

Global Tax Update

India

Deloitte Tohmatsu Tax Co.

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1. Payment to non-residents towards imported software cannot be characterised as 'royalty' as it amounts to simplicitor purchase of goods, not taxable in India, hence no taxes are required to be withheld

The Supreme Court of India (SC) in its landmark judgment has held that the amount paid by resident Indian end users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of computer software, cannot be characterised as 'royalty' (i.e. use of copyright in the computer software) under Article 12 of the Tax Treaties (DTAA) as the same amounts to simplicitor purchase of goods and therefore, does not give rise to a liability to deduct any taxes at source¹.

2. Existence of permanent establishment (PE) based on activities of subsidiary, taxability of offshore supplies

The Authority for Advance Rulings (AAR) rendered its decision that based on the facts of the case, the business transaction and related activities with subsidiary did not result in constitution of a PE of the taxpayer in India under the India-Japan tax treaty. Further, the offshore supplies were not taxable in India as their title passed outside India. Important observations of the AAR in relation to the existence of PE from this judgment are summarised as under:

- The AAR noted that the general definition of the term "PE" in Article 5(1) of the India-Japan tax treaty postulates two conditions to be fulfilled, namely:
 - i. existence of a fixed place of business; and
 - ii. business of an enterprise is wholly or partly carried out in India through such a fixed place.
- The AAR observed that the appointment and transfer of the expatriate employees in Indian subsidiary was regulated by the non-resident taxpayer or its regional headquarters. Therefore, it concluded that non-resident taxpayer may have a fixed place in India.
- The AAR concluded that the non-resident taxpayer did not satisfy the second condition of (i.e. business of the enterprise is carried out in India through a fixed place of business) on account of the following:
 - A mere reporting to the regional headquarters or the head office did not establish that the expatriate employees were doing functions on behalf of the taxpayer.
 - Market surveys were conducted by the Indian subsidiary in order to launch models in the Indian market and such market surveys were not conducted on behalf of the taxpayer.
 - With respect to negotiating and concluding the price, the non-resident taxpayer had submitted evidences that cost comparison amongst foreign supplier entities was done by the Indian subsidiary and parts were imported from the entity offering the least cost on competitive basis. Further, the Indian subsidiary could not become an extension of the taxpayer merely on the ground that employees placed the order and negotiated the price.
 - All imports were made by the Indian subsidiary and therefore, warranty claims were in favour of the Indian subsidiary. The warranty claims in respect of defective parts were settled by the Indian subsidiary and then, reimbursed by the non-resident taxpayer. The fact that certain claims made by

¹ under section 195 of the Income-tax Act, 1961 (Act)

the Indian subsidiary were not reimbursed by the taxpayer could not lead to a conclusion that the Indian subsidiary carried on business on behalf of the taxpayer. Similarly, for post-sale functions, since the products were first imported by the Indian subsidiary and then sold to the customers, it could not be said that such functions were done on behalf of the taxpayer.

3. Capital gains on sale of Indian company shares not taxable in India on satisfaction of conditions specified under the India-Singapore tax treaty

Based on the facts of the case, the AAR held that investment holding is a bona fide business activity and capital gains on sale of Indian company shares prior to 1 April 2017, is not taxable in India as all other eligibility conditions prescribed under the India-Singapore tax treaty and its protocol² were satisfied.

² as per Article 13(4)

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