Key takeaways from ITRAF's 2018 round table conference

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Background

After the successful launch of International Tax Research and Analysis Foundation ('ITRAF') in August 2015, ITRAF has engaged in various activities leading to its being a well-known Indian research-based organization today. ITRAF released various research papers as a part of its Occasional Paper Series authored by several of its members and external professionals on emerging issues in international taxation and base erosion and profit shifting (BEPS) concerns. The papers of 2015-16 and 2016-17 were published as two volumes. Two seminars/ conferences were also held in Bangalore to discuss the papers with interested participants.

During 2017-18, ten additional research papers are under preparation and as a part of its continuing interest in the dissemination of research, ITRAF conducted a roundtable on January 24, 2018 in Bangalore to discuss its ongoing research with select members from Industry and the Profession.

The round table was opened by a welcome address by Dr. Parthasarathi Shome (Chairman, ITRAF). Aptly stating that '*good research doesn't have to chase Government',* Dr. Shome expressed confidence that Government itself would chase good quality research while framing tax policies. He informed the audience that the younger bureaucracy has already shown interest in ITRAF work, which is an encouraging sign. Dr. Shome also urged tax professionals to submit research papers on any topical tax themes in 8000 – 12000 words which would stimulate intellectual debate and serve as a reference document for professionals all over the country.

The roundtable then saw some stimulating and thought-provoking discussions by tax stalwarts on issues ranging from philanthropy taxation to burning international tax topics like the digital economy, GAAR & impact of the recent US tax reforms in India, Insolvency and Bankruptcy Code (IBC) – Conflict with Income-tax law etc. These research papers are expected to be finalized and released in 2018 in the form of next volume.

Session 1 – Taxation of Philanthropy

The first technical session was presented by Mr. K.R. Girish who took the audience through his interesting research paper on Philanthropy Taxation. He commenced the session with some startling facts from a recently published report – post liberalization, 1% of the population holds around 73% of India's wealth and that 17.5 days salary of a middle level corporate executive = annual earning of a rural farmer. Mr. Girish then explained in detail the legal constitution for charitable & religious trusts and the income tax provisions which govern these institutions. Explaining the rationale behind providing tax exemptions for charitable contributions, Mr. Girish stated that *"Progressive taxation is the most efficacious route to redistribution. But a strong case* *for philanthropy is another way of making a strong case for lower taxation of the rich – to allow them with more money to spend on uplifting the poor."*

Thereafter, dwelling upon the international experience, Mr. Girish explained that while President Barack Obama made a number of attempts to limit the amount of giving that the rich can deduct from their taxable income, still US has the most generous tax incentives for charity, and has the highest giving as a proportion of GDP, at 1.67. Britain's tax breaks for charity are the next-most-generous, and it had the second-highest share of charity to GDP, 0.73%, followed by Australia, 0.69%, which also has significant tax breaks. He, however, stressed that charity comes from within and it is not derived from incentives. In this regard, Dr. Shome highlighted that in UK, HMRC had propagated a 'unique' proposal whereby the benefit of charitable contributions was to go to the donee and not the donor. Mr. Girish then dealt with the ugly side of charity whereby charitable institutions are used to facilitate tax evasion, crime and money laundering. Specifically in the Indian context, he stated that Corporate Social Responsibility (CSR) if approached as a 'tick-in-the-box' process may expose an organization to a variety of fraud risks like bribery/ corruption, advertising/ marketing fraud, financial frauds etc. all arising from ineffective due diligence and poor monitoring. Further, he highlighted that *"the number of anti-avoidance measures embedded in the Act proves the abuse of the existing tax regime".*

While advocating *'philanthropy over charity'*, Mr. Girish concluded his session by recommending the following:

- An exhaustive definition of charitable purposes should be introduced in the IT Act, in place of the present inclusive omnibus definition, to prevent too wide an interpretation.
- Shome Committee recommendation requiring that for eligibility for exemption, a charitable institution must have 90% of its receipts from donations alone should be implemented.
- Giving deductions u/s 80G for corporates needs a re-look just as CSR is not a deductible expenditure.

