Tax Matters

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The team at JMP Advisors is pleased to bring to you a gist of some of the significant developments in the direct tax space during July 2023:

Income tax rulings

- **Duration of actual drilling operations not the sole criteria for constitution of Permanent Establishment ('PE') in India**

  - Deep Drilling 1 Pte. Ltd. vs. The Deputy Commissioner of Income-Tax (IT) - 2(1)(2), Mumbai[1]

The taxpayer, a Singapore based company had entered into a contract for providing drilling services to an Indian company. The drilling rig was brought into India in April 2010 to carry out necessary upgrades/repairs to meet the Indian company's requirements. However, the actual drilling services were rendered for 119 days from December 2010 to March 2011.

Article 5(5) of the India Singapore Double Taxation Avoidance Agreement ('DTAA') states that an enterprise shall be deemed to have a PE in India if it provides services or facilities in India for a period of more than 183 days in a Financial Year ('FY') in connection with the exploration, exploitation or extraction of mineral oils in India.

The issue under discussion was that of the period to be considered for counting threshold of 183 days as mentioned in the DTAA, whether one needs to consider the period from when the drilling rig was brought into India or when the drilling operations actually commenced till the end of FY.

The Bombay High Court ('HC') made following key observations:-

1. The contract was entered only in June 2010 despite the fact that the drilling rig was brought into India in April 2010 for undergoing necessary upgrades/repairs to meet the requirements of Indian company.

2. If the argument of the taxpayer is accepted that only the period of actual drilling services rendered needs to be considered, then there was no need to bring the drilling rig into India in April 2010 and to hold meetings with the Indian company in April 2010.

3. The upgrades/repairs could have been made outside India and the drilling rig could have been brought into India later.

The Bombay HC held that the drilling rig was already in India for providing the services or facilities in connection with the exploitation, exploration or extraction of mineral oil in April 2010 itself and hence to compute the threshold period of 183 days, one needs to consider

[1] Income Tax Appeal No. 315 of 2018

the stay from April 2010 (i.e. the day on which the drilling rig entered into Indian waters to render services to Indian customers) and not December 2010.

JMP Insights *– This judgement clarifies that all activities connected to the main activity of rendering services need to be considered while computing the threshold period for construing a PE, provided all such activities are performed in India.*

- **Claim of Foreign Tax Credit ('FTC') based on 'tax sparing' concept embedded in the pre-amended India Thailand DTAA.**

  - Principal Commissioner of Income Tax – 7 vs. Polyplex Corporation Limited[2]

The taxpayer, an Indian company received dividend from its subsidiary company based in Thailand. While filing the return of income, the taxpayer offered the dividend income to tax in India and claimed FTC being the tax payable in Thailand ('Thai tax') as per India Thailand DTAA.

The tax officer disallowed the FTC as claimed by the taxpayer since no tax was actually paid in Thailand, based on the exemption provided as per the provisions of the Investment Promotion Act of Thailand.

The Delhi HC perused the provisions of Article 23(3) of the pre-amended India Thailand DTAA and noted that the term 'Thai tax' payable shall be deemed to include any amount of tax which is otherwise payable as 'Thai tax' but is exempted on account of the provisions laid down in the Investment Promotion Act of Thailand, which is designed to promote economic development in Thailand.

As per the provisions of Article 23(2) of the pre-amended India Thailand DTAA, the amount of 'Thai tax' payable under the laws of Thailand by the taxpayer, in respect of dividend arising in Thailand, on which tax is payable in both the countries, the 'Thai tax payable shall be allowed as a credit against the tax payable in India in respect of such dividend.

On a conjoint reading of the provisions of Article 23(2) and Article 23(3) of the pre-amended India Thailand DTAA, taxpayer is allowed to claim FTC being the 'Thai tax' payable even though it is exempt from income tax in Thailand as per the Investment Promotion Act of Thailand. Thus, the Delhi HC upheld the claim of FTC.

