



International Taxation

CA Avinash Gupta

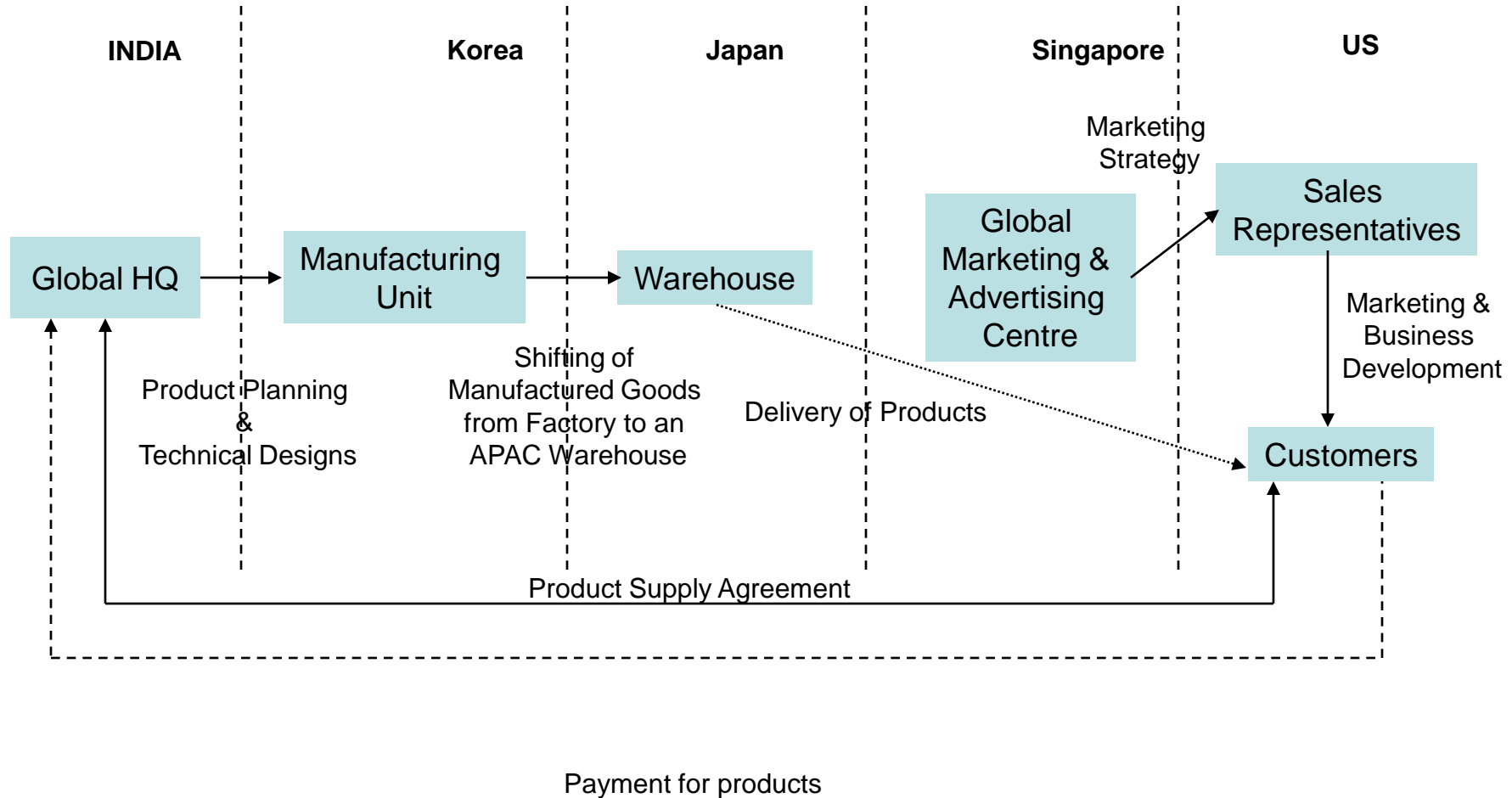


INDEX

UNDERSTANDING CONCEPT



Sharing of Tax Revenue



Provisions

- Section 9 of Income Tax Act, 1961
 - Business Connection
 - Interest
 - Royalty
 - Fee for Technical Services
- Rates of Tax under Income Tax Act, 1961
- DTAA
 - *Article 7 Business Profits read-with Article 5 of PE*
 - *Article 11 Interest*
 - *Article 12 Royalties*
 - *Article 13 Fee of Technical Services*
- Rates as per DTAA

DTAA

- Objectives of Double Taxation Avoidance Agreements:
 - to give equitable share of tax to the competing states;
 - to minimize tax evasion;
 - to promote development of international trade and commerce;
 - to cooperate in recovery of taxes; and
 - to ensure non discriminatory tax burden on a tax payer.

