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 June 2022:

Income tax rulings

- **Insolvency and Bankruptcy Code, 2016 ('IBC') cannot dilute the Revenue's right to continue the income tax proceedings initiated before approval of the Resolution Plan**

  - Dishnet Wireless Limited v. Assistant Commissioner of Income Tax (Madras High Court) (W.P. No. 34668 of 2018)

  The chronology of events in the taxpayer's case was as follows:

  - 28 February 2018 - the taxpayer voluntarily approached the National Company Law Tribunal ('NCLT') for initiating the Corporate Insolvency Resolution Process ('CIRP').
  - March 2018 (before admission of the application for CIRP) - the tax office issued a notice to reopen the assessment under section 148 of the Income-tax Act, 1961 ('the Act').
  - 12 March 2018 – NCLT admitted the application for CIRP.
  - 26 December 2018 – the taxpayer filed a Writ Petition before the High Court ('HC').
  - 27 December 2018 – HC passed an Interim order on the Writ Petition wherein the Revenue was allowed to proceed with the reassessment but was directed to keep the assessment under a sealed cover.
  - 21 May 2019 – The Resolution Plan was submitted to the NCLT. However, it did not consider any dues or proceedings pending under Section 148 of the Act.
  - 9 June 2020 – NCLT approved the Resolution Plan submitted by the Resolution Professional.

  The question for consideration before the HC was whether the initiation of the proceedings under Section 148 of the Act was without jurisdiction, since the taxpayer had filed the application for CIRP.

  Once the Resolution Plan has been approved by the NCLT, all the claims existing prior to the approval of the CIRP shall stand extinguished.

The Revenue's contention was that the claim had not crystalized and therefore the question of extinguishment of the claim that was yet to be articulated in an assessment order cannot be said to have been extinguished. Further, the taxpayer is allowed an alternate remedy to file an appeal against the assessment order that was passed and kept in a sealed cover.

The HC observed that the Resolution Plan submitted had not contemplated any possible demand or waiver thereof from the Revenue, though the notice under section 148 of the Act had already been issued in March 2018. Since the CIRP was initiated a few days prior to the initiation of reassessment proceedings, the taxpayer should have ensured proper notice to the Revenue is given and obtained appropriate concession in the Resolution Plan. The claims of the Revenue were not considered by the NCLT while approving the Resolution Plan and therefore, the question of abatement of rights of the Revenue to proceed with income tax proceedings cannot be countenanced.

The HC observed that the legislative intent behind CIRP is to freeze all the claims so that the resolution applicant starts on a clean slate. However, the provisions of the IBC cannot be interpreted in a manner which is inconsistent with any other law. The proceedings under the IBC cannot dilute the right of the Revenue to reopen assessments.

JMP Insights *– The IBC overrides all other laws. However, Madras HC in this case has held that the Resolution Professional needs to obtain appropriate clearance or waiver thereof from the Revenue for all pending cases, estimating the possible demand that can be raised. The resolution professional cannot curtail Revenue's right to scrutinize the income if the Resolution Plan was approved without considering all pending cases.*

- **Pure reimbursement for salary of seconded employees is not a sum chargeable to tax; certificate of 'Nil' withholding can be granted**

  - Flipkart Internet Private Limited v. Deputy Commissioner of Income Tax (Karnataka High Court) [Writ Petition No. 3619/2021(T-IT)]

The taxpayer is engaged in providing support services to the e-commerce industry. Under the Master Service Agreement ('MSA') between Walmart Inc. ('Walmart') and Flipkart Singapore (the parent company of the taxpayer), the former had seconded employees to the taxpayer, to work for the benefit of the taxpayer. The taxpayer had issued letters of employment to the seconded employees. Further, the taxpayer's name was mentioned as the 'Employer' on the employment visa of the seconded employees. The tax payable on the salary of the seconded employees and the Provident Fund contributions were paid by the taxpayer in India. For administrative convenience, Walmart paid salaries to the seconded employees and the taxpayer reimbursed the salaries to Walmart on a cost-to-cost basis, without withholding any tax.