JMP Insights - *Under the general provisions of the Act and DTAA, the taxpayer is allowed to claim FTC only if actual tax is paid. However, in various DTAAs, 'tax sparing' concept is embedded which emphasises on tax payable and not tax paid. This concept helps to promote economic development which is the real intent of the contracting state and to forego the tax which is otherwise payable on the dividend.*

It is important to note that the India Thailand DTAA has been amended in the year 2015 where the 'tax sparing' clause has been deleted. However, the above decision can be helpful to claim FTC under those DTAAs which have a similar 'tax sparing' clause.

[2] ITA 571/2019, ITA 573/2019, 574/2019 & ITA 575/2019 (Delhi HC)

- **Support services rendered to promote, sell and distribute books and journals published by the Indian company not taxable as fees for technical services ('FTS')**

  - CIT(IT) vs. Springer Nature Customer Services Centre GMBH[3]

The taxpayer, a non-resident company, entered into a commissionaire agreement with an Indian company. Further, the taxpayer directly supplied e-journals to Indian entities and received subscription fees.

The issue under consideration before the Delhi HC are as follows:-

1. Whether the services rendered by the taxpayer under the commissionaire agreement are taxable as FTS?

2. Whether the subscription fees received by the taxpayer on supplying e-journals taxable as royalty?

Issue1:-

The Delhi HC noted that the services rendered by the taxpayer under the commissionaire agreement can be brought to tax as FTS only if it falls within the nature of managerial or technical or consultancy services.

On a perusal of the commissionaire agreement, it observed that the taxpayer is required to promote, sell and distribute the books and journals published by the Indian company in print and electronic form. Apart from this, the taxpayer is also required to provide other services like order-handling, debtor management services, invoicing, stock keeping and inventory management and customer services, etc.

To render the aforesaid services, the taxpayer received commission from the Indian company. Importantly, the title in the publications remained with the Indian company.

The Delhi HC observed that the taxpayer was not required to discover, develop or define/evaluate the goals that the Indian company had to reach. The taxpayer did not even frame policies that led to these goals or supervise or execute or change policies that were already adopted. The taxpayer was not performing executive or supervisory functions. It was obliged only to render support to business operations. Hence, the services rendered by the taxpayer cannot be construed as managerial services.

The Delhi HC noted that there is no special skill or knowledge possessed by the personnel of the taxpayer to render the services in accordance with the commissionaire agreement. The taxpayer did not render any professional advice or service concerning a specialised field.

[3] ITA No. 306/2023

For services to be categorised as technical service, there should be usage of scientific knowledge for practical applications or industrial science concerning, relating to or derived from industry.

Promotion, sale or distribution of the Indian company's publications or rendering of support services, although involving human intervention, do not fall within the meaning of technical and/or consultancy services.

The commission received by the taxpayer does not amount to FTS as it is neither technical nor managerial/consultancy in nature.

Issue 2:-

Before the Delhi Tribunal, the Revenue had taken the stand of treating the subscription fees as royalty. However, before the Delhi HC, the Revenue changed the tax position and argued taxing the said subscription as FTS.

The Delhi HC dismissed the written submissions made by the Revenue and concluded that the subscription fees should not be treated as FTS, as the said position was not taken before it by the Revenue or by the taxpayer. This is a flip-flop by the Revenue, which is not acceptable.

Further, the subscription fees cannot be treated as royalty as there is no grant of right in respect of copyright to the concerned subscribers of e-journals. It is mere sale of the copyrighted publication without transferring the copyright. Relying upon the Supreme Court's ('SCs') ruling in case of Engineering Analysis Centre of Excellence Private Limited vs. The Commissioner of Income Tax & ANR.[4], the Delhi HC held that subscription fees received on supply of e-journals could not be treated as royalty.

JMP Insights – *The Delhi HC has emphaised on the fact that any payment made would be chargeable to tax as FTS only if the services are in the nature of managerial, technical or consultancy services. Mere intervention of human activities while rendering the services does not construe the services as technical services. In such cases, it is important to analyse the description of the services as mentioned in the agreement.*

Further, the Delhi HC as rightly pointed out that flip-flop of tax position by the Revenue before judicial forums is not acceptable.

