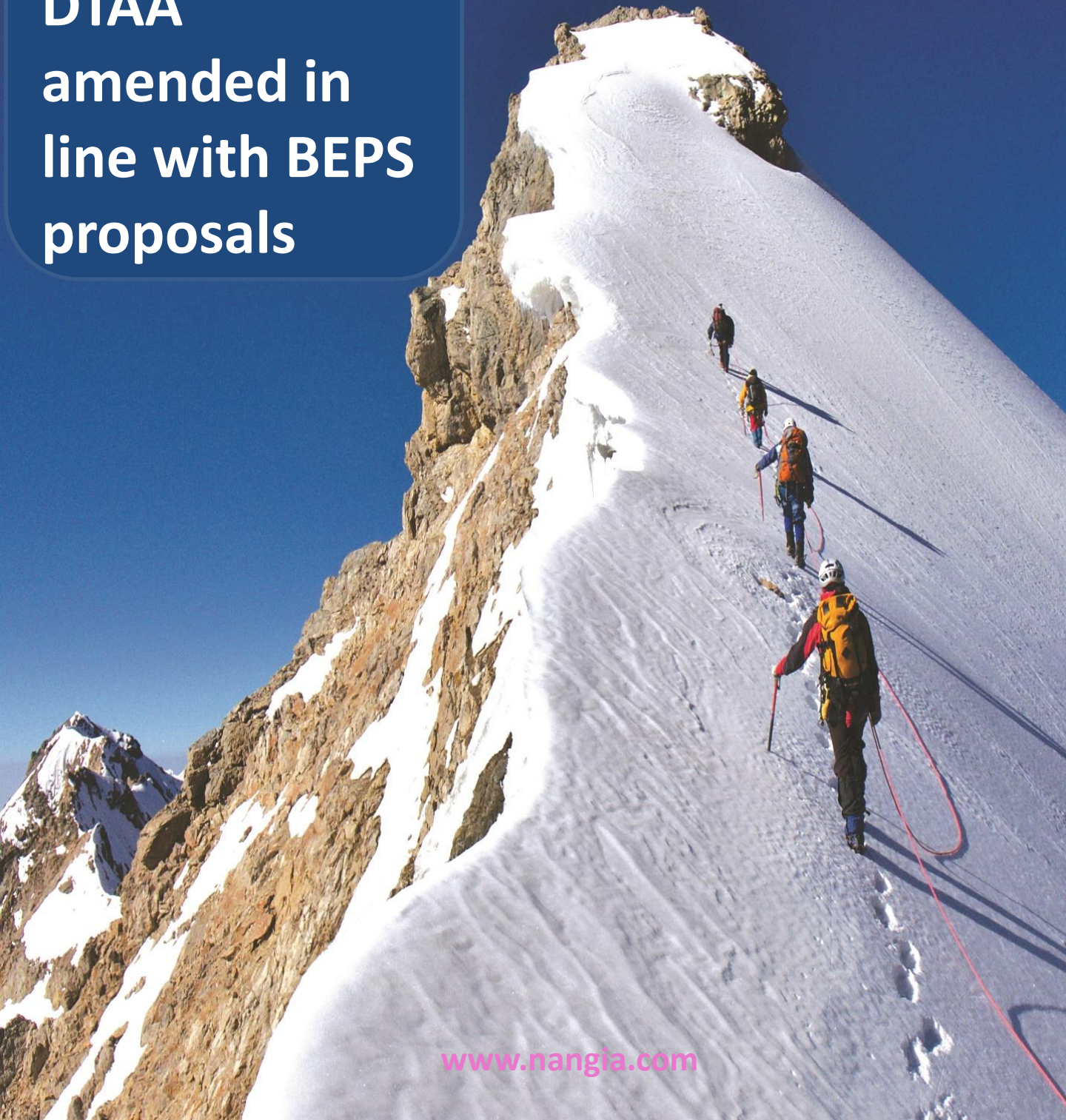


# NEWSFLASH

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**India-China  
DTAA  
amended in  
line with BEPS  
proposals**