The contention of the taxpayer was that Section 195 of the Act requires withholding of tax only when any sum chargeable to tax is paid to a non-resident. Since the payments are in the nature of pure reimbursements to Walmart, they do not constitute 'any sum chargeable to tax'. Further, Article 12 of India-USA Double Taxation Avoidance Agreement ('DTAA') states that unless any technology is 'made available' to the person acquiring the services, Fees for Included Services ('FIS') are not chargeable to tax.

The taxpayer had applied for a certificate under Section 195(2) of the Act for 'Nil' withholding tax on payments to Walmart. However, the tax officer rejected the application stating that the secondment did not create employer-employee relationship between the taxpayer and the seconded employees. It was further stated that withholding of tax on salary under Section 192 of the Act does not obviate the need to withhold tax on the payments made to Walmart.

The HC observed that for a service to constitute Fees for Included Services under the India-USA DTAA, the making available of technology to the taxpayer is an essential factor. Referring to the MSA, the HC held that since there is no element of 'make available' through the secondment, no further information needs to be examined.

Referring to the Co-ordinate Bench's decision in the case of *Abhey Business Services India Pvt Ltd [(2020) 122 taxmann.com 174 (Kar)]* the HC held that secondment agreement constitutes an independent contract of services in respect of the employment of the seconded employees with the taxpayer. The taxpayer is the real and economic employer of the seconded employees; the taxpayer indeed made a pure reimbursement to Walmart and that 'make available' condition was not satisfied.

Accordingly, the HC ruled in favour of the taxpayer and directed the tax officer to issue a 'Nil' withholding tax certificate under Section 195(2) of the Act.

JMP Insights *– The Delhi High Court in the case of Centrica India Offshore Pvt Ltd ('CIOP') [W.P. (C) No. 6807/2012] has held that secondment agreement constitutes an independent contract of services in respect of employment. The Karnataka HC has distinguished the facts of this case with that of CIOP. In the case of CIOP, the employees were seconded by the parent entity, to ensure smooth set up of operations in India and to ensure that the Indian vendors comply with quality guidelines. In Flipkart's case, there was an established set-up and the operations of Flipkart in India were not dependent on the seconded employees.*

This ruling is the second major ruling on seconded employees in recent times and further strengthens the need for appropriate documentation of the secondment arrangements in case of expatriate employees. Recently, the Supreme Court ('SC') in the case of Northern Operating Systems [Civil Appeal No. 2289-2293 of 2021] had ruled that the salary of seconded employees deputed to an Indian company that is reimbursed to the overseas entities will be subject to service tax.

Taxability of secondment of employees is a contentious issue. Varied conclusions can be reached depending on the facts of the case.

- **Commission earned on distribution of an Indian mutual fund abroad not 'reasonably attributable' to India**

  - Deputy Commissioner of Income Tax v. Credit Suisse (Singapore) Ltd. (Mumbai Tribunal) [ITA Nos. 6098/Mum./2019 and 7262/Mum./2019]

The taxpayer is a company incorporated in Singapore and is a tax resident of Singapore. It is registered as a Foreign Institutional Investor ('FII') with the Securities and Exchange Board of India ('SEBI') and conducts portfolio investments in India. The taxpayer and an Indian Asset Management Company ('AMC') had entered into an offshore agreement for distribution of mutual fund schemes launched by the Indian AMC to investors outside India. As per the agreement, the taxpayer created awareness about the mutual fund schemes among the potential investors outside India and procured subscription of the mutual fund units in accordance with the terms set out in the offer documents.

The contention of the tax officer was that the taxpayer was engaged in distribution of Indian AMC's products controlled and regulated by SEBI. Hence, the commission income earned from distribution of such mutual fund schemes created a 'business connection' in India.

The taxpayer contended that such commission is not taxable in view of Article 12 of the India-Singapore DTAA as the services provided by the taxpayer did not 'make available' any technical knowledge, skill or experience. Further, even if the commission was considered to be business income, it will not be taxable in India by virtue of Article 7 of the DTAA, as the taxpayer does not have a Permanent Establishment in India.