A central law on charities (should be framed which includes provisions for Anti-Money Laundering and Anti-Terrorist Financing and Reporting. During the panel discussion that ensued, Mr. Srinivasan stated that many developed countries have a central law on charity, which India can consider referring and implementing. Further, Mr. Srinivasan & Mr. Suresh Senapaty shared that if there is a risk of management takeover, then charitable institutions / NGOs will be more careful about their functioning & chances of abuse of provisions would reduce.

<u>Session 2 – Impact of US Tax Reforms on India</u>

The second technical session was presented by Mr. S. Krishnan who took the audience through his research paper on impact of US Tax Reforms on India. He started by giving a background of the US tax regime, highlighting that prior to 2018, USA had one of the highest corporate tax rates (upwards of 40% after including the corporate income taxes levied by various states and cities). He explained that this led to significant 'base erosion' as many US based MNCs relocated their intellectual property and income to lower-tax jurisdictions and further reduced their US tax base through cross border payments of tax-deductible interest, royalties or other fees. Further, since repatriation of earnings of foreign subsidiaries of US corporations triggered tax costs in the US, several MNCs retained a significant proportion of their overseas low taxed earnings abroad. It is estimated that US MNCs have nearly $2.6 trillion in untaxed earnings overseas.

Thereafter, he explained that US's "Tax Cuts and Jobs Act of 2017" [which was passed by the Senate on December 20, 2017 and signed into law by President Trump on December 22, 2017] represents the most significant changes to the US tax code since the tax reform enacted in 1986 during President Ronald Reagan's time. Mr. Krishnan summarized the impact of the recent US Tax Reform as follows:

- <u>Reduction in corporate tax rates</u>

The reduction of federal corporate tax rate from 35% to 21%; a 40% reduction; has resulted in $1.3 trillion reduction in corporate income taxes. Further, while worldwide corporate tax rate has declined significantly since 1980, recording a 41% reduction over 37 years, US has managed to implement such reduction in one stroke. Further, the reduced US tax rate is also lesser than the worldwide average statutory corporate income tax rate in 2017, measured across 202 tax jurisdictions, of 22.96%. Mr. Krishnan opined that "*Reduction in the U.S. federal corporate tax rate may force other countries, including India, to look at their domestic tax rates in order to retain their competitive positions in the world, obviously balancing this with the need to rein in the fiscal deficit*".

- <u>Introduction of quasi-territorial taxation</u>
    - Introduction of Participation exemption system for taxation of foreign Income
    - Introduction of deemed repatriation tax
- <u>Taxation to protect base erosion and anti-abuse</u>
    - Abolition of Alternative Minimum Tax (AMT)
    - Introduction of Base Erosion Anti-Abuse Tax (BEAT) on US Corporations
    - Introduction of incentives (in the form of Foreign Derived Intangible Income for corporations that leave their valuable IP in the U.S., and at the same time penalize corporations (on Global Intangible Low Taxed Income) that have migrated IP offshore to CFCs
    - Limits on business interest deductions
- <u>Investment incentive to expensing of asset purchase upfront instead of depreciating</u>

Further, Mr. Krishan explained that the impact of US Tax Reforms on Indian companies would be as follows:

- Typically, there would be little incentive for the Indian tax authorities to scrutinize subsidiaries incorporated in high tax jurisdictions from a POEM perspective, since there would be little, if any, incremental tax revenues accruing to India after giving credit for overseas taxes. This may no longer hold true in the US context under the new corporate tax rate structure. Hence, companies may be required to pay closer attention to POEM related risks in respect of their US subsidiaries, going forward.

