DIVIDEND AND INTERESTS

BY CA PRERNA PESHORI

Dividend taxation

As per Income-tax Act

Taxation Of Dividend As Per The Act

Section 2(24)(ii) - Income includes 'Dividend'

Section 2(22) provides an inclusive definition of 'Dividend' –

- Distribution of assets
- Distribution of debentures
- Distribution of bonus shares to preference shareholders
- Distribution on liquidation
- Reduction of capital
- Loan to the beneficial owner of shares holding >10% of voting power or to concern in which shareholder has substantial interest

Taxation Of Dividend As Per The Act

- **Section 9(1)(iv) –** Dividend deemed to accrue or arise in India if paid by Indian company outside India
- **Section 8 – Dividend Income**
  - Dividend is deemed to be the income of the tax year in which it is declared, distributed or paid.
  - Interim dividend shall be deemed to be the income of the tax year in which the amount of such dividend is unconditionally made available by the company to the SH who is entitled to it.

- **Requirement of regulatory approval**
- If regulatory approval required to declare dividend – taxability arises on grant of approval as income does not accrue prior to approval Nonsuch Tea Estate Ltd [1975] 98 ITR 189 (SC)
- If RBI approval required for remittance of dividend, taxability arises on declaration of dividend - Bhai Sunder Das & Sons Co. (P) Ltd [2003] 259 ITR 33 and Super Scientific Clock & Co. [1999] 238 ITR 731
- Pfizer Corpn. [2003] 259 ITR 391 (Bombay)

Declaration of dividend by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India does not have the effect of transfer of any underlying assets located in India and would not be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 to section 9(1)(i)of the Act - CBDT Circular No. 4/2015

Taxation Of Dividend As Per The Act

- **Section 57 – Deduction of Interest expenses**
- 20% of dividend income

- **Section 80-M – Intercorporate dividend set-off**
- Applicable to domestic companies whose GTI includes dividend from another domestic company, foreign company or business trust
- Applicable w.e.f. 1 April 2020
- Deduction allowed from the dividend received up to the amount of dividend distributed by it on or before one month prior to the due date of furnishing ITR under section 139(1)

HISTORY OF DIVIDEND TAX IN INDIA

1959

Imputation

1997

DDT

The procedure for tax collection is cumbersome and involves a lot of paper work

2002

Withholding tax

The dividend is income in the hands of shareholders and not in the hands of the company.

2003

DDT

Easier to collect tax at a single point, i.e. from the Company

PRESENT

Withholding tax

- Incidence of tax should be on shareholder than the company
- Regressive in nature
- Easy tracking available with technology

Taxation Of Dividend As Per The Act

Shareholder	Rate of dividend
Resident Shareholder	
Resident Corporate	• 34.94%/25.17%/17.16%/29.12%; S.115BBD withdrawn to bring parity • Roll over benefit deduction u/s 80M can be claimed in respect of dividend received from domestic / foreign co • Interest exp. allowed - 20% of dividend income • TDS – 10% on div in excess of Rs.5,000*
Resident Individual/HUF	• Slab Rate MMR -35.88% (max surcharge -15%) • Interest exp. allowed - 20% of dividend income • TDS – 10% on div in excess of Rs.5,000*
Resident LLP/PF	• 34.94% [Base tax of 30%+ Surcharge of 12%+ HEC of 4%] • TDS – 10% on div in excess of Rs.5,000*
Trusts	• 35.88% • TDS – 10% on div in excess of Rs.5,000*
• **Non-resident shareholder**	
Non-resident	• 20% gross basis (plus surcharge and cess - surcharge capped at 15%) u/s 115A subject to treaty rate • For NRI - 20% u/s 115E • TDS u/s 195 at rates in force**
FPI	• 20% gross basis (plus surcharge and cess - surcharge capped at 15%) u/s 115AD subject to treaty rate • TDS u/s 196D subject to treaty rates
Non-resident on dividend on GDR	• 10% u/s 115AC • TDS u/s 196C

*If the resident shareholder fails to submit his PAN, the TDS would be deducted at a higher rate of 20%.
** TRC required for claiming the treaty benefits

- Failure to obtain TRC does not disentitle the taxpayer from claiming treaty benefits
    - Skaps Industries India Pvt. Ltd. (Ahd ITAT)
    - Sreenivasa Reddy Cheemalamarri (Hyd ITAT)

Dividend taxation

As per Tax Treaty

01 **Primary right to tax**
Residence State right

02 **Sharing of taxing rights**
Source State right

03 **Definition**
Meaning of dividend

04 **Exception Rule**
PE Exception

05 Extra-territoriality restriction

Article 10 - Dividend

Article 10 - Dividend

Structure under OECD and UN Model

Article 10 - Dividend

OECD Model	UN Model
1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State	1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend); b) 15 per cent of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.	2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: (a) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend); (b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.
3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.	3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.
4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.
5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.	5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 10(1): Taxability Of Dividend In Resident Country

- "Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State"
- UN Model reproduces Article 10(1) of the OECD Model

- **'MAY BE TAXED'**
  - Country of residence of dividend receiver has the first right to tax
  - Right is not exclusive – Source Country may also tax it in certain circumstances
  - Turquoise Investment and Finance Ltd [2008] 300 ITR 1 - dividend income earned in Malaysia by an Indian Resident was not taxable in India.
  - Also see Kulandagan Chettiar [2004] 267 ITR 654 (SC)
  - A contrary view was taken in the case of Roop Rasyan Industries Pvt Ltd vs ACIT [2013] 36 taxmann.com 287 (Mumbai Tri)
  - Notification No.91/2008

Article 10(1): Taxability Of Dividend In Resident Country

- Dividend 'paid'
  - The term 'paid' has a very wide meaning since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or custom
  - Section 43(2) of the Act – 'Paid' means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head 'Profits and Gains of Business or Profession'
  - Section 8 of the Act w.r.t dividend – declared, distributed or paid
  - Thus, it would include the dividend declared by a company and incurred as liability by appropriate shareholders' consent in case of final dividend and board formalities in case of interim dividend

Pfizer Corpn. [2003] 259 ITR 391 (Bombay)

- In section 9(1)(iv), the words used are 'dividend paid by an Indian company outside India'.
- This is in contradiction to section 8 which refers to a dividend declared, distributed or paid by a company.
- The word 'declared or distributed' occurring in section 8 do not find place in section 9(1)(iv).
- Therefore, it is clear that dividend paid to non-resident outside India is deemed to accrue in India only on payment

Takeda A / S, NTC Parent [TS-1199-FC-2021(DEN)]

Tax withholding is required at the time of interest accrual itself and not at the time of payment of interest to the lender

Article 10(2): Taxability Of Dividend In Source Country

"However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend).

(b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases." The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid"

- Source Country can also tax the dividend
- Limited right to tax in source country on gross basis – no deduction allowed
- Direct Investment by companies vs Investment other than direct investment
- Surcharge and Cess not to be topped up on Treaty Rate

Beneficial Owner

OECD COMMENTARY PARA 12.1

- Not to be used in narrow sense
- To be used in the light of the object and purpose of the treaty
- Not a beneficial owner where contractual or legal obligation to pass on the payment
- A conduit company with very narrow powers - Not the Beneficial owner

KLAUS VOGEL

- Free to decide whether assets should be used or made available for use or how the yields should be used

SECTION 139 OF INCOME-TAX ACT - EXPLANATION 4

Individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.

CBDT CIRCULAR NO 789 DATED APRIL 13, 2000

- TRC would constitute sufficient evidence for accepting the residence, as well as beneficial ownership

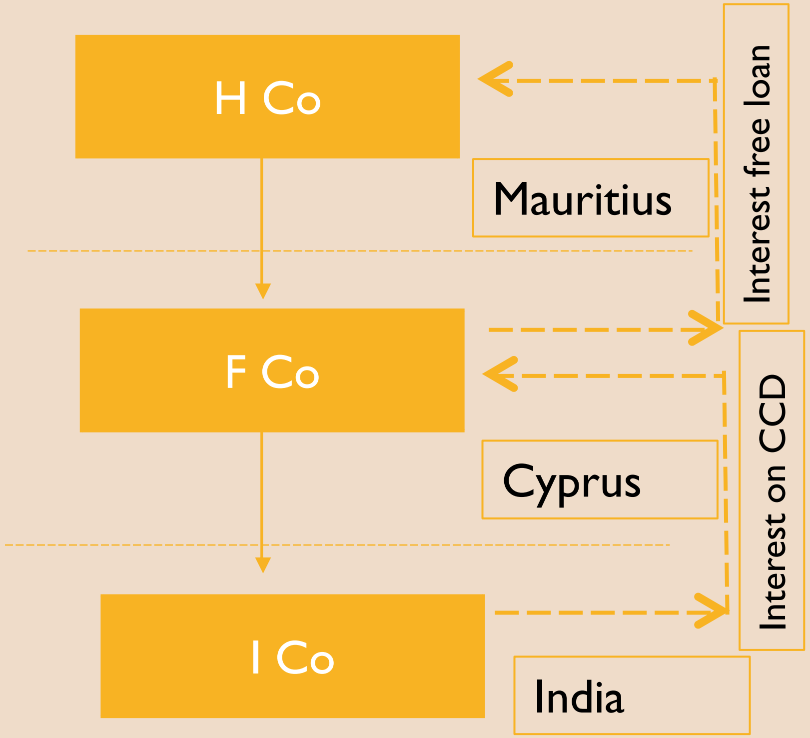
SC ruling in case of Azadi Bachao Andolan [2003] 263 ITR 706 (SC) upheld the validity of Circular

- In AB Mauritius [2018] 402 ITR 311 (AAR - New Delhi), the AAR observed that TRC gives a presumptive evidence of beneficial ownership and is not a conclusive presumption
- Ovvio Italia spa - TRC not conclusive proof of BO

Beneficial Owner - Decisions

- *NatWest – Advance ruling No. P 9 of 1995 (220 ITR 377)* - AAR found that Mauritian companies were not beneficial owner of shares. It rejected the application on the ground that transaction was 'designed prima-facie for the avoidance of tax' as Mauritius subsidiaries were incorporated only as a conduit for routing the investment from UK to India.
- As against this, in the case of *AIG (224 ITR 473)* it was observed that investment company in Mauritius was not mere insertion of intermediate step devoid of commercial purpose. Shareholders were located in different part of the world (though belonging to same group) and Mauritius was suitable central location for all of them. It was also demonstrated that cost for legal accounting and professional services in Mauritius were comparatively economical compared to other jurisdiction. Based on this AAR allowed concessional treatment of tax under India – Mauritius DTAA.
- In the case of *Prevost Car Inc (2008 TCC 231),* in the context of payment of dividends to Netherlands holding company, the Canadian Tax Court observed that *"the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short, the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income".*

Beneficial Owner - Decisions

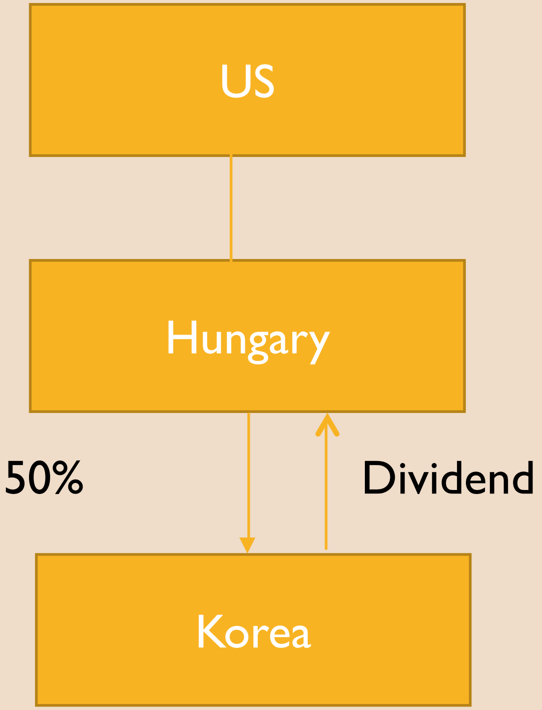


- In case of Indofood International Finance Ltd. v. JP Morgan Chase Bank NA London Branch *[2006] EWCA Civ 158*, a subsidiary company, which issued loan notes to various bond holders, had a back-to-back loan agreement with its parent company. As part of the loan agreement, the subsidiary was bound to pay the bond holders whatever interest amounts were received from its parent company. The subsidiary therefore had no power of disposition over the funds received from the parent company and thus was held not to be the beneficial owner thereof.
- Golden Bella Holdings Limited [2019] 109 Taxmann.com 83 (Mum. Tribunal)
  - Interest received for assessee's exclusive benefit and not for or on behalf of any other entity
  - Mere fact that CCDs were funded using monies received from immediate shareholder does not make the arrangement back-to-back transaction
  - Foreign exchange and counter party risk borne by F Co.
  - AO/DRP failed to prove F Co. was not free to utilize interest income at its sole and absolute discretion

