Deloitte.

India | Tax & Regulatory | For private circulation only | 28 June 2018

Global Business Tax Alert

Delivering Clarity

The AAR* held that doctrine of mutuality would not be breached if Applicant received certain money from incidental activity (including from non-members) and it is utilized for fulfillment of objectives

* 94 taxmann.com 27

Issue no: GBT/17/2018

In this issue:

Facts

- International Zinc Association [Applicant], a tax resident of Belgium, is registered as an 'International Non-Profit Association' in Brussels.
- The main objective of the Applicant is to help sustain long-term global demand for zinc by creating awareness about the key end uses of zinc, conducting programmes on its sustainability and environment etc., including regulatory affairs and research; human health and crop nutrition, R&D, and dissemination of information.
- The Applicant has set up a Liaison Office [LO] in India with the approval of the Reserve Bank of India [RBI]. The LO plays an important role in educating on the importance of zinc.
- The activities undertaken by the Applicant include training and networking opportunities, technical and marketing materials, organizing conferences and workshops, commercial listing, representation, technical and marketing services expertise, etc.
- The Applicant organized a conference in Delhi viz. International Zinc Galvanizing Conference [IGC], for which it had collected participation fees from members as well as non-members participants.
- The Articles of Association of the Applicant provides that in the event of dissolution, the surplus (if any) shall be allocated to another non-profit organisation having similar purpose and will not be available for distribution among the members of the Applicant.
- The Applicant approached the Authority for Advance Rulings [AAR], for determining taxability of the aforesaid activities.

Issues before the AAR

- Whether the LO would be liable to income-tax in India under the provisions of the Income-tax Act, 1961 [the Act] or the provisions of India-Belgium tax treaty [tax treaty].
- Whether the membership fee and contribution received from Indian members would be liable to tax in India under the provisions of the Act or the tax treaty.

Ruling of the AAR

'Specific services' as per section 28(iii) of the Act

- The Revenue has contended that the fees charged for services rendered by the Applicant fall into the category of 'specific services' and therefore fall under section 28(iii) of the Act. Thus income from the same should be charged to tax as business income. The AAR has disagreed with the contention of the Revenue on the following grounds:
    - The Applicant is a not-for-profit organization and works for the benefit of its members on the principle of mutuality, that is on the dictum that one cannot earn from oneself.
    - The services may be customized and focused but are not 'special services', in the sense that their utility is not restricted to a few beneficiaries, but across the board to all members and those in this industry.
    - The services are rendered in the ordinary course of its activities and are as per its stated objects, for which the Applicant has permission of the RBI.
    - There are no services focused at any specific member or the benefit of which is denied to others.
    - The conferences are also organised in the normal course for carrying out activities in accordance with its objects as outlined in the Articles of Association.
    - The services are performed in fulfilment of its objects for members in the normal course and there is nothing special about these services nor are they for any specific set of members, as contemplated under section 28(iii) of the Act.

- The AAR has also held that the surplus occurs incidentally and does not acquire the nature of profits as contemplated under the Act, since the receipts are from the execution of objects that are not in the nature of business, nor intended to be so.

- The AAR has observed that the real test in not-for-profit organizations is that the surplus is not siphoned off into private hands, especially the settlors/founders of the not-for-profit organization. The AAR has observed that in the present case, the surplus is ploughed back and applied for its objects.

- The AAR has accordingly held that so long as the objects are charitable and income arose from the fulfilment of its objects, the receipts so derived could not be brought to tax. Therefore, in the absence of profit motive, the provisions of section 28(iii) are not attracted.

Principal of mutuality

- The Revenue has contended that with receipt of outside subscription, i.e. from non-members, the mutuality principle has been breached.

- The AAR has agreed to the submission of the Applicant that the facts are squarely covered by the decision of the Supreme Court in the case of Standing Conference of Public Enterprises. In the said case, the Supreme Court had observed that where the main motive is to earn profit and the entity claiming to be mutual concern or

club is generating income from members and non-members through the business carried on by it, then only it would be treated as tainted with commerciality. It also held that simply because some incidental activity is revenue generating, the same does not provide any justification to hold that it is tainted with "commerciality" and reaches a point where relationship of mutuality ends and that of trading begins.

- The AAR has taken note of the submission of the Applicant that none of the clauses of the Articles of Association indicate that the Applicant intended to do any business or render services to non-members and RBI has never found any irregularity in its conduct.

- The Revenue has contended that whether the Applicant has an intention to earn profit or not is not relevant when the term business is to be interpreted. In this regard, the AAR has held that where the principle of mutuality operates and profits can only be utilized for the benefit of members as per the object of the organization, the same cannot be brought to tax as the activities *per se* are not created for doing business or earning profits.

- The AAR further held that the event was only a minor event in terms of expenditure and an isolated incidence, cannot be said to be a deviation from the dominant object of the Applicant.

- The Revenue has also contended that in the event of dissolution, the allocation of surplus to other non-profit organizations will violate the principle of mutuality. The AAR, based on the aforesaid ruling of the Supreme Court and rulings of the High Courts relied on by the Applicant, has held that the test of mutuality does not require that the contributors to the common fund should distribute the surplus among themselves; but it is enough if they have a right of disposal over such surplus.

- The AAR has accordingly held that the Applicant works on the principle of mutuality and is not an enterprise set up for the purpose of doing business or earning profit.

Permanent establishment [PE]

- On Revenue’s contention that the LO constitutes a PE in India, the AAR held that once it is decided that the Applicant works on principle of mutuality and is not engaged in any business, the question of PE does not arise.

Conclusion

The AAR has answered both questions in favour of the Applicant and has held that in the case of not-for-profit organizations, the dominant object should be considered to analyze the principal of mutuality and the same should not be impacted on the basis of certain incidental revenue generating activity.

Deloitte tax@hand App

Current. Comprehensive. Convenient.
Download tax@hand app, a secure digital platform for timely global and regional news, perspectives, and resources. Do visit the tax@hand webpage here.

Deloitte.

IOS

Download from App Store

Android

Download from Google Play

Website

Add to favorites

Do you know about Dbriefs?

Dbriefs are live webcasts that give valuable insights on important developments affecting your business. To register, visit the Dbriefs page.

Download the report

Deloitte makes an impact that matters