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Global Tax Update

India

Deloitte Tohmatsu Tax Co.

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India Tax Update: Recent Court Rulings

1. No PE[1] in the absence of control over premises

The Tribunal[2], based on facts, has held that mere access does not result in the taxpayer having right to use and having control over the premises resulting in non-satisfaction of "Right to Disposal Test" and therefore, no PE is created.

The taxpayer/ foreign enterprise participated in a global tender for providing engineering and project management consultancy services for an airport line of metro in a city in India. The taxpayer succeeded in the tender and accordingly, work was entrusted to the taxpayer by executing a contract. During audit proceedings, the Assessing Officer (AO) noticed that in total 24 employees had visited India during the relevant year. Out of which, 21 employees stayed in India for more than 183 days. Thus, the AO formed a view that the taxpayer had a Permanent Establishment (PE)/business connection in India.

Please note that existence of a PE in a country is a fact-based exercise. This ruling while holding that the taxpayer did not have a PE in India has upheld the following principles:

- The principal test to ascertain whether an establishment has a fixed place of business or not, is to see whether the premise is at the disposal of the taxpayer/ foreign enterprise i.e., the enterprise has right to use the place and has control thereupon.
- Merely giving access to a place to the foreign enterprise for the purpose of project would not amount to putting the premise at the disposal of the enterprise.
- The burden is entirely on the Revenue to establish that the enterprise has effective control over the premises.

Many Japanese Companies are looking at sending employees to execute projects in India. This ruling has a significant impact on such activities considering that tax issues around PE matters are contentious and subject matter of litigation. Japanese companies may want to evaluate the impact of this ruling to the specific facts of their cases.

For more details, please refer this link

Tax alert： No PE in absence of control over premises, income taxable as FTS (Deloitte India website)

2. Artificial splitting of contracts/ taxability of Offshore supplies

The Tribunal, based on facts, has held that there was no artificial split of bid into three separate contracts (offshore supply, onshore supply and onshore services) to avoid taxes in India and thus, the income from offshore supplies by the non-resident taxpayer, was not taxable in India.

Taxability of offshore supplies, especially in case of engineering, procurement and construction (EPC) contracts has been a subject matter of litigation in India. The taxpayer is engaged in the business of designing, engineering, manufacturing and supply of electric equipment that help in the transmission and distribution of power, commissioning and servicing of transmission and distribution systems on turnkey basis.

1 Permanent Establishment as per tax treaty between India and other countries
2 Delhi Bench of the Income-tax Appellate Tribunal

The taxpayer was awarded a contract by an Indian company (A Co) for setting up a terminal in India. There were three contracts of the following nature:

- First contract, also called 'offshore contract' was for supply of plant and equipment including spares outside India, type test and training to be conducted outside India.
- Second and third contract were 'onshore supply contract' and 'onshore service contract' which were assigned to an Indian associate enterprise (I Co).

This ruling based on the facts of the case, has held the following:

- There was no artificial split of bid into three separate contracts to avoid taxes in India.
- I Co had joined the taxpayer in terms of the requirement of the bid. There was a collaborative effort of the taxpayer and I Co and as such there was not actually a consortium to which one contract was awarded with bifurcation at level of the members of consortium.
- The arrangements, where the ultimate responsibility of execution and liability in case of breach remained with the non-resident taxpayer, are made for business prudence and to safeguard the rights of Indian entity which negotiates and gets executed such infrastructural facility contracts.

Further, it has upheld the principle that:

- Adjudication of an issue should be based on wholesome reading of the contract and context of terms.
- The onus is on the department to prove the existence of PE.

Many Japanese Companies are looking at participating in the infrastructure related projects in India. This ruling has a significant impact on such projects considering that tax issues around EPC contracts are subject matter of litigation.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases. For more details, please refer to this link

Tax alert：Offshore supply of plant and equipment not taxable (Deloitte India website)

3. Preparatory work for obtaining tender not counted for installation PE duration

Delhi High Court has held that preparatory work such as travelling for obtaining tender/contract cannot be deemed to be the starting point of the contract for the purposes of determining existence of permanent establishment.