- With the reduction in US tax rates, there is increased need for US corporations to evaluate their tax costs overseas, including specifically in high tax countries like India. This may warrant a rethinking of the entire India tax strategy including funding options for Indian entities, transfer pricing supply chain policies as well as repatriation options.
- Under the deemed repatriation provisions relating to accumulated post 1986 earnings, tax may become payable in the US, even though the earnings may not have been actually repatriated to the US. In addition, the tax reasons for retaining profits overseas no longer remain. This could lead to cash flow issues, which in turn may necessitate actual distributions from India. Such actual distributions would entail a tax cost for the Indian subsidiary, which again may not be fully creditable against US taxes.
- BEAT could lead to a significantly increased tax cost on companies that routinely make payments to affiliates in India, including towards outsourcing and sub-contracting of work. This increased cost could make outsourcing of activities to India less attractive.
- Lower tax rates and other base erosion rules forming part of the tax reform could lead to US companies unwinding these arrangements and moving assets and people back into the US. This may particularly be relevant in the context of businesses in the technology and pharmaceutical sectors, where existing intellectual property structures may warrant a complete overhaul.
- A lower tax rate will generally lead to increased valuations of U.S. business. However, in the context of acquisitions, one may also need to factor in the impact of changes relating to use of NOLs, deferred taxes and other tax attributes, such as available foreign tax credits. Specifically, the Tax Cuts and Jobs Act could make tax attributes less valuable, while deferred tax liabilities would become less costly.
- New acquisitions could be made more favorably through “asset” purchases or “deemed asset” purchases, based on the immediate expensing rule for new asset investment.

Session 3 – Mergers & Acquisitions – Changes in Indian Tax Law

The third technical session was presented by Mr. Rohit Roy who took the audience through his research paper on “Changes in Transnational and Domestic Tax Regulations affecting Cross-border Mergers and Acquisitions in India”. He explained the tax regulations affecting M&A, highlighting that there is GAAR at the National level, DTAAs at the Transnational level and BEPS Multilateral Instrument at the International level. Thereafter, he elaborated in detail about the provisions under the IT Act which deal with M&A, stating that *“the issue that arises in cross border M&As is that of transactions being taxed by both jurisdictions, amounting to double taxation – which may prove to be a disincentive for FDI.”* Mr. Roy then delved into the consequences of the retro-amendments introduced vide. Finance Act 2012 to the definition of ‘capital assets’, ‘transfer’ and ‘‘income deemed to accrue or arise in India’ to overrule the Vodafone SC ruling, stating that this has also led to re-negotiations and recent modifications of existing DTAAs. He also touched upon the applicability of GAAR to cross-border arrangements.

During the panel discussion that ensued, it was highlighted that in the context of M&A, it is necessary to evaluate whether Sec 79 of the IT Act (which is a hindrance to reorganizations) still serves purpose in the present context of private funding. Further, it is also necessary to analyze Sec 72A amalgamation provisions vis-à-vis other countries to see in what form we need it, if still relevant. Another issue that was prompted to be considered in the context of start-ups was the leverage for tax losses as well as taxation of share premium.

Session 4 – Digital Economy

The fourth technical session was presented by Mr. K.R. Sekar who took the audience through his incisive research paper on the hot topic of Digital Economy. He commenced his session by elaborating how the traditional supply chain has disappeared in the digital economy and new systems like remote monitoring & control, real time updation, logistics tracking etc. have emerged in the digital world giving rise to new business models such as online retailer model, social media model, subscription model & collaborative platform model. Thereafter, he highlighted the tax challenges in the digital economy related to nexus, data and characterization of income as well as the administrative challenges in determining extent of activities and identification of customers etc.

Mr. Sekar then elaborated on the limitation of options identified by BEPS Action 1 Task Force, in a nutshell, terming it as merely *'old wine in a new bottle'*:

- Modifying PE exemption rules - This option offers nothing new but simply reiterates India's position in 2010 OECD Model of rules of differentiating core & non-core activities ;
- Virtual PE – Under this option, regarding attribution of profits, developed countries favour a separate entity approach while developing countries favour global apportionment approach, although intangibles global allocation is a challenge;
- Significant digital presence – Definition of 'significant' is nebulous and developed countries are not in favour of this approach;
- Creation of withholding tax on digital transactions – While this is a better mechanism according to OECD, it is a challenging option for India to implement.

Mr. Sekar stated that while most countries have responded to digital economy challenges with Indirect taxes amendments, India is one of the few countries which have responded with amendment to direct tax law by introducing the Equalisation Levy. He stated that while the target of the levy largely seems to be corporates who have no presence in India and aid their customers advertise online without suffering any taxes in India, however, practically, it might merely add to the cost of the Indian parties remitting the consideration. Thereafter, he raised some pertinent questions regarding the position of Equilisation levy if MLI comes in and amends the treaty & whether Equalisation levy is like another FBT considering that total collection in the first year is only around Rs.380cr.