Business Profits

Article 7

Business Profits

- The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.
- Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Permanent Establishment

Permanent Establishment

- Concept of PE is important for different articles of a tax treaty, especially Article 7 (Business profits are taxable only if there is a PE)
- The concept of PE is used to determine the right of the Source State to tax the Business profits of the foreign enterprise
- Article on PE
 - Para 1 – PE means fixed place through which business is carried on
 - Para 2 & 3 - Specific instances of PE
 - Para 4 - Exclusionary clause
 - Para 5 & 6 - Agency PE
 - Para 7 - Subsidiary PE

Permanent Establishment

•Tests to be satisfied

- Place of business test – There must be a “place of business” such as premises or sometimes machinery or equipment
- Location test - The “place of business” must be located at a certain area
- Right of use test – The foreign enterprise must have a certain right of use to the place of business
- Permanence test – The use of place of business must last for a certain period of time
- Business activity test – The activities performed through the place of business must be a business activity for the foreign enterprise and such activities should constitute the “core activities”

A PE can be constituted under the “Basic Rule” only if all of the above conditions are satisfied

Permanent Establishment

- Article 5(1)
 - For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Permanent Establishment

- Specific Inclusions Article 5(2)
 - A place of management
 - A branch
 - An office
 - A factory
 - A workshop
 - A mine, an oil & gas well, a quarry or any other place of extraction of natural resources

Permanent Establishment

- Building and Construction PE - Article 5(3)
 - Building site or construction or installation project constitutes a PE only if it lasts more than **twelve** months
- Installation project - Includes the installation of new equipment
- Building site: not only the construction of buildings but also the construction of roads etc, renovation

Permanent Establishment

▶ Service PE

- ▶ Where services rendered in the other contracting state through employees (or other personnel) and activities of that nature in that State beyond a certain number of days
- ▶ India-UK treaty requires that services including managerial services (other than covered by the FTS clause) provided for a period longer than 90 days within any 12 month period
- ▶ India-US Treaty [90 days or 1 day]

Permanent Establishment

▶ Agency PE

- where a person — **other than an agent of an independent status** - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if :
 - (a) he has and habitually exercises in the first-mentioned State an authority to conclude on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph ;*
 - (b) he has no such authority but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in the State on behalf of the enterprise have contributed to the sale of the goods or merchandise ; or*
 - (c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.*

Attribution of Profits to Permanent Establishment

Attribution of Profits to PE

- **Rules under Model Conventions**
- OECD MC - Source or Attribution Rule
 - Only so much profits to be taxed in the Other State as are attributable to PE
- UN MC – Limited Force of Attraction Rule
 - In addition to profits attributable to PE, following should also be taxed in the Other State:
 - profits attributable to sales in that other State of the goods or merchandise of the same or similar kind
 - profits attributable to other activities carried on in that State of the same or similar kind as those effected through PE

Permanent Establishment

- Exclusions from the definition of PE (Article 5(4))
 - ▶ use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise
 - ▶ maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display
 - ▶ maintenance of a stock goods or merchandise belonging to the enterprise for the purposes of processing by another enterprise
 - ▶ maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise
 - ▶ maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity of a preparatory or auxiliary character

Interest, Royalty and Fee for Technical Services

Interest

- Section 9(1)(v) of Income Tax Act, 1961
 - Income by way of Interest payable by
 - The Government or
 - A person who is a resident, except where the interest is payable in respect of any debt incurred or money borrowed and used, for the purpose of a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India or
 - A who is a non-resident, where the interest is payable in respect of any debt incurred, or money borrowed and used, for the purpose of a business or profession carried on by such person in India

Interest

- DTAA - Article 11 Interest

Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

- 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 recipient is the beneficial owner of the interest, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.
- 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.

Interest

- DTAA - Article 11 Interest

- 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 such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply.
- 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.

