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 May 2022:

Income tax rulings

➢ **Statements of customers employees inadequate for determining existence of a Permanent Establishment ('PE') in India of Singapore company**

- AB Sciex Pte Limited v. ACIT (Delhi Tribunal) (ITA No. 514/Del/2021)

The taxpayer, a tax resident of Singapore, is engaged in the business of manufacturing and sale of scientific research instruments and peripheral and provision of repairs and maintenance services. The taxpayer has entered into three separate agreements with its Associated Enterprise ('AE') in India, namely:

- Sales Commission Agreement: For appointing Indian AE on non-exclusive basis to provide services related to sales, installation, warranty for the products and spares sold directly by the taxpayer to the customers in India;

- Distribution Agreement: For appointing the India AE as non-exclusive distributor for distribution of taxpayers' products and spare parts to customers within the territory; and

- Marketing Support Services Agreement: For marketing support services viz., identifying market opportunities, potential customers, conducting seminars, provide demonstrations, etc.

During the assessment proceedings, the tax officer relying on statements recorded pursuant to summons issued to two employees of a customer of the taxpayer concluded that Indian AE acted as representative of the taxpayer in India. Further, it was held by the tax officer that premises of the Indian AE was used to maintain inventory of spare parts of the taxpayer as well as sales outlet for soliciting or receiving orders. Therefore, the tax officer concluded that the taxpayer has a fixed place PE in India. Further, the tax officer observed that Indian AE acted solely on taxpayers' behalf while providing services to the customers of the taxpayer in India and therefore, India AE was held to be dependent agent PE of the taxpayer in India.

On detailed analysis of terms of the above-mentioned agreements between the taxpayer and the India AE, the Tribunal held as under:

- All the agreements define the scope of services for Indian AE very clearly. It neither envisage nor grant any authority to Indian AE to conclude any contract of sale on behalf of the taxpayer nor carry out negotiations with the customers on behalf of the taxpayer.

- The purchase of products /spare parts by the Indian AE from the taxpayer for the purpose of resale in India was on principal-to-principal bases and no agency relationship exist between the Indian AE and the taxpayer.

- The Indian AE has no right or authority to assume or create any obligation of any kind, express or implied on behalf of the taxpayer.

- The terms of the agreements make it clear that the taxpayer does not have a warehouse or sales outlet in India.

Additionally, the Tribunal observed that the employees of the taxpayer never visited India and direct sales through shipment from Singapore was made to Indian customers. The Tribunal held that the tax officer has not brought any material on record to demonstrate that the activities of Indian AE are wholly devoted on behalf of the taxpayer and as such it does not have any independent status and was not acting in the ordinary course of its business. Therefore, the Indian AE does not constitute dependent agent PE of the taxpayer in India.

The Tribunal held that the tax officer could not rely on adverse statement of two employees of a customer of the taxpayer without giving any opportunity to the taxpayer to cross examine. The Tribunal observed that the persons whose statements have been recorded are neither employees of the taxpayer nor Indian AE and they have only stated certain facts without being aware of the legal relationship and real nature of the transaction between the taxpayer and its Indian AE.

JMP Insights *– The issue regarding the determination of PE of a foreign company in India has been a subject matter of litigation before various courts. The determination of PE is a factual exercise and thus having well drafted documentation between the parties for such arrangements assumes utmost importance.*

➢ **Payments to business promotion agents not Fees for Technical Services ('FTS') but business income**

- Apurva Goswami v. DDIT [International Taxation] (Delhi Tribunal) (ITA Nos. 2401 to 2403/Del/2016)

The taxpayer, an individual, is in the business of contract research and specializes in the area of pharmacovigilance (drug safety) services. The taxpayer entered into Master Services Agreement ('MSA') with agents located outside India in order to expand his business in overseas markets. Such agents were entitled to receive a fixed minimum remuneration as well as a commission for new businesses materialised through them.

The issue before the Tribunal was whether the tax withholding is applicable on payments made to agents outside India for business promotion.

The Tribunal observed that agents were appointed only with a view to propagate and solicit business. They did not to render any managerial, advisory, and technical or consultancy services. Further, by relying on the terms of MSA, the Tribunal held that payments made to agents are not in the nature of FTS as no specialised technical services were provided to the taxpayer. It was held that the payments made to the agents were business profits, and the same is not taxable in the hands of agents in India in the absence of PE in India. The Tribunal also observed that just naming of the agents as 'consultants' in MSA cannot be basis of holding that payments made to such agents are FTS. Since the payments made to the agents, being not chargeable to tax in India, the taxpayer is not obliged to withhold any tax while remitting the amount to agents.