Thereafter, Mr. Sekar touched upon the proposals in the position paper recently released by UK HMRC on Corporate Tax and Taxation of Digital Economy. He highlighted that UK's stand is clear that only once the law matures internationally will they implement domestic law changes. He also took the audience through some landmark rulings like Spanish Supreme Court ruling in Dell Products wherein marketing office of Dell in Spain was held to be a Permanent Establishment (PE) of its Ireland parent company. Mr. Sekar highlighted that the focus of the Spanish Court was to capture profit on sale of goods and there was no focus on services at all. It was highlighted that this view differed from courts in France and Norway which found that commissionaire arrangements do not give rise to a PE. Mr. Sekar also discussed the Google Ireland State Aid ruling, stating that European Commission took a position that since Google was given a benefit in Ireland, other countries were losing out on Revenue. In this context, Mr. P.V.

Srinivasan, added that such State Aid rulings give rise to a bigger issue as the sovereignty of a country is questioned. Mr. Sekar concluded the session by briefly discussing the Indian Supreme Court ruling in Formula One World Championship and Bangalore ITAT ruling in Google India.

Session 5 – Copyright Law and Taxation Interplay

The fifth technical session was presented by Mr. Ganesh Rajgopalan who took the audience through his interesting research paper on Copyright Law and Taxation Interplay. Mr. Rajgopalan commenced the session by explaining that copyright is a negative right and the reward is the protection that the copyright derives. Thereafter, he touched upon the important issue of *situs* of a copyright which is relevant from a tax angle as transfer of capital asset situated in India attracts tax liability in India. In this regard, he elaborated on some principles of copyright situs emerging from judicial precedents & tax rules like copyright is situated in every territory it is protected [Foster's Australia AAR ruling], copyright is situated where it is exercisable [CBDT Circular No 3 (Wealth Tax) of 1957], copyright is situated where there is protection for use [US Source of income rules] etc. In the context of broadcasting, Mr. Rajgopalan illustrated with an example that copyright is situated where the broadcast originates [emission theory].

Regarding the place of protection of copyright, Mr. Rajgopalan stated that "*An act if infringes copyright, it implies protection*". He thereafter elaborated about how there are mosaic of similarities and differences in copyright laws of countries as to the subject matter of protection, term of protection and who is the first owner. Regarding territoriality, Mr. Rajgopalan added that there is no such thing as a global copyright and therefore on applicability of foreign law to the copyright debate, he opined that so long as the foreign law is referred to for looking into facts and not interpreting the law, its application is permissible.

Further, Mr. Rajgopalan discussed a hot button topic in the Indian context relating to whether computer software is to be treated as a copyright or a copyrighted article. He explained that to determine whether dealing with copyrighted article was a copyright, the 'first sale doctrine' and the 'principle of exhaustion' [issue of copies to public not being copies already in circulation and to sell or give on commercial rental or offer for sale or for commercial rental any copy of computer programme were relevant. He further stated that while payment for software will now qualify as royalty under the domestic law, the same may not be the case under the DTAA.

Mr. Rajgopalan also explained the difference between license & assignment, illustrating that giving an absolute right will be an assignment but giving restricted rights would be a license. In this context, it was also highlighted that the lifetime of the arrangement would also be a relevant factor as if the agreement was infinite it would result in an assignment.

Session 6 - Insolvency and Bankruptcy Code (IBC) – Conflict with Income-tax law

The sixth technical session was presented by Mr. Sunil Gupta who took the audience through his incisive research paper on Insolvency and Bankruptcy Code – Conflict with Income-tax law. He commenced the session by explaining the IBC process in brief, stating that a financial/operation creditor or a corporate debtor itself may apply for initiation of insolvency resolution proceedings before NCLT. Further, he elaborated on the scope of insolvency proceedings, stating that asset sale, slump sale, demerger, merger is out of the scope of the 'Resolution Plan'. He also highlighted that the 'Resolution Plan' has no power to override any provision of law including income-tax Act. The only power is that "NCLT-approved Resolution Plan" shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

Thereafter, Mr. Gupta dealt with the following conflicts that IBC poses with the Income tax law:

- Can existing tax demand as on the date of approval of Insolvency Plan be waived?

