

Global Tax Update

India

Deloitte Tohmatsu Tax Co.

May 2024

India Tax Update: India tax rulings and updates

1. Liaison office role not limited to preparatory or auxiliary work, constitutes PE in India

The taxpayer, a non-resident corporate entity incorporated in and a tax resident of Germany, is engaged in the business of publishing scientific, technical, medical books and journals. The business activities carried out by the taxpayer in India were as follows:

- Journal subscription;
- Direct import of books in India;
- Sale of books printed at export processing zone (EPZ) in India.

The Delhi Income-tax Appellate Tribunal (ITAT), based on the facts of the case, has held that the activities of the liaison office (LO) carried out in India constitutes permanent establishment (PE) of the taxpayer in India in terms of the India-Germany tax treaty.

The Tribunal noted that LO not only procures orders, but also works out the cost components and margin of the books to be reprinted in Export Processing Zone (EPZ) and sends for acceptance of the Head Office (HO). The LO has a major say with regard to not only the titles to be reprinted in India, but their pricing also. Although the taxpayer argued that LO cannot be taxed in India as it had not carried out any commercial activities, the Tribunal held that the activities undertaken by the LO were not merely preparatory or auxiliary character of a communication channel between the clients in India and HO.

This ruling reaffirms the principle that for the purpose of assessing whether activities undertaken by representatives / office of a non-resident in India are merely “preparatory or auxiliary” in nature, the deciding factor would be the criticality of such activities vis-à-vis the overall business of the non-resident. In addition to the technical aspects discussed in this ruling, one should also note the nature of detailed scrutiny undertaken by the tax authorities. Aspects such as email communication and statements of employees recorded during survey proceedings are generally key sources of information in such cases. Thus, in addition to intra-group contractual arrangements, one needs to review all the surrounding facts including internal and external email communication and how the representatives on the ground understand the business operations of the offshore group entities, to ensure that consistent positions are taken.

In the past, where a LO has exceeded its scope of permitted activities, courts have held that such an LO can constitute the PE of the foreign entity in India. Therefore, it is important to ensure at all times that an LO in India operates within limits set-out by RBI.

Additionally, in relation to tax treaties to which the provisions of Multilateral Instrument (MLI) regarding specific activity-based exemption apply, it will become important to demonstrate that the stated activity in the exclusion clause (advertising, storage, delivery, etc.) is indeed 'preparatory or auxiliary' in nature. As we move towards complex and innovative business models which rely on limited physical presence in the country where the customers reside, foreign players must assess, based on their facts, about whether their Indian presence can still be said to be merely aiding the core business, in order to avail exemption under the respective tax treaty.

For more details, please refer this link.

[Tax alert: Liaison office role not limited to preparatory or auxiliary work, constitutes PE in India](#) (Deloitte India website)

2. Scheme to promote manufacturing of electric passenger cars in India

The Ministry of Heavy Industries (MHI), vide notification dated 15 March 2024, has introduced a 'scheme to promote India as a manufacturing destination for Electric Vehicles (EVs) and attract investments from global EV manufacturers (Scheme)'. The Scheme is also intended to facilitate employment generation and achieve the goal of 'Make in India'

Key provisions:

- Eligibility conditions in terms of global turnover and global investment to be met.
- Minimum investment – INR 41,500 million (US\$ 500 Million)
- Investment commitment to be backed by bank guarantee.
- Timeline of 3 years for setting up manufacturing facility
- Minimum domestic value addition – 25% by third year, 50% by fifth year
- Bank guarantee to be invoked in case of non-achievement of domestic value addition and minimum investment criteria
- Vehicles of CIF value of US\$ 35,000 or above eligible for reduced Custom duty of 15% for a period of 5 years.
- Maximum 8,000 EVs can be imported each year for a period of 5 years, subject to amount of duty foregone or investment made.

The Scheme is a step forward in boosting the 'Make in India' initiative, strengthening the overall EV ecosystem by attracting investments from leading EV players and placing India on the global map for manufacturing of EVs.

For more details, please refer this link.