Royalty under Income Tax Act

Payable by

The Government

A resident

A non-resident

Exception/Condition

except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India

where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India

FTS under Income Tax Act

Payable by

The Government

A resident

A non-resident

Exception/Condition

except where the fee is payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India

where the fee are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India

FTS under Income Tax Act

- **Consideration for the rendering of any**
 - managerial services; or
 - technical services; or
 - consultancy services
 - (including the provision of services of technical or other personnel)

- **Exclusion - consideration for**
 - any construction, assembly, mining or like project or
 - income chargeable under the head “Salaries”

Royalty & FTS under DTAA

1. Royalties or fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such royalties or fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State the tax so charged shall not exceed 10 per cent of the gross amount of the royalties or fees for technical services.
3. (a) The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

Royalty & FTS under DTAA

- 3.(b) The term “fees for technical services” as used in this Article means payments of any kind, other than those mentioned in articles 14 and 15 of this Convention as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.
4. The provisions of paragraphs 1 and 2 shall not apply if the **beneficial owner** of the royalties or fees for technical services being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through **a permanent establishment** situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties or fees for technical services 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.

Payment of FTS – Application of “Make Available” Concept

- Payment of Fees for Technicians’ Services do not constitute Fees for Technical Services (FFTS) under Article 12(4)(b) of the Indo-Singapore DTAA dated 24.01.1994, as such services do not make available technical knowledge, experience, skill, knowledge or processes, which enable the person acquiring the services to apply the knowledge contained therein, as held by the Kolkata Bench of the Income-tax Appellate Tribunal in the case of DCIT v/s. ITC Ltd. (2002) 82 ITD 239 (Kol) and many other Judicial Decisions.
- The same is also not taxable in India as Business Income under Article 7 of the Indo-Singapore DTAA as it has been represented to us that the Beneficiary does not have a Permanent Establishment in India in terms of Article 5 of the said DTAA.

Recent Judgments

Issues

- Duty to deduct tax at source u/s 195 does not arise unless the remittance contains wholly or partly taxable income.
 - *GE India Technology Centre Pvt Ltd v CIT 327 ITR 456 (SC)*
- Where Tax authorities has accepted the fact that the NR is not liable to pay any tax in India, the payer is not liable to deduct TDS u/s 195.
 - *Van Oord ACZ India (P) Ltd v COIT 36 DTR 425 (Del)*
 - *Maharishi Housing Development Finance Corporation Limited*
- Liability to deduct tax for Sale of property arises when Sale deed clearly showed that seller is NR.
 - *Mrs. Meena S. Patil v ACIT 30 ITR 317 (Bang Tri)*

Issues

- Machinery imported along with design and commissioning. Whether payment is towards royalty or purchase. Hence, TDS is deductible or not.
 - *CIT v Neyveli Lignite Corporation Ltd. 243 ITR 459 (Mad)*
- Commission Income received by a non-resident for negotiating with prospective customer for participation of show in India. Right to receive commission arises in India. Hence, taxable in India.
 - *Rajiv Malhotra 155 Taxman 101 (AAR-Delhi)*
- Commission paid to NR for promoting products outside India is not taxable if there is no PE of NR in India.
 - *ACIT v Modern Insulators Ltd. 56 DTR 362 (JP Tri)*

Issues

- Discounting charges paid to NR who does not have any PE in India cannot be treated as interest. Hence, no need to deduct TDS u/s 195.
 - *CIT v Cargile Global Trading (I) Pvt Ltd. 56 DTR 188 (Del)*
- Fee collected by resident on behalf of NR for imparting distance education is not taxable in India if no PE in India.
 - *FICCI 320 ITR 124 (AAR)*
 - *CIT v Illinois Institute of Technology (India) P Ltd 321 ITR 79*
- Sponsorship to popular sports events is sales promotion expenditure. It cannot be treated as royalty. Hence, no TDS.
 - *DIT v Sahara India Financial Corporation Ltd 321 ITR 459 (Del)*

Issues

- Software maintenance services provided by NR from outside India and does not have PE in India. It is not taxable in India.
 - *Airport Authority of India 299 ITR 102 (AAR)*
- Payment for cost sharing of R&D Expenses is not treated as FTS or royalty. Hence, no TDS is to be deducted.
 - *ABB Limited (2010) TIOL 94 ARA-IT dt. 15.03.2010*
- Routine Data Processing services and document handling services provided by a NR who is not having any PE in India is not taxable.
 - *RR Donnelley India Outsourcing Pvt Ltd 56 DTR 1(AAR)*