Tax demands are at par with unsecured creditors, hence deemed written off as per order of the NCLT like any other unsecured creditor. However, it may be argued that such a direction in Resolution Plan would not be compliant with the extant law, and may be declared void.

- Can the tax liability of the period up to the date of approval of Insolvency Plan but crystallized afterwards be waived?

No, as such liability was never a part of the Insolvency Process. It does fall in the definition of debt as not due.

- Can the tax liability arising on implementation of the Resolution Plan be waived?

Write off of debt would be subject to MAT as well as normal tax liability. NCLT has no power to waive such taxation. Further, CBDT announcement of some relaxation under MAT is inadequate.

Thereafter, he explained the limitations of certain Resolution Plan options with the help of the following case study:

Financials of corporate debtor ABC Ltd under insolvency

	Rs. in Cr		Rs. in Cr
Capital (1cr share)	100	Assets	30,100
Reserves	(20,000)		
Bank loans	50,000		

Note:

1. ABC Ltd is a listed company and it is traded at Rs 2 per share
2. Fair market value of all its assets/enterprise is only Rs 5,000 cr.
3. ABC has carry forward tax losses of Rs 20,000 cr
4. A potential investor XYZ Ltd is ready to invest Rs 5,000 cr considering fair value of assets of the corporate debtor.

- Slump sale/demerger of the assets/enterprise to XYZ Ltd for Rs 5000 cr, which is paid to banks and balance debt is written off

This option is not feasible as sale of assets/enterprise is out of scope as definition of 'Resolution Plan' envisages that corporate debtor continues as a going concern. Further, as per Sec 170 of IT Act, -the successor in business is liable for tax of the predecessor company.

XYZ infuses capital of Rs 5000 cr; pays off bank loan, balance Rs 45,000 cr is written of Investor would be required to infuse capital at face value (as per Company Law) though net-worth is negative and trading price is only Rs. 2. Further, there are tax risks of existing, hidden as well as arising on implementation (e.g. MAT). Also, as per SEBI regulations, investor cannot have more than 75% shares of a listed company though open offer is waived.

Bank loans are converted into 25000 cr equity shares @ Rs 2 per share; XYZ buys these shares for Rs 5000 cr @ Rs 0.20 per share. Financial creditors are allowed to be issued shares at a discount under insolvency process as per the latest amendments. However, as per SEBI regulations, investor cannot have more than 75% shares of a listed company though open offer is waived. Further, there are tax risks of existing as well as hidden risks. Biggest tax exposure u/s 56(2)(x) i.e. deemed gift on difference between FMV and transaction price, further uncertainty as FMV is to be taken on the date of implementation.

Regarding how the existing IBC provisions should be modified, Mr. Gupta suggested that the entity should be treated as a new entity so that there is a green field for investors. On international experiences, he explained that some countries give moratorium on tax proceedings/ waiver of tax costs. On the question whether proceedings can be initiated against directors u/s 179 of the IT Act, Mr. Gupta stated that the IBC is silent in this respect.

Session 7 - GAAR

The seventh technical session was presented by Mr. PVSS Prasad who took the audience through his research paper on GAAR. He commenced the session by touching upon some pertinent issues relating to the interpretation of GAAR provisions. Regarding the initial burden of proof being on AO, he raised a question whether presumption u/s 96(2) shifts the burden of proof to the assessee thereby making Rule 10UA ineffective. On the interplay between Rule 10U(1)(d) and 10U(2) [Investment vs. Arrangement], he highlighted that one school of thought is that they are conflicting and therefore real grandfathering may not be available. In this regard, Dr. Shome clarified that grandfathering of 'arrangement' would mean that avoidance would go on till perpetuity, which would defeat the whole purpose of GAAR.

On GAAR vs. PPT, he explained that after a lot of consultative process, Government has laid down lots of checks and balances in GAAR such as approving panel, main purpose test, grandfathering etc. On the other hand, PPT relies on one of the 'principle purposes' with too much of discretion given to the AO. Further, he stated that while PPT has wider coverage, it also has a silver lining – treaty benefits in accordance with object & purpose of treaty will be allowed. Regarding the question whether taxpayer can opt himself to be governed by GAAR instead of PPT, he clarified that GAAR is a deterrent provision which is invoked by AO and cannot be invoked by the taxpayer himself.