## India-China DTAA amended in line with BEPS proposals

### Background

The Government of India and the People’s Republic of China, in order to further ripen their economic relationship and enhance cooperation in tax matters has amended the India-China DTAA. The aim is to eliminate double taxation, without creation of opportunities for tax evasion/avoidance. The revised agreement, which was signed on November 26, 2018 has been notified today and comes into force on from June 5, 2019. Any income arising in India during the financial year starting April 1, 2020, shall be governed by the provisions of the revised tax treaty.

### What has changed?

| Existing Provisions   | Revised Treaty   |
|---|--|
| <b>Treaty to also apply to Fiscally transparent entities</b>  |  |
| <b>The ‘persons covered’ under the treaty included an individual, a company and any other entity, being a taxable unit under the taxation laws of the Contracting States.</b>   | The treaty now includes within its scope a ‘fiscally transparent’ entity also.   |
| <b>Chinese taxes redefined</b>  |  |
| <b>The taxes to which the tax treaty applies in China included</b><br><ol style="list-style-type: none"> <li>1. The Individual income-tax</li> <li>2. The income tax for enterprises with foreign investment and foreign enterprises</li> <li>3. The local income-tax</li> </ol>  | Chinese taxes have been redefined to include all the taxes on enterprises and individuals. Now the local taxes shall not be considered as ‘taxes covered’ for the purpose of the tax treaty.   |
| <b>Residential status to be determined using Place of Effective Management (PoEM)</b>   |  |
| <b>The place of ‘residence’ of a person other than an individual who was a resident of both Contracting states was deemed to be the Contracting State in which its head office was situated.</b>  | The treaty has been revised to provide that competent authorities shall determine the residential status having regard to the PoEM and place of incorporation of such entity.  |
| <b>Scope of Permanent establishments widened</b>  |  |
| <b>A. Construction PE - The term “permanent establishment” included a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continued for a period of more than 183 days.</b> | The treaty now provides that where an enterprise of a Contracting State carries on such activities in the other Contracting State during one or more tax periods, the period of 183 days shall be the aggregate of all such periods of less than 183 days. |

|   |  |
|---|--|
| <p><b>B. Service PE</b> – It included the furnishing of services other than technical services, by an enterprise of the Contracting State through employees or other personnel in other contracting state, but only if the activities of that nature continue within that other Contracting state for a period or periods aggregating more than 183 days.</p>   | <p>The term PE shall now include the furnishing of services other than technical services, by an enterprise of a Contracting State through employees or other personnel in the other Contracting state, but only if activities of that nature continue for the same or connected project within that Contracting State for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned</p>       |
| <p><b>C. Agency PE</b> - Under the existing provisions, an agent constitutes a PE of the foreign enterprise only if he concludes contracts on behalf of the foreign enterprise</p>  | <p>Now the definition of Agency PE has been widened to include the following:</p> <ul style="list-style-type: none"> <li>• Where the agent habitually plays the principal role leading to conclusion of contracts in the name of such foreign enterprise/ for transfer of property of such foreign enterprise / for provision of services by such foreign enterprise or,</li> <li>• Where the agent habitually maintains stock and delivers them to customers</li> </ul> |
| <p><b>Business Profits</b></p>  |  |
| <p><b>The profits of an enterprise of a Contracting State were taxable only in that Contracting State unless the enterprise carried business in the other Contracting State through a permanent establishment situated therein.</b></p> <p><b>If the enterprise carried on business as aforesaid, the profits of the enterprise were taxed in the other Contracting State but only so much of them as were directly or indirectly attributable to that permanent establishment.</b></p> | <p>The revised treaty has removed this subjectivity in taxation of business profits and now if a PE is constituted, the profits attributable to the business activities of the enterprise shall be taxable as business profits.</p>  |

Apart from the above, the following changes have been made:

**Foreign Tax Credit** - Formerly, where a resident of China derived income from India, the amount of tax on that income payable in India was allowed to be credited against the Chinese tax imposed on that resident, though the amount of the credit shall not exceed the amount of the Chinese tax.