- **No profit attributable to PE in India as loss incurred globally.**

  - Hitachi Ltd vs. The Assistant Commissioner of Income - Tax (IT), New Delhi[5]

The taxpayer is a company based in Japan having a Project Office ('PO') in India and the said PO constituted PE of the taxpayer in India. The taxpayer supplied equipment to its Indian customer wherein the risk and title to the equipment was transferred outside India. Further, the taxpayer also provided onshore services through the PO subsequent to the supply of the equipment.

[4] Civil Appeal Nos. 8733-8734 of 2018
[5] Income Tax Appeal No. 2259/DEL/2022 and 2260/DEL/2022

The taxpayer did not offer any income earned from the offshore supply of equipment to tax in India on the basis that the supply was executed outside India and the PE in India had no role to play in the offshore supplies.

The tax officer attributed profit from offshore supplies to the PE in India at the rate of 35 per cent and relied on the global profit rate to determine profit from operations.

As per Article 7 of the India Japan DTAA, profit shall be attributable to the PE in India only if the PE in India is involved directly or indirectly in the transaction. In the present case, the PE in India had no part in the manufacture or procurement of the offshore supplies. The taxpayer placed reliance on the Delhi HC judgement in CIT vs. Nokia Solutions and Net Works OY[6].

The Delhi Tribunal relied upon the aforesaid ruling of the Delhi HC and on the basis of the facts of the case concluded that since the taxpayer had incurred net loss globally, no profit can be attributed to its PE in India, therefore the addition made by the tax officer in lines with the DRP directions was deleted.

JMP Insights – *The Delhi Tribunal decision is a welcome decision for taxpayers. However, while rendering the judgement, the Delhi Tribunal has not analysed the issue of existence of a PE in India. The India Japan DTAA does not have a clause dealing with provisions on splitting of contracts to avoid a PE in India. However, if a DTAA has this type of clause, then Action Plan 7 of Base Erosion and Profit Shifting ('BEPS')/Article 14 of Multilateral Instrument ('MLI') dealing with splitting of contracts needs to be considered in the analysis of relevant DTAA provisions, while attributing profit to its PE in India.*

Income Tax Notifications

- **Transfer of share or unit or interest in resultant fund pursuant to relocation of the original fund not taxable subject to prescribed conditions**

  As per section 56(2)(x) of the Act, any person who receives any property (except any sum of money or any immovable property) shall be liable to tax on receipt basis on the below amount:

  a. Property received without consideration – whole of Fair Market Value ('FMV') in excess of INR 50,000;

  b. Property received for a consideration where the FMV exceeds the consideration by INR 50,000 - amount of difference between FMV and such consideration.

  However, proviso to section 56(2)(x) of the Act is not applicable to property received from certain notified class of persons and subject to such conditions as may be prescribed. Rule 11UAC of the Income-tax Rules, 1962 ('the Rules') specifies the notified class of persons and prescribes conditions to be fulfilled for non-applicability of section 56(2)(x) of the Act.

[6] [2023] 147 taxmann.com 165 (Delhi)

Rule 11UAC of the Rules has been amended to include:

- Any shares or units or interest in a resultant fund [incorporated in India as an Alternate Investment Fund ('AIF') regulated by the Securities and Exchange Board of India ('SEBI') or the International Financial Services Centre ('IFSC') and is located in an IFSC] received by the fund management entity in lieu of shares or units or interest held by the investment manager entity in the original fund registered outside India, pursuant to its relocation.

  However, the aforesaid exemption is subject to fulfilment of following twin conditions:

  (i) Not less than ninety percent of share or unit or interest in the fund management entity of the fund are held by the same entities or persons in the same proportion as held by such entities or persons in the investment manager entity of the original fund; and

  (ii) The persons or entities who now hold at least ninety percent of the share or unit or interest in the fund management entity of the fund were holding not less than ninety percent of the aggregate of share or units or interest in the investment manager entity of the original fund prior to relocation of the original fund.

DID YOU KNOW?

As per Notification No.10/23-Central Tax issued by the Central Board of Indirect Taxes and Customs dated 10 May 2023, with effect from 1 August 2023, e-invoicing shall be mandatory for businesses having turnover exceeding INR 5 crore in the prior FY i.e. FY 2022-23.

Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

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