Beneficial Owner - Decisions

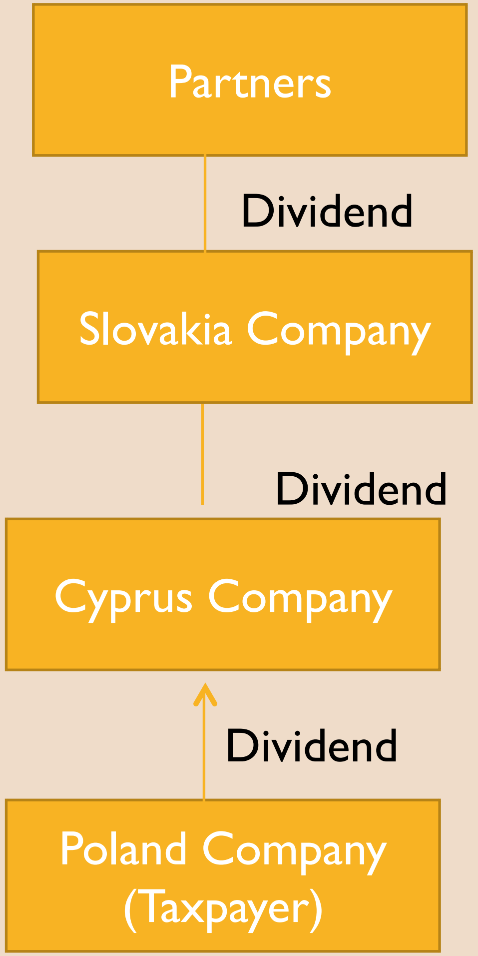
A beneficial owner is a person who is entitled to enjoy benefits of the dividend income received and who is neither bound by law nor by contract to re-transfer the relevant dividend income to another person

CORNING INC



- The Korean tax authorities contested that US Co and not Hungarian co is the beneficial owner of the dividend income.
- Accordingly, the Korean tax authorities held that the taxpayer should have deducted tax at 15% as per Article 12(2)(a) of Korea-US rather 5% under Korea-Hungary.
- Korean Supreme Court noted that Hungarian Co substantially performed duties as an intermediary holding company.
- It performed substantial functions such as receipt of dividend from subsidiaries, control of shares, management of investments and funds.
- It also acted as a service centre whereby it managed the general affairs, finances, data processing
- Korean Supreme Court noted that it never paid any dividends, and accordingly the dividend income received from the taxpayer was neither remitted nor reverted to the ultimate parent company.

Beneficial Owner - Decisions

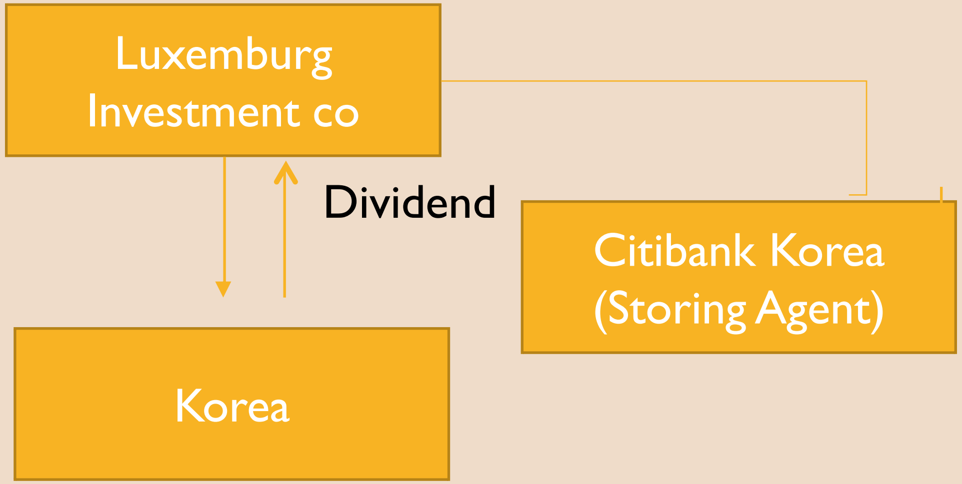


POLISH COURT RULING

- Cypriot parent on the same day issued such dividends to its parent company in Slovakia, which further issued to its shareholders
- Cyrpriot entity was not beneficial owner

Beneficial Owner - Decisions

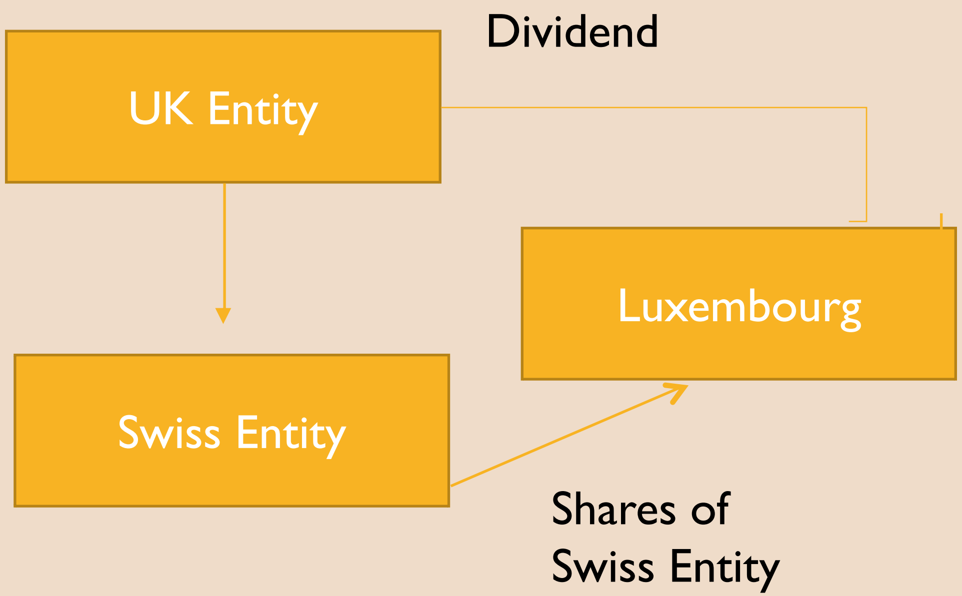
CITIBANK KOREA CO. LTD.



- SC observed that Luxemburg Co concluded investment contracts, obtained investment assets at their discretion and in their name without any instructions from investors, exercised the right regarding the payment of the dividends and interest by the storing companies and performed their economic activities such as investment and the distribution of investment returns.
- Accordingly, the Korean Supreme Court held that the taxpayers are the beneficial owner of the dividend and interest income received from the storing companies.

Beneficial Owner - Decisions

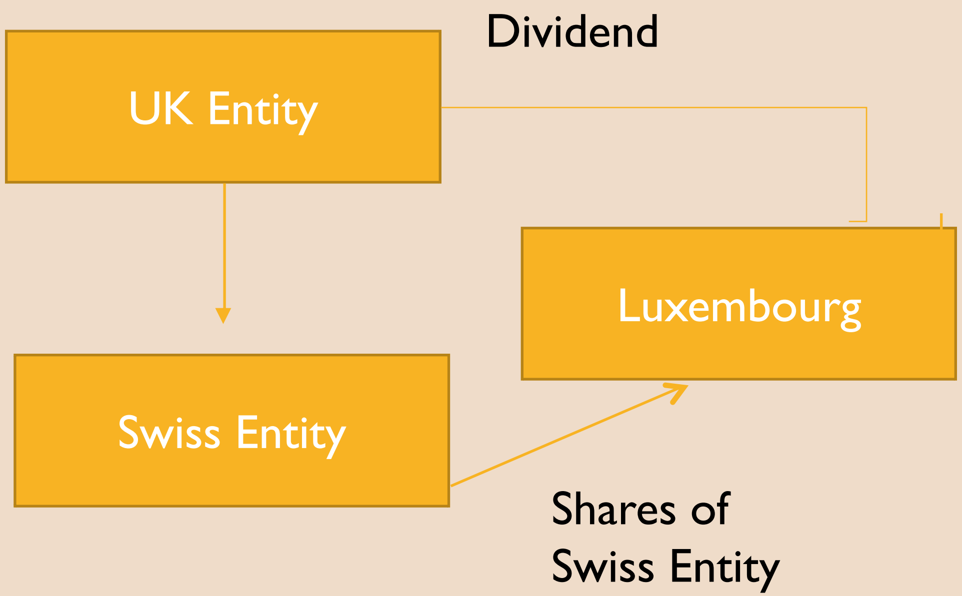
SWISS FEDERAL COURT



- Taxpayer borrowed certain Swiss shares from a UK based company
- The said Arrangements provided that in the event of dividend payment by the Swiss company, the taxpayer would be obliged to make a compensation payment of an equal amount to the UK entity
- Luxembourg-company [taxpayer] as not the beneficial owner of the Swiss shares held by it as a borrower under a stock lending agreement

Beneficial Owner - Decisions

SWISS FEDERAL COURT



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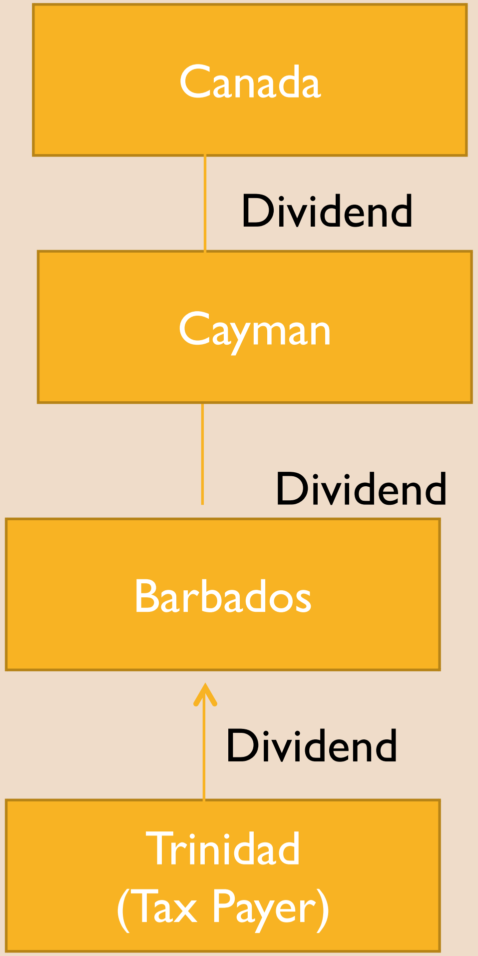
- Luxembourg-company [taxpayer] as not the beneficial owner of the Swiss shares held by it as a borrower under a stock lending agreement

Beneficial Owner - Decisions

Methanex Titan (Trinidad) Unlimited [TS-1202-FC-2021(T&T)]