Issues

- Telecommunication facility provided by a NR outside India is not regarded as FTS. Hence, no TDS.
 - *Wipro Ltd. v ITO 133 Taxman 149 (Bang Tri)*
 - *Software Technology Parks of India v ITO 3 SOT 529 (Bang Tri)*
- Other charges reimbursed along-with royalty payment by a resident hotel company to US NR is not chargeable under Royalty under India-US DTAA. It is taxable in India only if NR have PE in India.
 - *Six Continents Hotels Inc. v DCIT 11 taxmann.com 332 (Mum Tri)*
- Payment for Database maintained outside India by NR is not taxable in India if NR does not have PE in India.
 - *Gartner Ireland Ltd. v DCIT 42 SOT 21*

Issues

- Referral fee paid to NR is not taxable in India.
 - Cushman and Wakefield Pte Ltd. 305 ITR 208 (AAR)
- Reimbursement salaries & living allowances to deputees
 - Held salaries of technicians:
 - HCL Infosystems (274 ITR 261 – Delhi)
 - CIT Vs. BHEL (252 ITR 218 – Delhi)
 - Held as FTS & salaries:
 - AT & S India (P) Ltd. (287 ITR 421 (AAR))
 - Verizon Data Services P.Ltd.(AAR) (May 2011)

Export Commission

For:

- Circular No. 23 dt. 23.7.1969
- Circular No. 786 dt. 07.02.2000.

This view is also supported by

- Supreme Court in CIT v/s. Toshuku Ltd. (1980) 125 ITR 525 (SC).
- Delhi High Court in CIT v/s Eon Technology P. Ltd.(Nov. 2011)
- AAR in Spahi projects P.Ltd. 315 ITR 374 (AAR)

However there is a contrary ruling in case of Wallace Pharmaceuticals P. Ltd. 278 ITR 197 (AAR)

Reimbursement of Expenses

For:

- Lucent Technologies (82 TTJ 163)
- TCS (271 ITR 401)
- Nokia, Erricson and Motorola (95 ITD 269)
- Sonata Information Technologies (103 ITD 324 (Bang))
- Hewlett Packard (India)(P) Ltd[(2006)5 SOT 660(Bang)]
- Metapath Software Inernational Ltd [(2006)9 SOT 305]

Against:

- Samsung Electronics Co.Ltd. (Karnatka High Court)(Oct. 2011)
- Airports Authority of India Vs. DIT[304 ITR 216(AAR)]

Reimbursement of Expenses

For:

- CIT Vs. TELCO (245 ITR 823 (Bombay))
- DECTA v CIT (237 ITR 190 (AAR))
- CIT Vs. Industrial Projects (202 ITR 1014-Delhi)
- Sedco Forex International inc. vs. CIT (299 ITR 238 (Uttarakhand))
- Clifford Chance 82 ITD 106-Mumbai)
- Mahindra & Mahindra Ltd. (10 SOT 896 (Mum))
- Dolphin Drilling Ltd. vs. ACIT 121 TTJ 433 (Del))

Against:

- Cochin Refineries (222 ITR 354 (Ker))
- Hindalco (278 ITR 125 (AT))
- CIT Vs. Dunlop (142 ITR 493 (Cal))
- Ashok Leyland Ltd. vs. DCIT (119 TTJ 716 (Cal))
- Danfoss Ind. (268 ITR 1 (AAR))

A photograph of three business professionals sitting around a glass conference table. The table is highly reflective, showing a clear mirror image of the people and the papers on it. The person in the center is wearing a light blue shirt and a red patterned tie, and is holding a pen. The person on the left is wearing a dark blazer. The person on the right is wearing a light blue shirt and a dark tie. The background is a bright, slightly blurred office setting.

Questions ???

Let's Discuss



Acclaim Management Solutions
Private Limited
D – 10,
Kailash Colony
New Delhi: 110 048

Ph: +91 11 2410 8838
Fax: +91 11 40556069
W: www.acclaimindia.com

Avinash Gupta:
+91 98107 51999
avinash.gupta@acclaimindia.com
caavinashgupta@gmail.com