[Tax alert: Scheme to promote manufacturing of electric passenger cars in India](#) (Deloitte India website)

3. Input Service Distributor ('ISD') mechanism mandatory for distribution of input tax credit (ITC)

Concept of ISD and cross charge

- Under Goods and Services Tax laws (GST), the service rendered by one location of a company to another, is covered within the scope of 'supply' and accordingly, liable to GST. In terms of the said provision, the services procured by Head Office (HO) of a company on behalf of different branch offices located in different states, can be cross-charged by way of issuance of invoice by HO to branch offices.
- The GST provisions prescribe a specific mechanism (ISD) wherein the ITC on account of common input services is distributed among different locations. While the aforesaid concepts of cross-charge and ISD are different, both have been used interchangeably for apportionment of ITC of common input services across different offices.
- Given the ambiguity, the Government issued a Circular. (199/11/2023-GST dated 17 July 2023) to clarify the ambiguity around the taxability of services between distinct persons. The said Circular, clarified that ISD is not mandatory for common third-party services procured by HO. It also provided the mechanism of cross-charge for internally generated services including valuation.
- However, an amendment was proposed in the Interim Budget announced for FY 2024-25 making the ISD mechanism mandatory for businesses having multiple offices (under the same PAN). Further, ISD has been defined explicitly to include distribution of input tax credit under reverse charge mechanism.

Deloitte's Comments

Given the proposed amendment, it becomes pertinent for Japanese companies having presence in multiple States to consider the below mentioned points and analyse the implications:

- **Registration:** The companies should analyse its business structure and identify locations at which they are receiving common input services. Taxpayers are required to obtain registration as ISD for distribution of ITC to its other locations.
- **Identification of services:** To ensure compliance with ISD provisions, there is a need to analyse and identify the common services (which are consumed at multiple locations) being availed from third-party vendors. Further, for internally generated services (admin, IT etc.), the companies would be required to continue raising invoices under cross charge mechanism.
- **Identification of RCM services:** It has been proposed that ITC on third-party common input services taxable under reverse charge shall also be distributed from ISD registration. Hence, it becomes relevant to identify such third-party services taxable under reverse charge and distribute the credit to relevant locations.

- **Distribution mechanism:** GST provisions provide for mechanism for distribution of credit in the prescribed ratio. Companies need to ensure proper compliance with the provisions to avoid any litigation from GST authorities.
- **Compliances:** For distribution of ITC, the companies need to follow specified compliances (such as filing of monthly GST returns) and documentation requirements (such issuance of ISD invoice) as part of proper compliance. This may lead to additional compliances for the companies on which ISD would be applicable.

4. Dispute on taxability of corporate guarantee between related persons

Background

Corporate guarantees are agreements/arrangements where one company pledges to meet financial obligations of another company (beneficiary) in case the beneficiary fails to fulfill its obligations.

In terms of GST provisions, supply of goods/services between related/distinct persons qualify as supply even if made without consideration. As regards valuation, as per the GST Rules, the transaction value for supply between related persons is deemed to be as Open Market Value (OMV). However, in case recipient of services is eligible to avail full ITC, invoice value shall be deemed as OMV.

In view of the above, a guarantee provided amongst associate enterprises in respect of borrowings obtained by another is viewed as *supply* under GST even if there is no consideration. However, there was an on-going dispute between taxpayers and authorities on the taxability of corporate guarantee between related persons (whether the said activity qualifies as supply or not) and its valuation.

Amendment in GST provisions

Vide a Notification (dated October 26, 2023), the Government introduced a specific rule laying down that in case of corporate guarantee transactions between related persons, value of service shall be higher of:

- **1 percent of the amount for which guarantee is offered or**
- **The actual consideration**

A circular was also issued which clarified that such corporate guarantee shall be treated as supply of services and thus, attract GST.

Recent High Court (HC) Rulings on the issue

1. Recently, Punjab and Haryana HC in the case of **Acme Cleantech Solutions Private Limited** dealt with the similar issue of corporate guarantee between related persons. Highlights of the Ruling are as follows:
 - The petitioner company challenged that the Circular incorrectly clarified that it will be supply and such clarification leads to taking away the adjudicatory powers of the Authorities.
 - The High Court took a note of the above argument and granted a stay on the operation of the Circular to the extent it clarified that service by way of providing Corporate Guarantee is supply under GST.

Accordingly, the HC directed the **authorities to decide case without being influenced by the Circular issued.**

2. A ruling was issued by Delhi HC in the case of **Sterlite Power Transmission Limited** wherein the petitioner challenged validity of GST levy on Corporate Guarantee provided by holding company on behalf of its Subsidiary before the Delhi HC. The Petitioner challenged the levy on below mentioned grounds:
 - The activity of a holding company providing a guarantee to a banking company / financial institution on behalf of a subsidiary is towards protecting the company's own investment. As such, it is not a "supply" or "supply of services" qualifying for taxation under the CGST Act
 - Valuation of supply at 1% of the guaranteed amount is confiscatory measure for the Company giving guarantee.