- Court of Appeal of Trinidad and Tobago denied the dividend withholding tax on dividend payments by Assessee (resident of Trinidad) to Barbados-based entity as they were artificial and fictitious as the dividends were intended to be, and were in fact, payments to the ultimate parent company in Canada.
- It opined that the Barbados-based entity was used as a conduit to abuse the provisions of CARICOM tax treaty;
- Assessee-Company [Methanex Titan (Trinidad) Unlimited], a tax resident of Trinidad and Tobago and wholly owned by Methanex Barbados, declared and paid dividend four times amounting to $85.4 million, during the year 2007;
- Methanex Barbados declared and paid identical dividends to its sole shareholder Methanex Cayman, which in turn paid identical sums as dividend to Methanex Canada, the ultimate parent company;
- The Court referred to the chain of emails between Assessee and Methanex Canada, observes, "*This email clearly contemplates that those payments requested were for funding, and were being requested in the form of dividend payments to Methanex Canada.*";
- Clarified that the declaration of dividends in general by Methanex Trinidad and the corresponding receipt of dividends in general by Methanex Barbados would not by itself be either artificial or fictitious, "*What was artificial or fictitious in relation to this transaction was that these four payments for income year 2007 included payments that were requested by Methanex Canada and which, though paid to Methanex Barbados, were efficiently and effectively routed to Methanex Canada, albeit via Methanex Barbados and Methanex Cayman Islands.*

Article 10(2): Taxability Of Dividend In Source Country – Meaning Of Term – Capital

- “Capital" has not been defined as per the UN Commentary - Reference has been drawn to include the following
- Capital means paid up capital shown at face value in the Company’s Balance Sheet
- Reserves such as Share Premium not be taken into account
- Differences in voting rights, types of shares etc. not to be considered
- Amounts treated as capital under ‘thin capitalization’ to be considered
- In case of bodies having no share capital, like Company limited by guarantee, capital means total of all the contributions to the body which are taken into account for the purpose of distributing profits
- Some DTAAs use the term voting power instead of capital. This means equity shares only

MLI EFFECT

Article 10(2): Taxability Of Dividend In Source Country – MLI Insertion

- As per Article 8(1) of the Multilateral Convention:

"Provisions of a Covered Tax Agreement that exempt dividends paid by a company which is a resident of a Contracting Jurisdiction from tax or that limit the rate at which such dividends may be taxed, provided that the beneficial owner or the recipient is a company which is a resident of the other Contracting Jurisdiction and which owns, holds or controls more than a certain amount of the capital, shares, stock, voting power, voting rights or similar ownership interests of the company paying the dividends, shall apply only if the ownership conditions described in those provisions are met throughout a 365 day period that includes the day of the payment of the dividends"

Scope of Article 8

- Minimum Shareholding period of 365 days
- Without modifying element such a tax rates, ownership threshold and form holding
- Wherein treaties exempts or limit rate of tax on dividend subject to conditions

Scope Limitation

- Article 8 not applicable where changes in ownership result directly from a corporate reorganisation

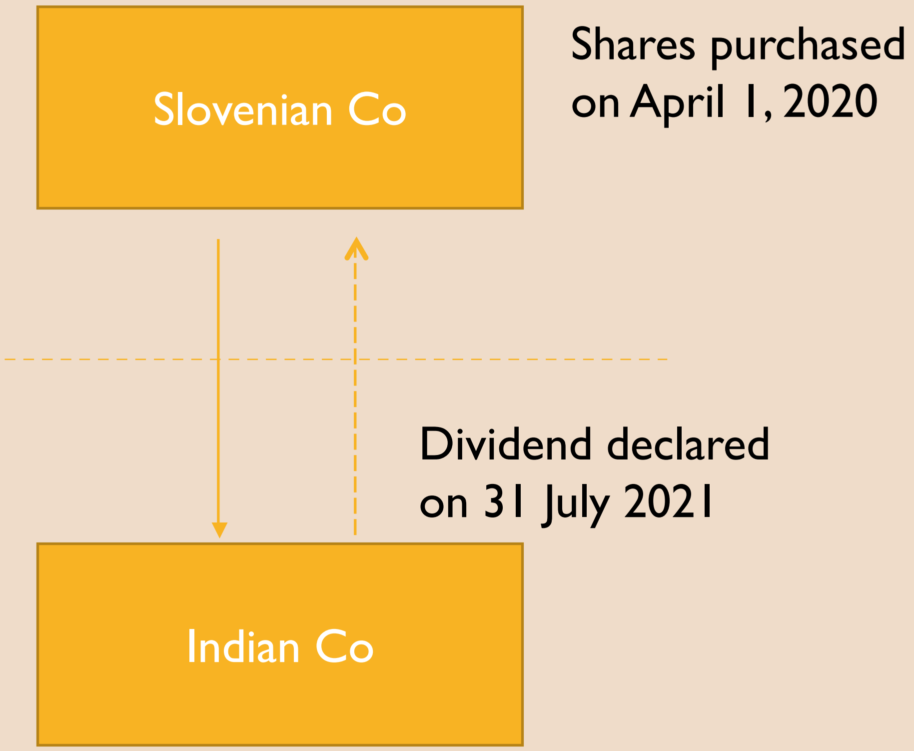
Conditions

- Recipient or Beneficial owner of dividend is a company which is resident of other contracting state and
- Owns, holds or controls more than certain amount of the capital, shares, voting power of payer company

Impact on Tax Treaties with India

- Slovak Republic
- Slovenia
- Serbia
- Canada

Case Study



- **Facts of the case**
- India and Slovenia Signatories to MLI and have notified their treaties
- Both have notified Article 10(2)(a)
- Article 10(2) of India-Slovenia Tax Treaty provides beneficial rate on dividend of 5% if beneficial owner holds at least 10% of capital otherwise 15%
- **Questions**
- What would be the applicable rate of tax on dividends in the hands of Slovenian Co. 5% or 15% ?

Case Study

- **Facts of the case**
- India and Serbia Signatories to MLI and have notified their treaties
- Both have notified Article 10(2)(a)
- Article 10(2) of India-Serbia Tax Treaty beneficial rate of 5% if beneficial owner holds atleast 25% of capital, otherwise 15%
- **Questions**
- What would be the applicable rate of tax on dividends in the hands of Serbian Co. 5% or 15% ?

MOST FAVOURED NATION CLAUSE

MFN Clause

Concept

- Limitation of taxation at source if India restricts its taxing right or a scope in any Tax Treaty subsequently signed.
- With OECD Member
- Beneficial Treatment granted to others in respect of
  - Lower tax rate
  - Limited scope of definition of a particular income stream

India's tax treaties having MFN

- Switzerland
- Finland
- France
- Sweden
- Netherlands
- Hungary

OECD Members with which India has lower tax rate on dividend

- India-Slovenia and India-Lithuania tax treaties – 5% tax rate on dividend
- Colombia recent member of OECD – 5% tax rate on dividend (no participation threshold)

Favourable Treaties of India resulting in MFN applicability

Particulars	India-Slovenia DTAA	India-Lithuania DTAA	India-Colombia DTAA
Date of signature of DTAA with India	13 January 2003	26 July 2011	13 May 2011
Date of entry into force of the DTAA	17 February 2005	10 July 2012	07 July 2014
Date of becoming an OECD Member	21 July 2010	5 July 2018	28 April 2020
Rate of taxation in source country	5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 10 per cent of the capital of the company paying the dividends;	5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;	5% of the gross amount of the dividends for the beneficial owner of the income who is a resident of the other Contracting State
MLI - PPT test	Yes	Yes	Yes. But Colombia has not yet deposited its instrument of ratification of MLI
MLI – Article 8 – Div. transfer transaction	Yes, additional condition of 365 days	No	No

MFN In Treaties

India-NL DTAA

- If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention

India-Sweden DTAA

- In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services) if under any Convention. Agreement or Protocol between India and a third State which is a member of the OECD , India limits its taxation at source on dividends, interest, royalties, or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention.

India-Swiss DTAA

In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services), if under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD signed after the signature of this Amending Protocol , India limits its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower than the rate provided for in this Agreement on the said items of income, the same rate as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply between both Contracting States under this Agreement as from the date on which such Convention, Agreement or Protocol enters into force.

MFN Clause Clarification by other countries

Decree issued by Netherlands (Decree No IFZ 2012/54M dated 28th Feb 2012)
Netherlands has provided the benefit of 5% withholding tax with reference to participation dividend paid by companies resident in Netherlands to a body resident in India from the date when Slovenia became a member of OECD

- **Switzerland Clarification**
- ***From July 5, 2018, residual tax rate in the source State (i.e. India in the present case) for dividends stands reduced for qualified taxpayers from 10% to 5% by virtue of MFN clause of India-Switzerland DTAA read with India-Columbia DTAA.***
- ***They have also clarified that request for tax refunds can be made from fiscal year 2018 onwards by 31 December 2021.***
- ***However, the federal department has reserved its rights to reverse the interpretation and to readjust the treaty rates to income accruing as of 1 January 2023, if reciprocity in the interpretation of the most favoured nation clause is not guaranteed by the Indian tax authorities***
- It is also clarified that Swiss residents would get a tax credit of 5% instead of 10%. In case where the Indian Authorities does not accept the interpretation, there could be tax hit to the Swiss Residents as they may be compelled to pay 10% tax in India and may get only 5% tax credit in Switzerland, atleast till the time litigation on the matter continues in India or position is adjusted by the Swiss Authorities.

- **India's clarification CBDT Circular N.3/2022**
- Rejects the common interpretation adopted by Delhi HC
  - The bulletin/decree of Swiss, Netherlands and France do not represent shared understanding with India and are unilateral views
- Third state should be member at the time DTAA was signed with it for applicability of MFN
- Reliance on Slovenia's membership at the time of applicability of DTAA defeats the object and purpose of MFN
- Applicability of MFN from the date of entry into force of DTAA with third country and not from date when third country becomes OECD Member.
- Requirement of notification u/s 90(2)
- Circular not to affect assessee's having favourable court order

Case Study – Whether Rate Of Dividend Can Be Restricted Due To MFN Clause

- Indian company declares dividend to its Netherlands shareholder (who is also the beneficial owner) on 01 April 2021
- India-Netherlands DTAA is entered into in 1989
- India-Netherlands DTAA has MFN clause
- Rate of tax on dividend income as per India-Netherlands DTAA is 10%, forms part of the protocol to the DTAA
- Rate of tax on dividend income as per India-Columbia DTAA is 5%
- India-Columbia DTAA is entered into post 2010

At what rate should taxes be withheld on dividend income paid by the Indian Company to its Netherlands shareholder?

Import Of The Beneficial Treatment Using The MFN Clause

Particulars	India-Colombia DTAA
Date of signature of DTAA with India	13 May 2011
Date of entry into force of the DTAA	07 July 2014
Date of becoming an OECD Member	28 April 2020
Rate of taxation in source country	5% of the gross amount of the dividends for the beneficial owner of the income who is a resident of the other Contracting State

Note: India-Slovenia and India-Lithuania Treaties also provide 5% beneficial rate with additional conditions which are relevant for corporate assessee in view of MLI

Whether one can reduce tax rate on dividend income to 5% as provided under India-Colombia DTAA, which was not an OECD member when the respective Treaties with other countries were entered by India but became an OECD member on a later date ?

Treaties With Lower Rates For Dividend Income

Country	Tax Rate on Dividend as per Treaty	Beneficial Rate considering MFN clause
France	15%	5%
Hungary	10%	5%
Switzerland	10%	5%
Sweden	10%	5%
Netherlands	10%	5%

Impact of MLI on MFN - Whether minimum holding period required under India Slovenia through MLI should be applicable to Switzerland and Netherlands DTAA?