The Tribunal, while analysing the definition of 'business connection' as per Explanation 1 to Section 9 of the Act observed that in the case of business where all the operations are not carried out in India, only the income reasonably attributable to the operations carried out in India shall be taxable in India. In the instant case, since the taxpayer has carried out the distribution of the mutual fund schemes entirely outside India, no income can be reasonably attributable to India. Reliance is also placed on the decision of the SC in the case of *Commissioner of Income Tax vs. Toshoku Ltd.*, [1980] 125 ITR 525 (SC), wherein the SC had held that agency commission earned for services rendered outside India cannot be deemed to have accrued or arisen in India, if no operations are carried out in India for earning such Income.

JMP Insights *– Taxability of offshore services has been the subject matter of litigation in India. The SC decision in the case of Ishikawajima-Harima (288 ITR 408) has elaborate discussion on the concept of territorial nexus being fundamental in determining taxability of income in India. Similarly, this ruling has discussed the concept of 'reasonably attributable' where it is held that the income earned by a non-resident from carrying out business activity outside India, cannot be attributable to the business activities carried out in India in absence of sufficient nexus of such income with Indian operations.*

- **Payment to Cambridge University and International Baccalaureate for imparting instructions on syllabus not taxable in India as Fees for Technical Services**

  - Deputy Commissioner of Income Tax, Central Circle – 3(2), Hyderabad v. Hyderabad Educational Institutions Pvt. Ltd. (Hyderabad Tribunal) (ITA Nos. 1004/Hyd/2019 to 1007/Hyd/2019 & 437/Hyd/2019)

  The taxpayer is a company which is running a school. The taxpayer had made payment to two foreign universities/institutions i.e. Cambridge University and International Baccalaureate. The payments pertain to the examination fee collected from students, fees for syllabus, setting up of question papers, training of teachers, etc. While making this payment, no tax was deducted under Section 195 of the Act.

  The Tribunal noted that no part of receipt had been retained i.e. what was received from the students had been remitted to the Universities. No additional expenditure has been incurred. The taxpayer is imparting instructions in India as per the syllabus set by the foreign universities and the foreign universities are conducting the examinations before issuing the degrees to the students. The taxpayer is only a pass-through entity since they are only collecting the exam fee on behalf of the foreign universities.

  The definition of FTS under Article 13(5)(c) of the India-United Kingdom DTAA and Article 12(5)(a) of the India-Switzerland DTAA specifically does not include any amount paid for teaching in or by educational institutions. The Tribunal held that the expression 'teaching in or by educational institution' cannot be confined to the activity of imparting the instructions alone. It also includes the activity of conducting examinations. Considering the nature of activities carried out by the taxpayer, the amounts paid by the taxpayer to the two universities are not taxable in India.

  JMP Insights *– Services rendered by teaching or educational institutions are not taxable in India as FTS as per the relevant DTAA. The activity of teaching needs to be understood in a broader sense. A similar view was taken by the Authority for Advance Rulings, New Delhi ['AAR, New Delhi'] in case of Sri Ramachandra Educational & Health Trust [2009] 181 Taxman 74 (AAR).*

Notification

- **Exemption from withholding tax on aircraft lease rent paid to a unit located in International Financial Services Centre ('IFSC')**

  The Central Board of Direct Taxes ('CBDT'), vide Notification No. 65/2022/F. No. 275/20/2019-IT(B), dated 16 June 2022, has specified that no tax is to be withheld under Section 194-I of the Act, in case of lease or supplemental lease rent for lease of an aircraft paid by any person ('the lessee'), to an International Financial Services Centre ('IFSC') unit ('the lessor'), subject to the following conditions:

For lessor

- Furnish, a statement-cum-declaration in Form No. 1 in each FY, specifying the 10 consecutive financial years ('FYs') for which it opts to claim deduction under Section 80LA.

For lessee

- No withholding of tax is to be made on payments made to the lessor on receipt of the copy of statement furnished by the lessor in Form No. 1;
- The lessee shall furnish the particulars of the payments made to the lessor on which tax has not been deducted, in the quarterly statement of deduction of tax.

DID YOU KNOW?

- CBDT has notified 331 as the Cost Inflation Index for FY 2022-23.
- CBDT has extended the applicability of the rates as per safe harbour rules to FY 2021-22.

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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