capital gain income of $ 1,000,000 apart from dividend income, if any. Given however huge trading loss, the company reported net loss.

(v) Certain incriminating documents found in the course of search suggest that during FY 2011-12, the effective control and management of Holdco was in India. It was also found that part of the control and management of some of the underlying companies was also in India.

5.4. In this background, kindly opine:

(i) Which of the overseas companies of Indian Group is likely to be considered as a controlled foreign company, and what is the likely amount of income which may need to be offered by resident shareholders as a result of CFC pick up

(ii) Which is the resident entity in whose assessment such CFC picked up income needs to be offered to tax

(iii) Which is the year in which income will be offered to tax

(iv) Wealth Tax exposure in respect of the structure in terms of section 113(2)(k) of DTC 2010

(v) Kindly also opine on the co-relation, if any, between the concept of place of effective management and the CFC Regulations vis-à-vis all the overseas companies

5.5. Reference Material

- The Twentieth Schedule read with section 58(2)(u), 113(2)(k) and section 291(9)(c) of DTC 2010.

- OECD publication on “Studies in Taxation of foreign source income : Controlled Foreign Company Legislation”.