Delhi HC Ruling In Case Of Concentrix Services Netherlands B.V. And Optum Global Solutions International B.V

- Word "is" a member of OECD has to be read as follows according to HC:
- The word "is" describes a state of affairs that should exist not necessarily at the time when India-NL DTAA was executed but when a request is made by the payer or deductee for issuance of a lower rate withholding tax certificate under the ITL.
- Even if language is susceptible to two readings, to obtain the intent of the India and Netherlands in framing MFN clause reliance can be placed on the decree issued by Netherlands, wherein Netherlands has provided the benefit of 5% withholding tax with reference to participation dividend paid by companies resident in Netherlands to a body resident in India from the date when Slovenia became a member of OECD.
- In the present case, Netherlands has interpreted the MFN clause in a particular way and, therefore, the principle of common interpretation should apply on all fours to ensure consistency and equal allocation of tax claims between the contracting states.
- While interpreting international treaties including DTAAs the rules of interpretation that apply to domestic or municipal law need not be applied, as international treaties, conventions and DTAAs are negotiated by diplomats and not necessarily by men instructed in the law.
- Therefore, interpretation of DTAAs is liberated from the technical rules which govern the interpretation of domestic/municipal law.
- The core function of a DTAA should be seen to aid commercial relations and equitable distribution of tax revenues in respect of income which falls for taxation in both the contracting States.

Delhi HC in Nestle SA has accepted that the case is covered by the earlier ruling of *Concentrix Services* and hence benefit of lower rate shall be available for India-Swiss DTAA.

Decisions After Concentrix Case

- Delhi HC in Cotecna Inspection SA [TS-1132-HC-2021(DEL)] allows Assessee's writ petition seeking direction for issuing certificate prescribing withholding rate of 5% on dividend covered by India-Switzerland DTAA, follows coordinate bench rulings in Concentrix Services and Nestle SA
  - Similar in Deccan Holdings BV [TS-1008-HC-2021(DEL)]
- Delhi HC has granted interim relief to Saint Gobain challenging CBDT's Circular No. 3 of 2022 dt. Feb 3, 2022 and the Section 197 Certificate directing Saint Gobain India Pvt. Ltd. to withhold 10% tax instead of 5% on dividend payable to the French shareholder
- Karnataka HC granted similar relief to a Swiss shareholder and a Dutch shareholder where the Revenue denied lower tax withholding certificate by relying on CBDT's Circular No. 3 of 2022.
- SLP pending before SC

Impact Of CBDT Circular On MFN Applicability

- **ITAT PUN GRI Renewable Industries S.L [TS-79-ITAT-2022(PUN)]**
- Pune ITAT holds that CBDT Circular No. 3 of 2022 dt. Feb 3, 2022 specifying the need for a separate notification for importing the beneficial treatment from another DTAA cannot have a retrospective effect; Observes that once DTAA is notified all its integral parts, including Protocol, get automatically notified and there remains no need to again notify the individual limbs of the DTAA; On analysis of the Circular, ITAT observes that, "it becomes ostensible that the CBDT has mandated the issuance of a separate notification for importing the benefits of a treaty with second State into the treaty with the first State" by relying on provisions of Section 90(1); Further observes that the Circular specifying the need for a separate notification for importing the beneficial treatment from another DTAA as a corollary of Section 90(1) overlooks the plain language of the provision in juxtaposition to the language of the Protocol, which treats the MFN clause an integral part of the DTAA; Opines that it is trite law that a CBDT Circular is binding on the AO and not on the assessees or the ITAT or other appellate authorities and the Circular transgressing the boundaries of section 90(1) cannot bind the ITAT; Observes that the Circular attaches a new disability of a separate notification for importing the benefits of a DTAA with the second State into the treaty with first State, thus, cannot operate retrospectively to the transactions taking place in any period prior to its issuance; The appeal before ITAT pertained to AY 2016-17 and involved invocation of MFN clause under the Protocol to India-Spain DTAA by resorting to India-Portugal DTAA for taxability of royalty/FTS at a lower rate or 10%.:
- **Apollo Tyres Ltd [TS-585-HC-2017(KAR)]**
- HC rules that the Protocol to the India- Netherlands DTAA itself provide for automatic application of subsequent Treaty, to the India-Netherlands Treaty in hand and therefore, no such separate Notification was envisaged to be issued for enforcing such subsequent Treaty with another OECD country, viz., Finland
- Similar conclusion in Steria (India) Ltd [TS-416-HC-2016(DEL)]

Article 31(2) of the Vienna Convention, which provides guidance on the general rule of interpretation states as under:
"2. *The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:*
(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty."

Recent SC ruling in Nestle SA

1] Whether the MFN clause is required to be given effect to automatically or pursuant to a Notification issued under section 90(1)

- The Supreme Court held that entering into a DTAA or a Protocol to a DTAA does not result in automatic enforceability thereof, till such time an appropriate Notification under section 90(1) of the ITA is issued.

- It observed that the fact of lower rate and/ or restricted scope of taxation having been agreed upon with other OECD countries subsequently did not result in automatic extension or penetration thereof into the India – Netherlands DTAA, the India – France DTAA or the India – Canada DTAA, absent an express Notification under section 90(1) of the ITA.
- Supreme Court held that omission of certain benefits available to third country members of OECD in a Notification under section 90(1) of the ITA is indicative of India's intention to per se not grant all benefits available to such third country members to every other country. In this regard, it noted that the "make available" condition" in the DTAA between India and Portugal ("India – Portugal DTAA")[14] and DTAA between India and United Kingdom ("India- UK DTAA")[15] has consciously been omitted from Notification No. S.O. 650(E) dated 10.07.2000 issued to bring into effect Clause 7 to the Protocol to the India – France DTAA and therefore, it was held that the same may not be read into the India – France DTAA. On this basis, the well-reasoned judgment in Steria (India) Ltd. (Supra) was overruled

2] Whether there is any right to invoke the MFN clause when a third country with which India entered into a DTAA was not a member of OECD at the time of entry into force of the DTAA between India and the said third country?

Recent SC ruling in Nestle SA

2] Whether there is any right to invoke the MFN clause when a third country with which India entered into a DTAA was not a member of OECD at the time of entry into force of the DTAA between India and the said third country?

- It was held that a third country is required to be a member of OECD when it enters into a DTAA with India for an intended beneficiary to claim parity by invocation of the MFN clause.

South African Ruling On MFN

- Tax Court in South Africa ('SA'), in its ruling ABC PROPRIETARY LIMITED [TS-862-FC-2019(SAFR)], had granted the benefit of lower rate / exemption on dividend to a Netherlands entity by virtue of the MFN clause in SA-Netherlands treaty.
- The South African treaties with Netherlands as well as Sweden provide a 5% withholding tax rate of dividend, and both the treaties contain MFN clause.
- The differentiating factor between the treaty with Netherlands and that with Sweden is that the MFN clause in the Netherlands treaty allows a taxpayer to import a benefit from <u>subsequent</u> treaties of SA with other states, whereas the Sweden treaty allows the import of benefit from even<u> an existing as well as future</u> <u>treaties</u>.
- SA's treaty with Kuwait provides for a full exemption on dividends in the source state (i.e., nil withholding), providing exclusive right of taxation to the resident state. The Kuwait treaty had entered into force prior to both of the abovementioned treaties (i.e., SA-Netherlands and SA-Sweden).
- Dutch taxpayer's contention was that SA-Netherlands treaty provides that in the event of another state receiving preferential treatment from SA in the future, the Dutch resident must be given the same preference.
- As per the SA-Sweden treaty, residents of Sweden should receive the same preferential treatment as any other party contracting with SA regardless of when such other state's residents obtain such preference, i.e., irrespective of whether it was before the conclusion of the agreement with Sweden or afterwards.
- When the agreement was concluded with Sweden, the residents of Kuwait already had preferential treatment and therefore, the residents of Sweden were automatically entitled to the same treatment (i.e., nil withholding).
- Sweden treaty being subsequent to the Netherlands treaty, it was argued that the same benefit as available to Sweden (i.e., nil withholding), should also be accorded to the residents of Netherlands.
- The Court ruled in favour of the taxpayer, disregarding Revenue's evidence relating to the intent at the time of conducting treaty negotiations, stating that when the law is clear and unambiguous, there is no need to look into its intent.

Does Tax Treaty Apply To Erstwhile DDT Provisions ? (Relevant For Period Prior To April'20)

- Section 115-O
  - Non-obstante clause
  - Refers to additional income-tax at the rate of 15%
- Tax on shareholder's dividend income vs tax on distributed profits

For	Against
• The SC in Tata Tea Co Ltd [2017] 85 taxmann.com 346 - Dividend income is income in the hands of the shareholder and DDT paid by the Company declaring the dividend is on behalf of the Shareholder	• SC in Godrej & Boyce Manufacturing Co. Ltd. v/s DCIT 394 ITR 449 - DDT is tax on company's distributed profits & is not paid on behalf of the shareholders • Article 10(1) & 10(2) – refers to recipient i.e. shareholder & not payer company • Volkswagen of South Africa (Pty) Ltd - rate of levy of secondary tax on companies (similar to DDT) is not reduced by the Dividend Article of DTAA as it was tax on companies

Does Tax Treaty Apply To Erstwhile DDT Provisions ? (Relevant For Period Prior To April'20)

- Delhi ITAT in Giesecke & Devrient [India] Pvt Ltd [TS-522-ITAT-2020(DEL)] ruled in favour of assessee co. and held "DDT levied by the assessee should not exceed the rate specified in Article 10 in India Germany DTAA".
- Similarly, Kolkata Tribunal in a recent case of Indian Oil Petronas Private Limited (ITA Nos 1884 & 1885/KOL/2019 and CO Nos 26 & 27/KOL/2020), has held that the beneficial tax rates specified in the India - Malaysia DTAA in respect of dividend shall be applicable over DDT rate specified under section 115-O of Income tax Act, 1961.
- Delhi HC in case of Maruti Suzuki admits additional ground on applicability of lower rate as per tax treaty to DDT under section 115-O.

Provisions of the protocol to India–Hungary DTAA introduced in 2003 reads as under: "With reference to Article 10 : When the company paying the dividends is a resident of India the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend."

Does Tax Treaty Apply To Erstwhile DDT Provisions ? (Relevant For Period Prior To April'20)

- Mumbai ITAT Special Bench has held that where dividend is declared, distributed or paid by a domestic company to a non-resident shareholder, which attracts Dividend Distribution tax (DDT) under Section 115-O then tax shall be paid by the domestic company at the rate specified under Section 115-O and not at the rate of tax applicable to the non-resident shareholder in the relevant DTAA for taxation of dividend
- Parties to the treaties, wherever intended, have extended the treaty benefit w.r.t. DDT specifically in the tax treaty itself, e.g., India-Hungary DTAA
- It held that Chapter XII-D is a complete code and rejected the Assessees' submission that the incidence of tax in the form of DDT is on the domestic company but in effect it is a tax paid on behalf of the shareholder. It clarified that such a proposition does not flow from SC ruling in Godrej & Boyce and relies on jurisdictional HC ruling in SIDBI where it was held that DDT is not a tax on dividend in the shareholder's hands but additional income-tax payable on profits of a domestic company;
- Also rejected Assessees' reliance on SC ruling in Tata Tea with a remark that therein SC was not dealing with whether DDT is a tax on the company or a tax on the shareholder
- It held that DTAA does not get triggered at all when a domestic company pays DDT