Thereafter, Mr. Prasad highlighted some suggestions from the Shome Committee Report which are yet to be considered:

- Where treaty itself has anti avoidance provisions GAAR should not be invoked
- Tax mitigation should be distinguished from tax avoidance. Illustrative examples and negative list for the purposes of invoking GAAR should be specified
- GAAR should not be invoked in intragroup transactions which may result in tax benefit to one person but overall tax revenue is not affected either by actual loss or deferral of revenue.
- Where SAAR is applicable to a particular aspect /element, then GAAR should not be invoked to look into the same.

During the panel discussion that ensued, Dr. Shome gave an incisive background on how the GAAR provisions evolved to their present form. He explained that the 2012 GAAR proposal was most restrictive when compared to other countries. Accordingly, certain changes were recommended like 'one of the main purposes' was changed to 'main purpose', onus was placed on AO and not assessee & approving panel was changed to include independent persons. Thereafter, it was highlighted that India has followed UK's position that even if SAAR is available, GAAR + SAAR will apply. However, in this regard, Dr. Shome clarified that while UK implemented GAAR as an anti-abuse provision (which is more restrictive), India implemented it as an anti-avoidance provision and therefore the position was not the same. Further, he stated that if an aspect is not covered under DTAA, then it can be examined under GAAR (e.g. round tripping in case of Singapore), as clarified by the Circular on GAAR.

Mr. Sunil Gupta also contributed some trivia as to how the threshold of Rs.3cr for GAAR was arrived at. He stated that according to the revenue receipts budged, 50,000 taxpayers reported income more than Rs.10cr. Accordingly, applying 30% tax rate on Rs.10cr income gave an Rs.3cr amount which was set as the threshold.

<u>Session 8 – Taxpayer rights</u>

The eighth technical session was presented by Mr. Padamchand Khincha and his team who took the audience through their research paper on taxpayer rights. They began the session by explaining in detail the measures to curb tax avoidance and tax evasion like co-operation between tax administration and taxpayers, Tax Information Exchange Agreements (TIEAs), Common Reporting Standard (CRS), Exchange of Information on Request (EOIR), Automatic Exchange of Information (AEOI), Foreign Exchange and Tax Compliance Act (FATCA) and Global Forum on Exchange of Information and Transparency for Tax Purposes. Specifically in the context of CRS, they referred to OECD's October 2017 report on confidentiality requirement wherein it was stated that India's confidentiality processes are reasonably strong. The report also mentioned that in terms of asking for information, India goes much beyond what is required for the stated purpose while in case of sharing information India was slow and ill at ease.

Mr. Khincha and team stressed that *"International agreements need to help protect taxpayer privacy rights while simultaneously encourage a more effective sharing of taxpayer information across borders and ensure effective collection of taxes"*. Further, they stated that tax information exchange should be accompanied by assurance to Governments that the rights of their citizens will be respected.

Quoting Nina E. Olson (US national taxpayer advocate) that "*At their core, taxpayer rights are human rights*", they proceeded to explain the fundamental principles supporting taxpayer rights like proportionality principle (disadvantages suffered must be in proportion to the object) and *Ne bis in idem* (no legal action can be instituted twice for the same cause of action), *Audi alteram partem* (opportunity of being heard) and *Nemo tenetur se detegere* (right to remain silent). They also delved into the details of standard taxpayer rights like right to privacy, right to fair trial, freedom from discriminatory tax laws, freedom from self-incrimination & respect for rule of law. Finally, they stressed that taxpayers must be protected against fishing expedition and should have the right to confidentiality.

On the question whether information obtained from illegal/ extra legal means can be said to be information obtained in breach of taxpayer confidentiality, Mr. Khincha referred to SC ruling in Poonam Singh wherein the process of search conducted by the tax department was held to be invalid but the material obtained during the search was held to be valid. Regarding recent leaks like the Panama Papers & Paradise Papers, it was highlighted that the tax department doesn't think highly of such leaks.