



Global Business Tax Alert Sharp Insights

SC rules that success fees received is taxable as FTS as per source rule under the Act

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Synopsis

The Supreme Court has held that success fees charged by a non-resident entity for fund raising activities of Indian company is taxable as fees for technical services ('FTS') under clause (b) of Section 9(1)(vii) of the Act. Such services would come within the ambit of the term "consultancy" since the non-resident entity had the skill, acumen and knowledge in that particular field.

Facts

- GVK Industries Limited ('taxpayer') is an Indian company and was incorporated with the objective of setting up a 235 MW gas based power project at Jegurupadu (Rajahmundra, Andhra Pradesh), to generate and sell electricity.
- The taxpayer entered into an agreement with ABB – Projects & Trade Finance International Ltd., Zurich, Switzerland, non-resident entity ('NRC') for raising funds from India and abroad. The services rendered by non-resident entity under the agreement included:
 - financial structure and security package to be offered to the lender,
 - assessment of export credit agencies,
 - obtaining commercial bank support,
 - assistance in loan negotiations and documentation with the lenders, and
 - closing the financing for the project in a coordinated and expeditious manner.
- The NRC rendered all the services from outside India
- The NRC charged success fees of 0.75% of the total debt financing (USD 17.15 million) as payment for the services.
- The tax payer approached the Assessing Officer for issuing a No Objection Certificate ('NOC') to remit the amount of payment without deduction of tax at source.
- The Assessing Officer refused to issue "No Objection Certificate". The said decision was upheld by the Commissioner of Income-tax, Hyderabad.

- The taxpayer then approached the Andhra Pradesh High Court. The High Court held that there is no business connection of the NRC in India. However, success fees paid would come within the scope of technical services (i.e. within the ambit of Section 9(1)(vii)(b) of the Act)

Issue before the Supreme Court

Whether success fees paid to the NRC is subject to tax in India and therefore the tax authorities were justified in not granting the “No Objection Certificate”

Ruling of the Supreme Court

Business connection

- The conclusion of the High Court that the transaction / activity did not have any business connection is defensible.

Source Rule

- The provisions of clause (b) of Section 9(1)(vii) of the Act is known as “source rule: i.e., income of the recipient to be chargeable in the country where the source of payment is located; to clarify where the payer is located. This clause further mandates and requires that the services should be utilized in India.
- It is well settled that the source based taxation is accepted and applied in the international tax laws.
- The source rule is in consonance with the nexus theory and does not fall of the said doctrine on the ground of extraterritorial operations

Fees for technical services

- The obligation of the NRC was to-
 - Develop comprehensive financial model to tie-up the evaluate the foreign currency loan requirements of the projects;

- Assist expat credit agencies worldwide and obtain commercial bank support on most competitive terms;
- Assist the tax payer in loan negotiation and documentation with the lender
- Pursuant to the aforementioned exercise carried out by NRC, the taxpayer was successful in availing the loan/financial assistance in India from Industrial Development Bank of India and foreign currency loan from International Finance Corporation, Washington DC, USA
- NRC acted as a consultant. It had the skill, acumen and knowledge in specialised field i.e preparation of a scheme for required finances and to tie-up required loans
- The nature of services by NRC comes within the ambit of “consultancy services” and therefore it has been rightly held that the tax at source should have been deducted as the fees paid could be taxable under the head “fees for technical services”
- Once tax is payable paid, the grant of “No Objection Certificate” was not legally permissible.

Comments

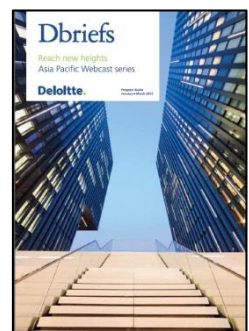
The Supreme Court has upheld the applicability of source rule and held that the success fee paid by Indian entity is taxable in India. The ruling upholds the validity of Section 9(1)(vii) of the Act in the given facts. Reference in the order is also made to the order of the Constitutional Bench of the Hon’ble Supreme Court in the case of the taxpayer (331 ITR 130) dealing with the powers of Parliament to legislate extra territorial aspects.

Source: Supreme Court decision in the case of GVK Industries vs. ITO (Civil appeal No. 7796 of 1997)

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