Article 10(3): Meaning Of The Term Dividend

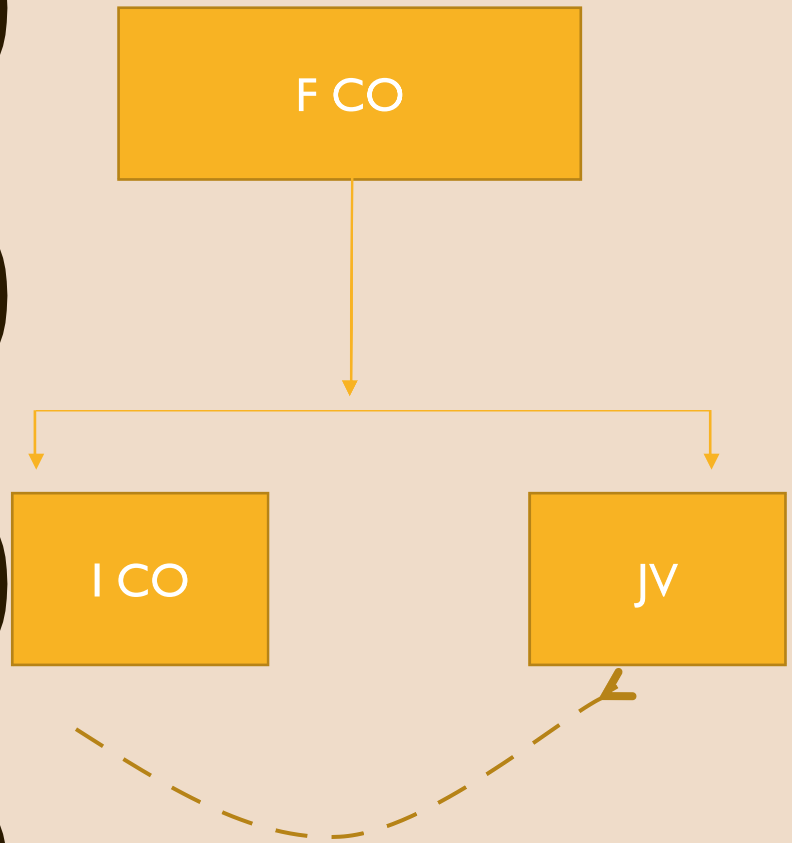
- The UN Model Convention defines the term "dividend" to mean income from
- Shares
- "Jouissance" Shares
- "Jouissance" Rights
- Mining Shares
- Founders' shares
- Other rights (not being "Debt Claims") participating in profits
- Other corporate rights which are subjected to the same taxation treatment as income from shares by the local laws.
- In the Indo-US Treaty, the following additional item is included in the definition of Dividend - "Arrangements (including debt obligations) carrying the right to participate in profits to the extent so characterized under local laws."

ARTICLE 10(3): MEANING OF THE TERM DIVIDEND

- **Treated as dividend**
- Distributions of profits by Limited Liability Companies, Co-operative Societies
- Distribution on capital reduction and profits on liquidation
- Issue of Bonus Shares is treated as dividend as it is "other corporate rights"
- Purely contractual rights subjected to same tax treatment as income from shares

- **Not treated as dividend**
- Distributions of profits by partnership
- Interest on convertible debentures (before conversion)
- Debt-claims participating in profits
- Distributions by a Company which has the effect of reducing the membership rights, for instance, payments constituting reimbursement of capital in any form

Case Study – Whether Loan Treated As 'Deemed Dividend' Be Taxed Under The DTAA



- I Co has significant accumulated profits and grants loan to I Co I
- Is the amount chargeable in the hands of 'shareholder' or the 'recipient'?
- If amount held chargeable in hands of shareholder
  - Evaluate applicable treaty and dividend article
  - Refer OECD Definition of dividend
  - Dividend means income from other corporate rights which are subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident
  - Even if dividend, does charge fail as not paid to F Co?
  - Benefit of treaty rate available?
- Is the taxation required to be evaluated under 'Other Income'?

Deemed Dividend Whether Covered?

- Article 10(3) of the UN Model Convention states that "…income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the state of which the company making the distribution is a resident".
- Rajiv Makhija vs DDIT, New Delhi, ITA No. 3148/Del/2008 - deemed income in the form of loan cannot be brought into the tax net.
- Mum ITAT in KIIC Investment Company [TS-708-ITAT-2018(Mum)]– Deemed dividend is included under the tax treaties as it falls within 'income from corporate rights which is subjected to same taxation treatment as income from shares by the laws of contracting state of which the company making the distribution is a resident of.'

Deemed Dividend Whether Covered?

- **Taxability – in the hands of the shareholder or the concern?**
  - National Travel Services [2018] 89 taxmann.com 332 (SC) - To state, therefore, that two conditions have to be satisfied, namely, that the shareholder must first be a registered shareholder and thereafter, also be a beneficial owner is not only mutually contradictory but is plainly incorrect
  - Gopal & Sons (HUF) [391 ITR 1 (SC)] - Payment received by the HUF from ICo, in which HUF's Karta was a registered shareholder and held substantial interest in the HUF, is deemed dividend under the provisions of the Act and is rightly assessed in the hands of the HUF
- View 1 The limited question issue before SC was trigger of section 2(22)(e) of the Act rather than on the aspect of the entity in whose hand the amount is to be assessed as income. The issue was neither raised before SC nor has been decided by SC and hence the present position of taxing the deemed dividend in the hands of shareholders (even when the loan is given to concern) continues to hold
- View 2: The SC decision concludes that assessment in the hands of concern is required once the conditions of second limb of section 2(22)(e) of the Act are fulfilled. Assessment in the hands of concern is the principle emerging from the ruling.

Deemed Dividend Whether Covered?

View 1

- Income from shares: No
  - Not income from shares but arises from grant of loan or advance - Not 'distribution' based on ratio of shareholding.
  - Clause (a) to (d) of section 2(22) take into account 'distributions' made by a company for the purpose of dividend
  - However, clause (e) envisages certain types of a 'payments' made by a company
- Income from other rights: No (As per OECD Comm., this refers to all other securities, assimilated to shares (e.g. founders shares), which carry a right to participate in profits)
- Income from other corporate rights: No
- Income from arrangements: No – Loan arrangement between company and concern does not grant shareholder the right to participate in profits.
- Whether dividend 'paid' (if payment qualifies as dividend)
  - Payment not made to non-resident shareholder.
  - OECD Comm. – However 'Paid' has wide meaning – Fulfilment of obligation to put funds at the disposal of shareholder in the manner required by contract or by custom.

View 2:

- 'Income' not defined in Treaty – Domestic law referable
- Section 2(24) included 'Dividend'. Hence dividend would be income for the purpose of the Act and further for Section 2(24) dividend means as defined under Section 2(22)
- Since payment of loan / advance is income under Act, it would be income for Article 10(3)
- Based on Para 23 of the OECD Commentary that causes one to refer to domestic law of the Source State (in this case, Indian law), one may argue that the definition of 'dividend', has to be interpreted in the light of domestic tax law

Deemed Dividend Whether Other Income

View 1

- deemed dividend not expressly dealt with – Covered under Art. 23
- India's right to tax deemed dividend arising in India under Article 23(3).

View 2:

- If item of income is classified as dividends under domestic tax law of source state, but does not fall within the scope of Article10 under India-USA DTAA, it should be considered as being dealt with in Article 10
- Technical Expln. to India USA DTAA - Item of income is 'dealt with' when items in same category are addressed or defined in the Article, whether or not treaty benefit is granted to that item.
- However, In DLJMB Mauritius Investment Co Ltd v CIT [1997] 228 ITR 268, the AAR ruled that dividends from a mutual fund, not being dividends paid by a company, would not fall within Article 10 of the Mauritius DTAA but would fall within the Other Income Article.
- Dividend on IDR covered under Article 21 and not Article as paid by Indian branch of UK Company [i.e. not resident of India] Morgan Stanley Mauritius Co Ltd [TS-400-ITAT-2021(Mum)]

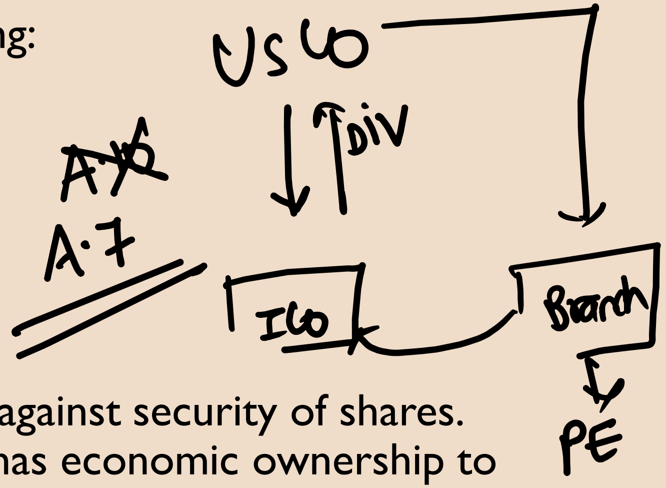
Article 10(4): Permanent Establishment Situation

- Article 10(4) of the UN Model reads as follows: "The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply".
- Objective - provisions of Paragraphs 1 and 2 not to apply if beneficial owner of dividend
  - Carries on business/performs independent personal services in the source country through a PE/Fixed base
  - The holding of shares/rights is effectively connected with the PE/Fixed base
  - Dividend taxable as 'Business Profit

Article 10(4): Permanent Establishment Situation

- Meaning of the term effectively connected
- The term effectively connected has not been defined in the UN Model
- Mere recording of shareholding in the books of PE without any business operation, not 'effectively connected'

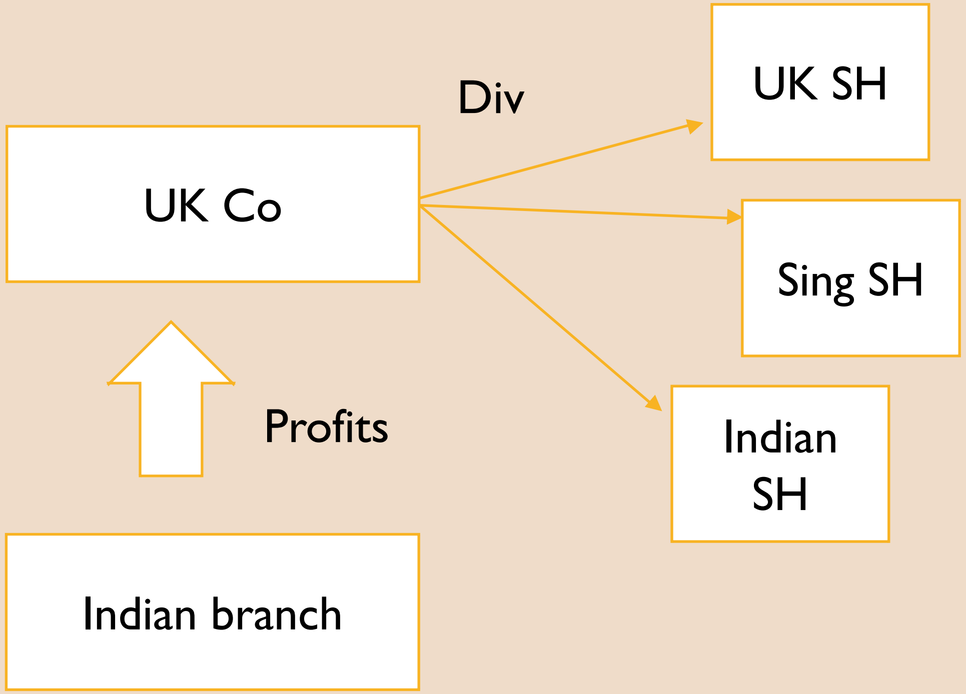
- Effectively connected with a PE or fixed base may be determined by the following:
  - Forms part of the assets of PE
  - Enhances economic strength of the PE
  - Claim connected in form and substance
  - Really connected rather than legally connected
  - It creates a right which gives right to dividend
- For E.g. Citibank USA has a branch in India which advances a loan to Indian Co. against security of shares. Therefore, shares are held by Citibank India and it receives dividend. i.e. the PE has economic ownership to exploit the asset. Such dividend shall be "effectively connected" with the PE in India and hence, taxed as Business Income.



Article 10(5): Extraterritorial Taxation Of Dividend

- Article 10(5) of the UN Model reads as follows:
- "Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State".

ARTICLE 10(5): EXTRATERRITORIAL TAXATION OF DIVIDEND



- A UK Co. has a branch in India carrying out business operations
- All of UK profits are attributable to the Indian branch
- UK Co declares dividend out of the profits accruing in India to its shareholders.
- Can India tax the dividend

Underlying Tax Credit

India-US

In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income—

(b) in the case of a United States Company owning at least 10 per cent of the voting stock of a company which is a resident of India and from which the United States company receives dividends, the income-tax paid to India by or on behalf of the distributing company with respect to the profits out of which the dividend is paid.