The taxpayer is engaged in the business of dredging and pipeline related services for oil and gas installations. The taxpayer was awarded contract by another foreign entity (A Co.) for placement of rock in seabed for laying of gas pipelines and providing umbilical of sub-structures in oil and gas field off the eastern coast of India.

Under the tax treaties, a building site, construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continues for a certain period[3] may be considered as a construction/ installation PE of the foreign enterprise in India.

During the course of audit proceedings, the Assessing Officer (AO), observed that one of the taxpayer's employees had come to India prior to the contract date, to collect data and information. The AO included the preparatory period in the computation to determine the construction/ installation PE and concluded that the taxpayer had rendered service for a period in excess of the prescribed period under the relevant tax treaty.

Auxiliary and preparatory activity, purely for tendering purpose before entering of the contract and without carrying out any activity of economic substance or active work qua that project could not be construed as carrying out any activity of installation or construction. Also, it is settled law that preparatory work such as travelling for obtaining tender/contract could not be deemed to be the starting point of the contract or PE in India.

For more details, please refer to this link

Tax alert：Preparatory work for obtaining tender not counted for installation PE duration (Deloitte India website)

3 Generally, about 6 to 12 months

4. Excess share premium not taxable on shares issued to 100% holding company

The Tribunal, based on facts, has held that any excess monies received over fair market value for allotment of shares at premium to a 100% holding company is not taxable.

As per provisions[4] of the IT Act[5], a specific anti-avoidance provision, any excess monies received by an Indian Company over the fair market value of shares[6] is taxable in the hands of the Indian Company as "Income from other sources". There is no specific carve-out for any shareholder except for certain notified angel investors. The objective behind the provisions is to prevent unlawful gains made by issuing company in the form of capital receipts and preventing black-money transactions.

The Tribunal held that the object of deeming an unjustified premium charged on issue of share as taxable income is wholly inapplicable for transactions between holding and its subsidiary company where no income can be said to accrue to the ultimate beneficiary, i.e., holding company. The Tribunal also held that the transaction of allotment of shares at a premium between a holding company and its subsidiary company when seen holistically, there is no benefit derived by the taxpayer by issue of shares at certain premium notwithstanding that the share premium exceeds the fair market value.

Recently, in the Budget 2023, the above provisions have also been made applicable to monies received by an Indian Company from non-resident shareholders as well. Also, please note that this is only a Tribunal ruling and the issue has not reached certainty. Japanese Companies, investors, etc. may want to evaluate the impact of this ruling to the specific facts of their cases.

For more details, please refer this link

Tax alert：Excess share premium not taxable on shares issued to 100% holding company (Deloitte India website)

4 As per section 56(2)(viib) of the IT Act
5 Income-tax Act, 1961
6 As per choice of the taxpayer, net asset value as per tax records and discounted cashflow method

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For Enquiries

Deloitte Tohmatsu Tax Co. International Tax and M&A Team

Partner	Masumi Hirayama	masumi.hirayama@tohmatsu.co.jp
Managing Director	Pawankumar Kulkarni	pawankumar4.kulkarni@tohmatsu.co.jp

Deloitte India

Senior Manager	Yasuhiko Yamazaki	yyamazaki.ext@deloitte.com
Manager	Yuki Shoji	yshoji@deloitte.com

Publisher

Deloitte Tohmatsu Tax Co.
Tokyo Office

Location -〒100-8362 Marunouchi Nijubashi Building, 3-2-3 Marunouchi, Chiyoda-ku, Tokyo
Tel 03-6213-3800
email tax.cs@tohmatsu.co.jp
Company Profile www.deloitte.com/jp/tax
Tax Services www.deloitte.com/jp/tax-services

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