**However, where a person (other than an individual) who is resident of one country and has its PoEM in the other country and the competent authorities do not reach to an agreement on the residential status of such person, Foreign Tax Credit shall not be allowed.**



Similar provisions have been incorporated for elimination of double taxation in India also.

**Exchange of information** - To match international standards, the clause governing exchange of information has also been altered. The new clause provides that India and China shall exchange information/documents as are foreseeably relevant for administration or enforcement of domestic laws.

The information so obtained shall be kept as 'secret' and shall be disclosed only to persons or authorities concerned with procedural work in relation to taxation and for stipulated purposes. However, the information might be disclosed in public court proceedings or in judicial decisions.

In order to safeguard the public interest and adhering to the legitimate practices of both the Contracting States, it has been cited that the no such information could be transmitted which is unattainable under the laws of both the Contracting States or the disclosure of which might be contrary to public policy.

Earlier, the scope of taxes was limited to those covered by the treaty. Now, it has been widened to include within its ambit, taxes of every kind and description imposed on behalf of the contracting state or of their political subdivisions or local authorities.

Moreover, now a Contracting State could use such information for other purposes provided such information should be sanctioned to be used for such other purpose under the laws of both the states and such use is authorized by the competent authority of the supplying state.

The supplying state cannot deny deliverance of the information so sought by other Contracting State merely because it does not have any domestic interest in such information. It shall use its information gathering sources to deliver the sought information to the other Contracting State even though the information is not being used by the supplying state for its own tax purposes.

The span of Article 26 has been dilated to encapsulate exchange of information held by bank or any other financial institution, nominee or any other person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

A **new clause 27A** has been inserted to provide that a benefit under this Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction. However, if it is established that granting such benefit would be in accordance with the objects of this treaty, the benefit shall not be denied.

## NANGIA'S TAKE

*The revision of treaty between India and China is another step towards developing our economic affiliation with China and improve cooperation in tax matters. Moving from traditional process (location of head-office) of determining residential status, competent authorities shall now determine the same having regard to the PoEM. Through this change, the two countries have adopted the internationally accepted standards of determining residential status of an entity in case of a tie.*

*It is pertinent to note that PoEM has been devised as a mechanism for the competent authorities to determine residential status of a person (other than Individual) who is a resident of both the countries. Where a person is a resident of one country and his PoEM is in the other country and the competent authorities do not reach to an agreement as to which is the country of residence of such person, provision for foreign tax credit have been amended to provide that such person shall not be allowed to claim credit of taxes paid in the other country while discharging his tax liability in his country of residence. This amendment to the treaty may have huge ramifications for the foreign companies that become resident of the other country owing to its PoEM being in the other country and the competent authorities do not reach to an agreement on residence of such company.*

*The revised treaty also plugs the loophole used by foreign entities to avoid constitution of PE by restricting their activities in the other country to less than 183 days in case of a building site, construction, installation, or assembly project. Now fragmentation of activities to avoid constitution of PE shall not sail through and such periods of less than 183 days shall be aggregated to determine the threshold of 183 days. For this purpose, even the connected activities conducted by closely related parties of such foreign entities shall be considered while determining the threshold of 183 days. It may be noted that anti-fragmentation is one of the resolutions suggested by OECD's BEPS project.*

*The treaty until now was subjective in respect of taxability of business profits. The foreign entity was given an opportunity to prove that the PE could not have undertaken the business activities or such activities were not connected to the PE so constituted. However, now if a PE is constituted, the profits attributable to the business activities of the enterprise shall be taxable as business profits.*

*Additionally, the provisions for exchange of information have also been adapted in accordance with the international standards.*

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