India-Singapore

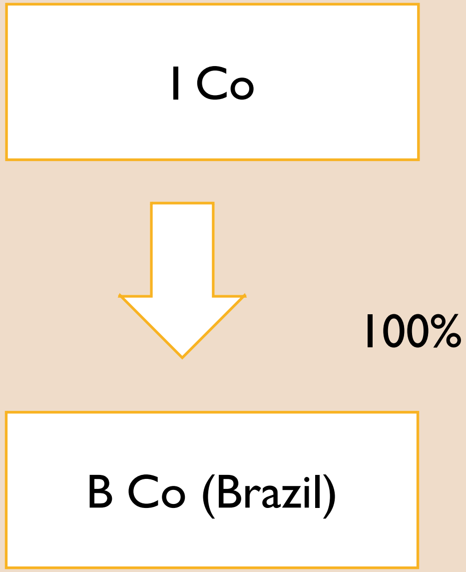
Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in Singapore, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Singapore tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Singapore tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable to the income which may be taxed in Singapore."

India-Mauritius

In the case of a dividend paid by a company which is a resident of Mauritius to a company which is a resident of India and which owns at least 10 per cent of the shares of the company paying the dividend, the credit shall take into account [in addition to any Mauritius tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph] the Mauritius tax payable by the company in respect of the profits out of which such dividend is paid.

CASE STUDIES

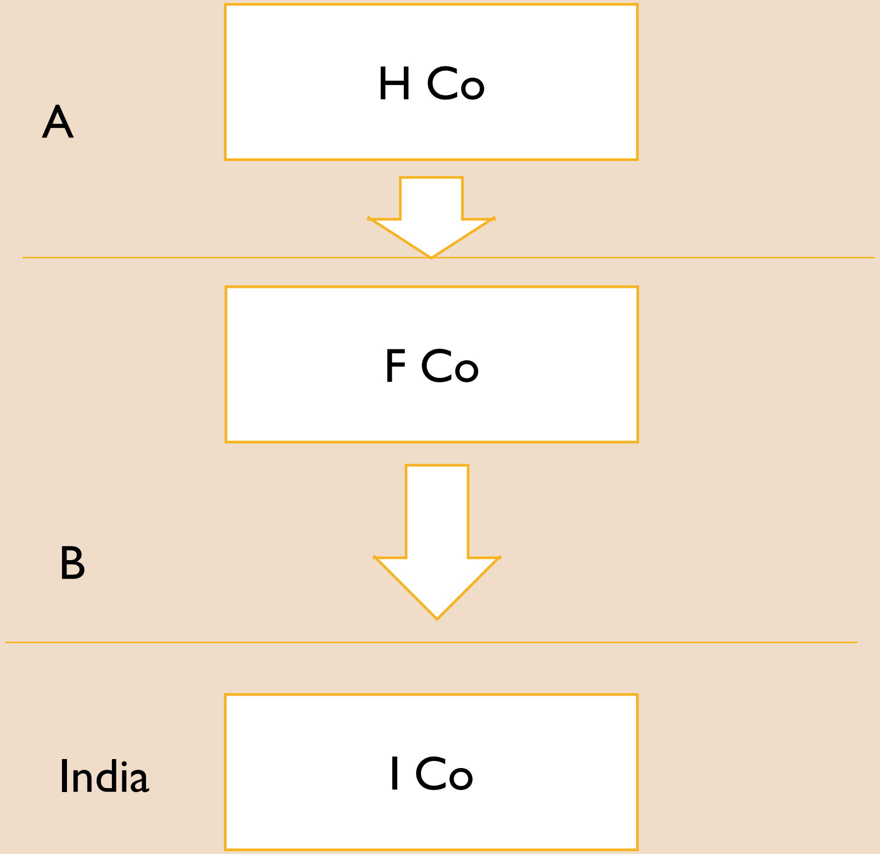
Case Studies



- I Co. is an Indian company headquartered in India.
- B Co. Brazil, is entirely held by I Co. India.
- Recently, B Co has declared dividend to it's shareholders.
- There is no tax on dividend in Brazil

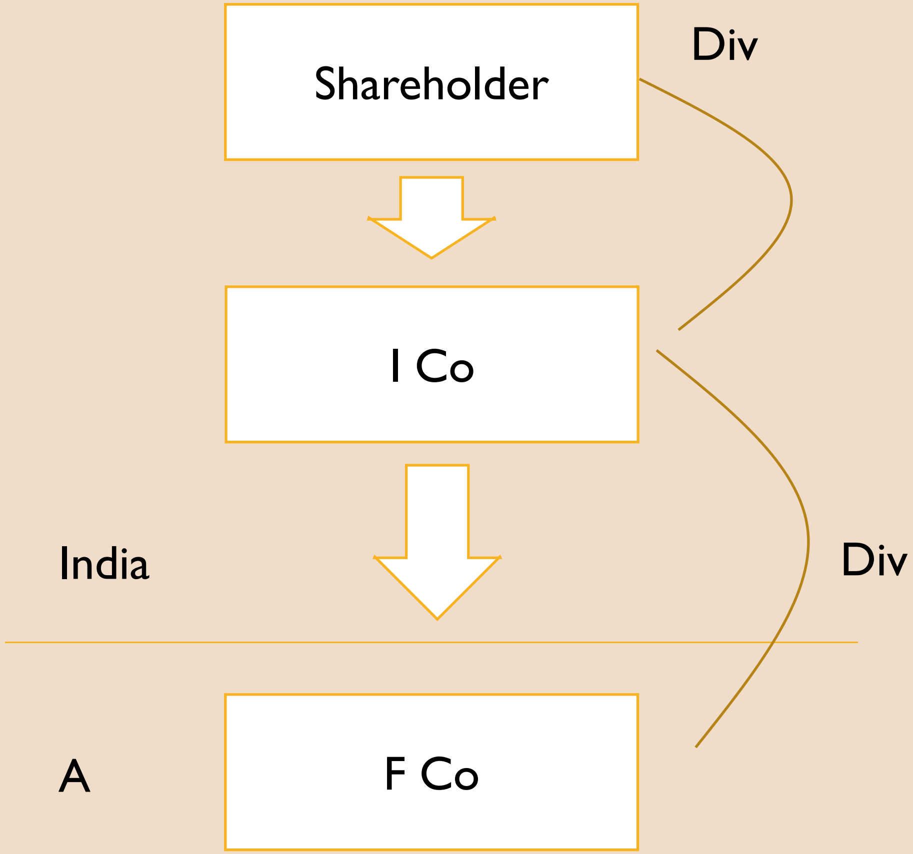
Whether declaration of such dividend B Co. Brazil. to I Co. will be taxable as dividend under the India Brazil DTAA?

Case Studies



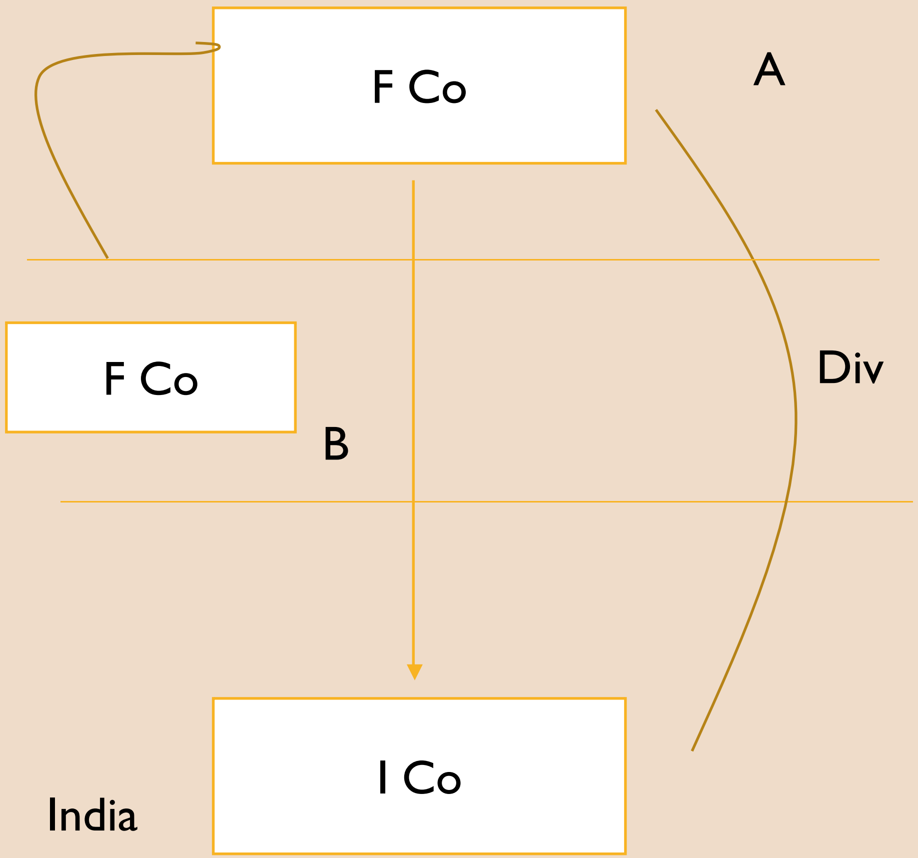
- H Co. is Ultimate Holding Company of the Group
- F Co. is based in State B and holds entire equity of I Co.
- F Co. derives value substantially from assets located in India
- F Co. is contemplating to redeem ordinary shares by way of Capital Reduction
- **Questions**
- Whether the said transaction is liable to tax in India ?
- Since there is no change in effective holding can we say this is not covered by Indirect Transfer provisions ?
- Can the same be classified as deemed dividend ?
- Tax Treaty benefit available to F Co. on deemed dividend ?
- Can reliance be placed on Circular 4/ 2015 to say this is not-taxable in India ?