The Delhi High Court considering the above arguments issued notice to the Revenue and **ordered that no coercive steps shall be taken** against the Petitioner. The matter is now placed for further hearing on July 8, 2024.

Deloitte's Comments:

Given the specific amendment in GST laws regarding valuation, it becomes relevant for the Japanese Companies to re-look at the arrangements and analyse the applicability of the same to ensure compliance and avoid litigation from GST authorities.

Further, in view of the multiple rulings from various HCs, it becomes pertinent to track the developments/ updates on the issue. Given the possibility that valuation in the said issue may play a significant role, the Companies need to take a considered call for quantification of GST liability and also to analyse the applicability of the said provision on corporate guarantees taken in the previous periods.

5. Dematerialisation of Securities by Private Companies, etc.

Ministry of Corporate Affairs, on 27 October 2023, has notified rules for dematerialisation of securities by private companies and issue of dematerialised shares against share warrants by all public companies. Private companies are required to (which is not a small company) dematerialise their existing securities within a period of 18 months from closure of FY ending on or after 31 March 2023 and issue new securities only in dematerialised form.

As per the new rules, a private company which is required to dematerialise its securities as above, shall ensure that before making the following offers, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised:

- Fresh issue / offer of any securities
- Buyback of securities
- Bonus shares
- Rights offer

On or after 18 months from the date of applicability of dematerialisation provisions to a private company, the holders of securities of private company shall ensure the following:

- Transfer of shares in dematerialised form only
- Prior to subscribing to the shares of such private company, all their securities are held in dematerialised form before such subscription.

Above provisions on mandatory dematerialisation of securities by private companies are not applicable to small companies and Government company. Small company means a company, other than a public company, whose paid-up share capital is less than or equal to (\leq) ₹ 40 million and turnover as per the last financial year is less than or equal to (\leq) ₹ 400 million. Following are not considered as small company viz.

- Holding company or a subsidiary company
- Section 8 company
- Company/ body corporate governed by any special Act

For more details, please refer this link

[Tax alert: Dematerialization of shares](#) (Deloitte India website)

Archives

For past newsletters, please visit the website below:

www.deloitte.com/jp/tax/nl/ao

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

Director	Yukari Inoue	yinoue@deloitte.com
Senior Manager	Deepali Grover	deepgrover@deloitte.com
Senior Manager	Yasuhiko Yamazaki	yyamazaki.ext@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

Deloitte Tohmatsu Group (Deloitte Japan) is a collective term that refers to Deloitte Tohmatsu LLC, which is the Member of Deloitte Asia Pacific Limited and of the Deloitte Network in Japan, and firms affiliated with Deloitte Tohmatsu LLC that include Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Risk Advisory LLC, Deloitte Tohmatsu Consulting LLC, Deloitte Tohmatsu Financial Advisory LLC, Deloitte Tohmatsu Tax Co., DT Legal Japan, and Deloitte Tohmatsu Corporate Solutions LLC. Deloitte Tohmatsu Group is known as one of the largest professional services groups in Japan. Through the firms in the Group, Deloitte Tohmatsu Group provides audit & assurance, risk advisory, consulting, financial advisory, tax, legal and related services in accordance with applicable laws and regulations. With approximately 20,000 people in about 30 cities throughout Japan, Deloitte Tohmatsu Group serves a number of clients including multinational enterprises and major Japanese businesses. For more information, please visit the Group's website at www.deloitte.com/jp/en.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

Deloitte provides industry-leading audit and assurance, tax and legal, consulting, financial advisory, and risk advisory services to nearly 90% of the Fortune Global 500® and thousands of private companies. Our people deliver measurable and lasting results that help reinforce public trust in capital markets, enable clients to transform and thrive, and lead the way toward a stronger economy, a more equitable society, and a sustainable world. Building on its 175-plus year history, Deloitte spans more than 150 countries and territories. Learn how Deloitte's more than 450,000 people worldwide make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, or their related entities (collectively, the "Deloitte organization") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. DTTL and each of its member firms, and their related entities, are legally separate and independent entities.

Member of

Deloitte Touche Tohmatsu Limited

© 2024. For information, contact Deloitte Tohmatsu Group.



IS 669126 / ISO 27001



BCMS 764479 / ISO 22301