JMP Insights *– In this ruling, the Tribunal has examined the terms of MSA in detail while deciding in favour of the taxpayer. Given this, it is extremely important that contracts with non-resident service providers are well drafted, articulating clearly exact nature of services, the role and responsibility of the service provider, etc. to substantiate the tax withholding position adopted by the Indian taxpayers.*

- **Taxpayer not entitled to avail benefit under the India-Singapore Double Taxation Avoidance Agreement ('India-Singapore DTAA') on freight not 'remitted to' or 'received in' Singapore.**

  - M/s. PACC Container Line Private Limited v. ITO (International Taxation) (Hyderabad Tribunal) (ITA Nos. 25/Hyd/2018 to 27/Hyd/2018 and 550/Hyd/2021 to 551/Hyd/2021)

In the given case, the taxpayer, a tax resident of Singapore, earned freight income from operation of ships in international traffic. While remitting the freight to the taxpayer's bank account in Singapore, the shipping agent of the taxpayer in India, deducted its commission and remitted only the balance amount of freight.

The issue before the Tribunal was whether the Article 24 of the India-Singapore DTAA providing for 'Limitation of Relief' to be invoked for restricting the benefit of Article 8 of the India-Singapore DTAA to freight income of shipping companies 'remitted to' or 'received in' Singapore only:

- Article 8 of the India-Singapore DTAA provides that profits derived by Singapore tax resident shipping companies from the operation of ships in international traffic shall be taxable in Singapore only.
- Article 24 of the India-Singapore DTAA provides that in respect of an income which is taxable in Singapore on receipt basis, taxpayer will be entitled to claim tax exemption in India to the extent such income is 'remitted to' or 'received in' Singapore.

The Tribunal has held that the taxpayer being tax resident of Singapore entitled to claim benefit of Article 8 of the India-Singapore DTAA. However, Article 8 of the India-Singapore DTAA cannot be applied on stand-alone basis and the effect of Article 24 of the India-Singapore DTAA was required to be given. The Tribunal also held that the word "remitted

to or received" in Article 24 of the India-Singapore DTAA must be interpreted literally. The word "remitted" cannot be read as accrued. Therefore, the Tribunal held that the amount of the commission deducted by the shipping agent before remitting the net amount to Singapore is subject to tax in India. Only the net freight income which was remitted to Singapore is exempt from tax in India in the hands of the taxpayer.

***JMP Insights** – In this case, the taxpayer relied on the decision of the Rajkot Tribunal in the case of Albara Shipping, wherein it was held that where freight income received by a tax resident of Singapore, was taxable in Singapore on accrual basis, Article 24 of the India-Singapore would not apply. However, the Tribunal in this case distinguished Albara Shipping ruling on the basis that the onus is on the taxpayer to substantiate that the freight income was taxable in Singapore on accrual basis to claim for tax exemption in India on the entire freight income. This is an important aspect to be noted by the taxpayer especially for tax residents of Singapore, engaged in business of operation of ships in international traffic.*

- **Amended proviso to section 201(1) of the Act for payment made to non-resident should be given retrospective effect**

  - M/s. Shree Balaji Concepts v. ITO (Panaji Tribunal) (ITA No. 73/PAN/2018)

In the given case, the taxpayer, a resident of India made payments to two non-residents towards purchase of immovable property in India. While making the remittance, the taxpayer failed to deduct tax at source as per Section 195 of the Income-tax Act, 1961 ('the Act'). The tax officer issued a demand notice to recover the tax not deducted along with interest from the taxpayer.

The taxpayer argued that the two non-residents had offered to tax the amount received from the taxpayer and filed their return of income. Hence, the recovery proceedings initiated for not deducting tax should be dropped.

As per Section 201 of the Act, no tax along with interest may be recovered from the taxpayer if the payee files return of income in India by considering the amount on which the taxpayer had failed to withhold tax and pays the tax due on the income declared in such return of income. This beneficial provision was inserted in the Act from 1 July 2012, only for resident payees. The Finance Act, 2019 from 1 September 2019 extended this benefit to non-resident payee as well.

The taxpayer argued that the amendment of the Finance Act, 2019, is intended to remove the anomaly in the law and thus, the said amendment needs to be given retrospective effect.

The Tribunal after going through the documentary evidence filed by the taxpayer as well as relying on judicial precedents accepted that the Finance Act, 2019 removed the anomaly in the law and needs to be given a retrospective impact. Thus, for the present case where the relevant Financial Year ('FY') is 2011-12, the benefit should be available to the taxpayer. Since the two non-residents have filed their return of income and offered to tax the sale consideration received, the tax officer cannot recover the amount of tax not withheld from sales consideration

by the taxpayer. However, the taxpayer is liable to pay interest from the date on which the tax was required to be deducted to the date on which the return of income is filed.

JMP Insights *– This is a welcome judgement setting a precedent for retrospective application of beneficial amendment in the law. It will reduce the hardship faced by taxpayers' owing to an anomaly in the law which is sought to be clarified by way of amendments in subsequent Finance Acts.*

DID YOU KNOW?

- The Central Government has notified the Faceless Penalty (Amendment) Scheme, 2022, thereby amending the existing Faceless Penalty Scheme 2021. One of the key amendments is that a personal hearing (through videoconferencing) will no longer be discretionary and shall be granted upon request by the taxpayers.
- As per the amended Companies (Appointment and Qualification of Directors) Rules, 2014, a person who is a national of a country sharing a land border with India, seeking appointment as a director, is required to obtain prior security clearance from the Ministry of Home Affairs, Government of India.

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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