Case Studies

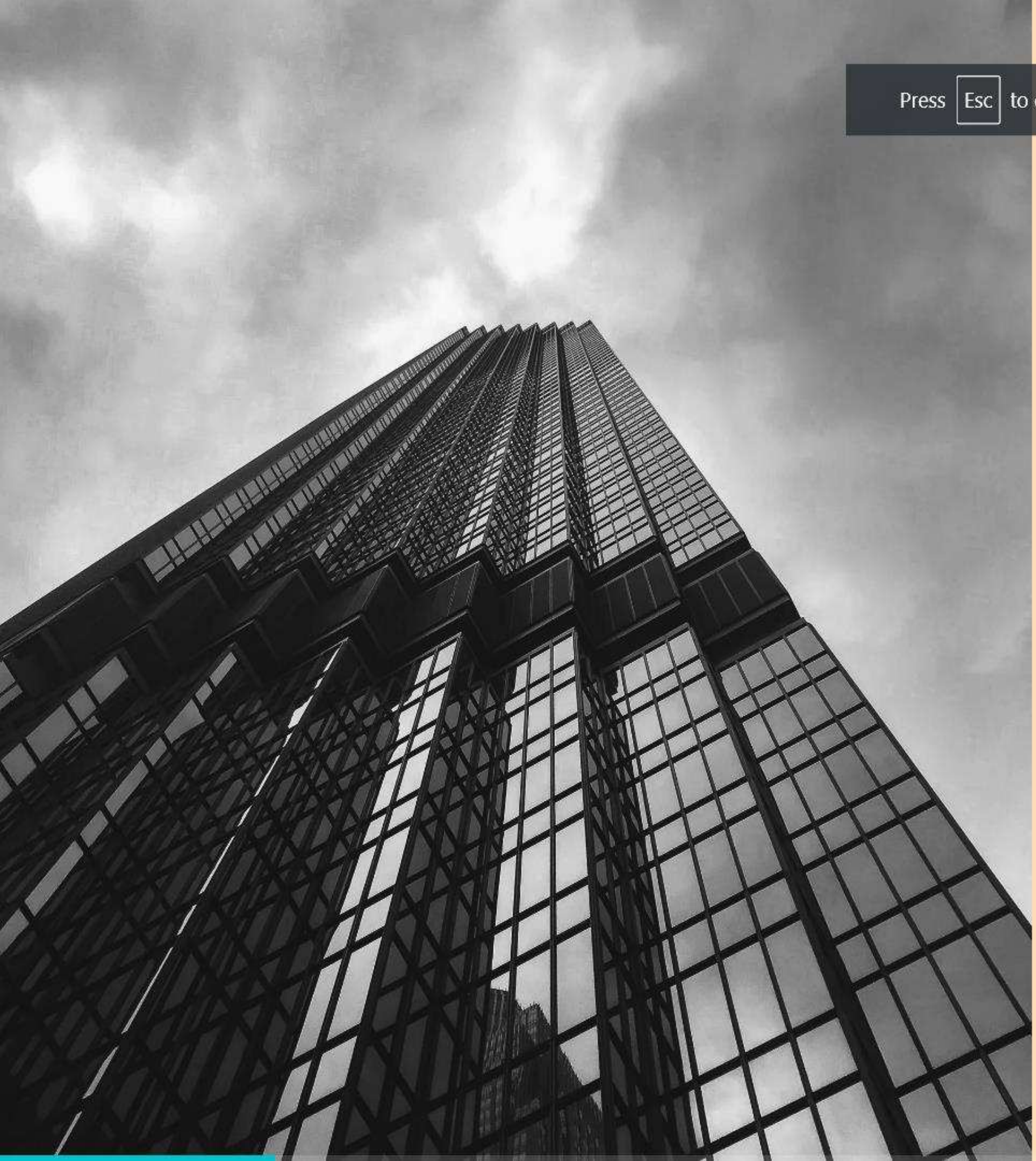


- F Co. is a Foreign Company shares of which are held by I C.
- F Co. has paid dividend to I Co. during the year
- I Co. proposes to declare dividend to its shareholders
- **Questions**
- I Co. eligible to claim 80 M benefits ?

Case Studies



- F Co. is a Foreign Company resident of State A
- I Co. is a subsidiary of F Co.
- F Co. is redomiciled to State B
- I Co. has paid dividend to F Co.
- **Questions**
- Is F Co. eligible to claim treat benefit ?
- If yes, India treaty with State A ? Or Treaty with State B ?



Interest taxation

As per Income-tax Act

Interest Deemed To Accrue Or Arise In India

- Section 9(1)(v) provides for deemed accrual of interest

Payer	**Deemed Accrual**
Government	Deemed Accrual in India
Resident	Deemed Accrual in India **Exceptions:** A) interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India or B) for the purposes of making or earning any income from any source outside India
Non-resident	Deemed Accrual in India **if interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India.**

Interest Taxability Under Act

- Section 2(28A) defines interest to mean *interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised*
- Section 2(28B) defines interest on securities to mean (i) Interest on Govt (State or Central) securities; (ii)interest on debentures or securities issued by company, Govt (State or Central or Provisional) corporation or local authority
- Interest income typically taxable under Income from Other Sources and taxable at applicable slab corporate tax rate
  - Section 56(2)(id) – Interest on securities, if not taxable under PGBP
  - Interest earned in the course of business PGBP vs Income from Other Sources whether inextricably linked to the business
  - Taxability of interest earned by Partner PGBP
- Section 145A- Taxable as per cash mercantile system followed by the tax payer
  - Exception Interest received on compensation enhanced compensation deemed to be income in the year of receipt Section 56(2)(vii)

Interest Taxability Under Act

- Certain interest are exempt
  - Interest on NRE account
  - Interest on lease of aircraft paid by unit in IFSC
  - Interest on FCNR or RFC account
- Tax Rate

Interest	Rate
Interest on forex loans or rupee denominated bonds, payable to NR or Foreign Co or Business trust u/s 194LC	5%
Interest on RDB or Govt security to FII/QIB u/s 194LD	5%
Interest payable by business trust to unit holder u/s 194LBA	5%
Other Interest u/s 115A	20%

Section 94B – Thin Capitalisation

Borrower/Guarantor →
- Indian company or
- PE of foreign company
- Other than Banking or Insurance business

Lender →
- Non-resident

Interest →
- Exceeds Rs. 1 Crore
- Deductible under PGBP

Excess shall mean lower of:
A) Total interest paid or payable in excess of 30% of EBITDA
or
B) Interest paid or payable to AE

→ C/fwd for 8 years

Interest taxation.

As per Tax Treaty

Article 11 – Interest

- Sharing of taxing rights →
  - Article 11(1) – Residence State right
  - Article 11(2) – Source State right
- Definition → Article 11(3) – Meaning of Interest
- PE Exception → Article 11(4)
- Source Rules → Article 11(5)
- Special Relationship → Arm's Length Condition

Article 11 - Interest

OECD Model	UN Model
1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State. (COR)	1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State
2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.	2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.
3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.	3. The term "interest" as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.
4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.	4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 or Article 14, as the case may be, shall apply.
5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated. (source rule)	5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.
6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.	Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 11(1) – Residence Country Right

- Article 11(1) - Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State
- Country of residence of interest receiver has the first right to tax
- Right is not exclusive – Source Country may also tax it
- Arise in a Contracting State
  - Art. 11(5)

Meaning of the term 'paid'

- Means the fulfillment of the obligation to put funds at the disposal of the creditor in a manner required by contract or custom
- Section 43(2) of the Act as discussed earlier
- According to the Commentary on Article 11 of the OECD Model, the term 'paid' has a very broad meaning, covering any "fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom"

- Vogel (1997) - Article 11 of the OECD Model does not cover fictive interest, which is neither paid nor earmarked for future payment.
- The Gerechtshof 's-Hertogenbosch (Court of Appeal of 's-Hertogenbosch (the Netherlands), GHH)) determined in its decision of 2003 that no tax could be levied on deemed interest income, as article 21 and not article 11 of the Belgium-Netherlands Income and Capital Tax Treaty (1970)[359] applied to deemed interest, which was not charged and therefore was not paid.
- Decision of 2004 of the Hoge Raad (Supreme Court of the Netherlands, HR) confirmed this interpretation of the tax treaty. Specifically, the HR held that notional interest that is neither paid nor charged is not interest for the purposes of the tax treaty.
- In contrast, the Tribunal Supremo (Supreme Court of Spain, TS) held in 2003 that the application of the presumption that interest is paid on a loan between associated parties is not incompatible with article 11 of the France-Spain Income and Capital Tax Treaty (1995). The TS, therefore, indirectly held that an actual payment is not required by article 11 of the tax treaty but that the payment can be presumed or deemed in certain situations.

Meaning Of Paid

- Mumbai ITAT in case of Ampacet Cyprus Ltd v DCIT [2020] 119 taxmann.com 277 refers to Special Bench

“In all the coordinate bench decisions, there is no discussion whatsoever to the connotations of the expression 'paid' and these decisions simply proceed on the basis that because the expression 'paid' is used article 11(1) of Indo Cyprus tax treaty, the taxability of interest can only be on cash basis . The expression "paid" is admittedly not defined in the treaty …What essentially follows is that unless the context otherwise requires, the definition of the undefined treaty term, under the domestic law of the source country i.e. India and preferably under the domestic tax laws, is to be adopted.“

It is in this context, Section 43(2) of the Income tax Act, 1961 may perhaps be relevant …While it is indeed true that this meaning cannot be imported in the tax treaty mechanically, without any application of mind and as a sort of automated process, undoubtedly a call is to be taken by the bench as to whether or not this domestic law meaning of the expression 'paid’ will be relevant.”

Special Bench holds that the reference made to SB to decide upon Article 11 is irrelevant since no interest was actually paid

Article 11(2): Source State Taxing Right

- However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.
- Right to Source State
  - Provides right to tax interest to Source State as per the domestic laws or at the concessional tax rate subject to fulfilment of following conditions:
  - Recipient of interest - resident of other State
  - Beneficial owner of interest
  - Taxation of gross basis – no deduction can be claimed
- DTAA's wherein interest is taxable only in the state of Source subject to fulfilment of conditions – Austria, Finland, Greece, Libya, Malaysia

Article 11(2): Taxability Of Interest In Source Country

- Many treaties provide for exemption from tax if the recipient of the interest is the government of the other state or a government agency or a government owned bank
- Most treaties provide for exemption or concessional rate of tax if the recipient is a bank
- Exemption in the India - Mauritius Treaty

3. Interest arising in a Contracting State shall be exempt from tax in that State provided it is derived
and beneficially owned by:
(a) the Government or a local authority of the other Contracting State ;
(b) any agency or entity created or organised by the Government of the other Contracting State

- Exemption in the India - UK Treaty

Exemption in the India - UK Treaty
3(b) where the interest is paid to the Government of one of the Contracting States or a political subdivision
or local authority of that State or the Reserve Bank of India, it shall not be subject to tax by the
State in which it arises.

Article 11(3): Meaning Of The Term Interest

- Article 11(3) of the UN Model reads as follows: "The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article."

- Exhaustive definition of interest - covers all kinds of income which may be regarded as interest in various domestic tax laws - No reference made to the domestic tax laws while defining the term interest (as opposed to the article on dividends)

- Debt claim of every kind – Broad meaning
  - Sum of money which is now payable or will become payable in future by reason of a present obligation
  - Liability depending upon a contingency is not a debt till the contingency happens
  - Debt even if amount to be ascertained provided liability is certain and only quantification of the amount remains
  - Includes cash deposits, security in form of money, Govt. securities, bonds & debentures, mortgage interest, loans

Article 11(3): Meaning Of The Term Interest

- OECD Model
  - Payments under non-traditional financial instruments (interest rate swaps) not included.
  - Penalty charges for late payment not included as interest
- Interest vs Dividend
  - Interest on participating bonds or on convertible bonds should not be considered as dividend until such time the bonds are actually converted into shares. But the interest on such bonds should be considered as dividend if the loan effectively shares the risks run by the debtor company.
  - Hazard of credit risk (not being able to enforce debt claim / debt irrecoverable) vs hazard of business risk of the borrower
  - Klaus Vogel - Interest is no more than the remuneration received for making capital available subject to repayment, and does not include profits from providing funds in cases where the provider accepts the hazards of the borrower’s business

Article 11(3): Meaning Of The Term Interest

- Guiding Principles as per NA General Partnership & Subsidiaries, Iberdola Renewables Holdings Inc. & Subsidiaries vs. Commissioner of Internal Revenue [2012] 22 taxmann.com 245 (TC-IS)

Type of certificate issued (Promissory Note vs. Share Certificate)

Absence or presence of Fixed Maturity Date

Whether or not repayments are contingent on earnings

Presence or absence of obligation to repay

Increase in management rights

Status equal to or inferior to regular corporate creditors

Parties Intent

Inadequate capitalisation

Sole shareholder's advance

Lack of interest payments

Ability to obtain comparable loan from other institutions

Article 11(3): Meaning Of The Term Interest

- **Services Charges on credit card** – Does not constitute interest as they are for credit facility
- **Bill of exchange discounting charges** – Not in the nature of interest - supported by ABC International Inc. [2011] 241 CTR 289 (AAR) and CIT vs. Cargill Global Trading (P.) Limited [2011] 335 ITR 94 (HC Delhi) as no creditor-debtor relationship; They are for the purpose of discounting
- **Interest on Income-tax Refund**
- The HC in B. J. Services Co Middle East Ltd (380 ITR 138)(Utt). ruled that:
  - The interest was paid under the Act at the statutory rate fixed hence arises a debt claim; and
  - The interest is effectively connected with the permanent establishment
  - Accordingly, Article 12(6), which provides that the provisions of Article 7, which relate to Business profits, of this Convention, as the case may be, shall apply
- Contrary View in Delhi ITAT in Clough Engineering [TS-184-ITAT-2011(DEL)] and Mumbai ITAT in Bechtel International Inc. [TS-72-ITAT-2012(Mum)] – Interest on tax refund is taxable on gross under Article 11 as it was not effectively connected with PE
- Similar conclusion in Transocean Offshore International Ventures Ltd [TS-56-ITAT-2022(DEL)]
- Kolkata ITAT holds that income-tax refund paid to the Netherlands-based company (parent of Philips Group) under Section 244A(1)(a) is not liable to TDS by virtue of beneficial provision of Article 11 of India-Italy DTAA read into Article 12 of India-Netherlands DTAA by resorting to MFN Clause under the Protocol Koninklijke Philips N.V [TS-699-ITAT-2022(Kol)]
  - interest on income-tax refund is debt claim under India-Italy DTAA

Article 11(3): Meaning Of The Term Interest

- **Interest Paid by branch to HO -** Diverging views

(a) Interest paid by PE is deductible and taxable at concessional rate prescribed under the Income-tax Act or applicable tax treaty in the hands of HO;

(b) Interest paid by PE is payment to self, hence not deductible and not taxable in the hands of the HO; and

(c) Interest paid by PE is payment to self, hence not deductible but taxable in the hands of the HO at either the concessional rate or at the rate applicable to foreign company.

Sumitomo Mitsui Banking Corporation vs. DDIT [2012] 136 ITD 66 (MUM.)(SB) in the context of India-Japan and India-Belgium DTAA, which specifically provided for deduction in respect of interest paid by Indian Branch of banking company to its HO

- Interest paid to the HO by its PE is though not deductible as expenditure under the domestic law being payment to self, the same is deductible while determining the profit attributable to the PE as per Article 7(2) and 7(3) of the Tax Treaty;
- The interest paid by the PE to its HO / Offshore Branches is not income chargeable to tax in India as being payment to self which cannot give rise to income that is taxable in India as per the domestic tax law. Further, the tax implication under the tax treaty was not examined as interest is per se not taxable under the Act (domestic law).
- Separately, since the income is not chargeable to tax in India, provisions of section 195 are not attracted and there being no failure to deduct tax at source from the payment of interest by the PE, the interest is held allowable as deduction for the Indian Branch.

Article 11(3): Meaning Of The Term Interest

- **ABN Amro Bank, N.V. vs. CIT [2012] 343 ITR 81 (HC Cal.)**
  - Branch & PE are distinct & separate
  - Deduction allowed to branch
  - Interest not taxable in the hands of HO
- **Circular 740 of 1996** on "Taxability of interest remitted by branches of banks to the head office situated abroad, under the Foreign Currency Packing Credit Scheme of Reserve Bank of India".
  - Branch & HO separate entities

Explanation to Section 9(1)(v)

- In case of non-resident, engaged in the business of banking, any interest payable by the PE in India to the HO or any PE shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the PE in India
- The PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly.

Meaning Of Interest

- **Guarantee Fees -** Payment towards guarantee fee cannot be regarded as income from debt claim
  - ACIT vs GMAC Financial Services Pvt Ltd [2012] 25 taxmann.com 4143(Chennai ITAT)
  - Vetas Wind Technology(2016)(69 taxmann.com 382)
  - Container Corp v Comr 134 TC No 5 (2/17/10)
  - Neo Sports Broadcast (P) Ltd (2016) 159 ITD 136
  - Johnson Matthey Public Ltd. Company (2018) 191 TTJ 1 (Del ITAT)
- **Interest on Compensation -** Goldcrest Exports v. ITO [2010] 134 TTJ 355 (ITAT Mum.)
  - Interest partakes the character of the compensation (under the arbitration) under judgement debt, which was not taxable in India as per Article 7(1) of the treaty.
- **Upfront Appraisal Fees -** DIT vs. M/s. Commonwealth Development [ITA No. 1058 of 2011, HC Bombay]
  - The fee is not payable in respect of any money borrowed or debt incurred.
  - The fees was paid irrespective of loan being granted or not
  - Therefore, not interest, but business income

Meaning Of Interest

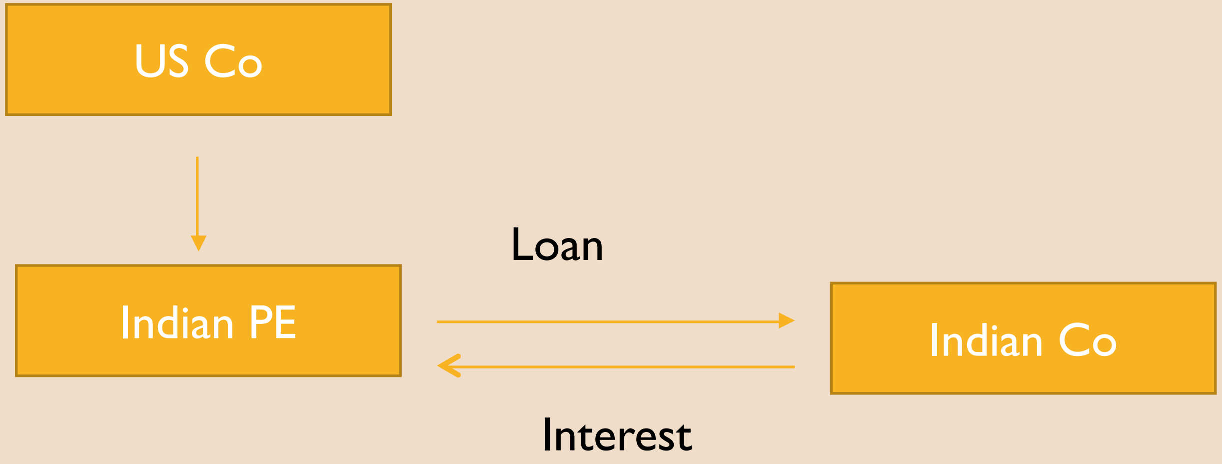
- **Interest on Bid Money -** Cauvery Spinning and Weaving Mills Limited vs. DCIT [2011] 238 CTR 55 (HC Chennai)
  - Interest was to be paid as fixed percentage of instalments of bid
  - Not interest as it was not on any debt or borrowing
- **Usance Charges** –Interest
  - Interest CIT vs. Vijay Ship Breaking Corporation [2008] 314 ITR 309 (SC)
  - ACIT vs Indian Furniture Products Ltd [2015] 53 taxmann.com 440 (Panaji ITAT)
  - ACIT v. Bhavani Enterprises [2014] 52 taxamn.com 489 (Panaji – Trib.)
  - Uniflex Cables Ltd. V. DCIT [2012] 136 ITD 374 (Mumbai)
  - For assessees in ship breaking activity – exempt Explanation 2 was added to section 10(15)(iv)(c)
- **Interest on Convertible Bonds -**Interest
  - LMN India Limited [2008] 307 ITR 40 (AAR) – Interest

Meaning Of Interest

- **Sale of Compulsory Convertible Debentures -** Zaheer Mauritius vs DIT [2014] 47 taxmann.com 247
  - Mauritius Co entered into SHA & SSA with Vatika
  - The agreement provided for a call option and a put option to Vatika to purchase or sell the CCDs
  - Vatika exercised call option & purchased CCDs
  - Delhi HC held that gain by Mauritius company from sale of CCD's in JV Company to Indian Partner under exit option was not "interest" u/s 2(28A) but "capital gains" even if the exit option assures a minimum assured return.
  - Whether a CCD is a loan simplicitor or whether it is in the nature of equity, depends entirely on whether the debentures are capital assets in the hands of its holder.
- **Interest on Capital Gains -** Genesis Indian Investment Co. Ltd.V. CIT[2013] 36 com 300 (Mumbai – Trib.)
  - Interest on delayed payment in the nature of sale consideration & not interest

Article 11(4): Permanent Establishment Situation

- Article 11(4) of the UN Model reads as follows: "The provisions of paragraphs 1 and 2 shall not apply if the **beneficial owner of the interest**, being a resident of a Contracting State, **carries on business in the other Contracting State** in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the **debt claim in respect of which the interest is paid is effectively connected with** (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of **Article 7 or Article 14**, as the case may be, shall apply."



Marubeni Corporation, Japan [TS-485-ITAT-2022(Mum)]
'Effective Connection' with PE, prerequisite for taxability of interest under Art.7

Article 11(5): Source Rule

- Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State.
- Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated
- The OECD Commentary (Para 27 Article 11) has cited a few possible situations where the above principle laid down by Paragraph 5 of Article 11 can be examined:

(a) The management of the PE has contracted a loan which it uses for the specific requirements of the PE; it shows it among its liabilities and pays the interest thereon directly to the creditor.

(b) The head office of the enterprise has contracted a loan the proceeds of which are used solely for the purposes of a PE situated in another country. The interest is serviced by the head office but is ultimately borne by the PE.

(c) The loan is contracted by the head office of the enterprise and its proceeds are used for several PE's situated in different countries.

Article 11(6): Arm's Length Condition

- Article 11(6) of the UN Model reads as follows:
- "Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention"
- **Special relationship:**
  - Participation in management, control and capital (direct or indirect)
  - Relatives (relationship by blood or marriage)
- Article 11 to apply on arm's length interest only
- OECD Commentary (Para 35 Article 11)
  - Taxation treatment to be applied to the excess part of the interest shall depend on the exact nature of such excess according to the circumstances of each case
  - Permits only the adjustment of the rate at which interest is charged and not the reclassification of the loan in such a way as to give it the character of a contribution to equity capital

MCQ TIME

MCQ

1. ABC Ltd. is a resident of India and is WOS of PQR Inc. UK Company. ABC Ltd. during the year has declared the dividends of Rs. 1 Lakh to PQR Inc. Determine the taxability of dividends:
   a) The dividends would be taxable at the rate of 15% as per Section 115BBD
   b) The dividends would be taxable at the rate of 20% as per Section 115A
   c) The dividends would be taxable at the rate of 10% as per India-UK DTAA
   d) The dividends would be taxable at 10.4% under India-UK DTAA

2. ABC Inc. is a US Co and has a branch in India. The Indian branch carries on the business in India on behalf of the ABC Inc and has earn profit of $2000. The global profits were $5,000. During the year ABC Inc has declared dividends worth $10,000 to its 3 shareholders, one amongst them is Indian resident. The capital is contributed equally. Determine the taxability in India
   a) $4,000 would be taxable at the rate of 15% as per Section 115BBD
   b) $4,000 would be taxable at the rate of 20% as per Section 115A
   c) The dividends cannot be taxed in India
   d) The dividends would be taxable in India attributable to Indian shareholder at slab rates

MCQ

1. ABC Plc a UK Co had granted loan to PQR Inc a US Company of $ 1 Mn. The interest earned on same was $50,000. ABC Plc. utilized the loan for the purpose of its branch in India. Determine the taxability of the interest income
   a) The interest would be taxed at the rate of 20% u/s 115A
   b) The interest would be taxed at the rate of 5% as provided under US-UK DTAA
   c) The interest would be not taxable in India
   d) The interest would be taxed at the rate of 15%
2. ABC Ltd. an Indian company had obtained the loan from Dubai branch of Citibank USA. It made the interest payment of $10,000. Determine the withholding tax liability of ABC Ltd.
   a) The interest would be taxed at the rate of 5% u/s 194LC
   b) The interest would be taxed at the rate of 5% as provided under India-US DTAA
   c) The interest would be not taxable in India
   d) The interest would be taxed at the rate of 5% under India-UAE DTAA

MCQ

1. Citibank USA's branch in India has granted loan of INR 10 Lakh to Indian Company ABC Ltd. The Indian company has paid the interest of Rs.2 Lakh. Determine the taxability of interest
   a) The interest would be taxed at the rate of 20% u/s 115A
   b) The interest would be taxed at the rate of 5% as provided under India-US DTAA
   c) The interest would be not taxable in India
   d) The interest would be taxed as per Article 7 of India-US DTAA at the rate of 40%

Thanks !

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