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TRIBUNAL HOLDS BVI COMPANY RE-DOMICILED IN MAURITIUS ENTITLED TO INDIA-MAURITIUS TAX TREATY BENEFITS, ALSO HOLDS AGENCY PE TO BE TAX NEUTRAL

11 August 2021

In a first ruling on the issue, the Income Tax Appellate Tribunal, Mumbai (Tribunal) in its recent judgment in the case of *Asia Today Limited* (Taxpayer) [ITA No. 4628/2006, ITA No.4629/2006, ITA 1877 of 2008 and CO No. 123/2008], ruled that re-domiciliation from British Virgin Islands to Mauritius cannot by itself result in denial of the benefits of the India-Mauritius tax treaty (Tax Treaty).

Further, following the Supreme Court ruling and various other judgments, the Tribunal holds that where Taxpayer has a Permanent Establishment (PE) in the form of a dependent agent in India who is remunerated on an arm's length basis, no further profits are to be attributed to the PE in India. However, the Tribunal does note that this treatment is incompatible with the scheme of taxation of non-residents having a PE in India as the remuneration received by the agent is taxed in India anyway de hors the existence of a PE and this conclusion effectively makes it tax neutral for the non-resident having a PE in India.

Entitlement to Tax Treaty benefits

Background

The Taxpayer is a foreign telecasting company and was incorporated in British Virgin Islands (BVI) in the year 1991. It re-domiciled / migrated to Mauritius in the year 1998. As a result, the Taxpayer was deregistered as a company in BVI and got registered as a company in Mauritius on 30 June 1998. Further, the Taxpayer was issued a tax residency certificate (TRC) by the Mauritius authorities on 29 June 1998.

As the Taxpayer was a company originally incorporated in BVI, the tax authorities denied the Tax Treaty benefits to it. In response, the Taxpayer submitted that though originally incorporated in BVI, it has been registered in Mauritius on account of re-domiciliation, holds a valid TRC and therefore, is entitled to Tax Treaty benefits.

The Commissioner of Income Tax (Appeals) upheld Taxpayer's claim. Aggrieved, the tax authorities preferred an appeal before the Tribunal.

Tribunal ruling

The Tribunal ruled in favour of the Taxpayer and held that re-domiciliation cannot result in denial of Tax Treaty benefits basis and made the following important observations:

- Re-domiciliation is a process by which a company moves its 'domicile' (or place of incorporation) from one jurisdiction to another, whilst maintaining the same legal identity. The rationale for re-domicile could include dynamic and evolving business requirements, rules and regulations of jurisdiction of incorporation

being no longer suitable to the business purpose of the taxpayer or the future business plans and prospects, etc.

- Appreciating the commercial reality, the Tribunal observed that many jurisdictions permit and even facilitate re-domiciliation and restructuring and re-domiciliation of corporate entities is a fact of life.

- The issue regarding jurisdiction of incorporation determining treaty entitlement of the Taxpayer is being raised for the first time by the tax authorities after the end of almost two decades from the relevant period, without any specific ground. The Tribunal viewed this as an inordinate lapse of time which does extend finality to the findings about the foundational aspects where the tax authorities granted the treaty benefits all along and revisiting such a foundational aspect is not appropriate.

- The fact of re-domiciliation could at best trigger detailed examination whether the redomiciled company is actually fiscally domiciled in that jurisdiction, but there is nothing to suggest that Taxpayer is not fiscally domiciled in Mauritius except for a doubt in the mind of the tax authorities, which cannot by itself lead to denial of treaty entitlement.

PE in India

Background

The Taxpayer earned advertisement revenue by selling advertising time and subscription revenues from India through its Indian affiliates, Zee Telefilms Limited and El Zee.

In the facts of the case, the tax authorities concluded that the Taxpayer had a taxable presence in India (in the form of a fixed place PE and an agency PE) and argued on principles of profit attribution to the PE.

The tax authorities claimed that the Indian affiliates / agents constituted virtual projection of the Taxpayer in India and therefore, a fixed place PE in India on the basis of the following:

- The brand used by the Taxpayer was same as that of its Indian affiliates and accordingly, for the person intending to do business with Taxpayer in India, there was no difference between the Taxpayer and its Indian affiliates.

- The employees in India performed the functions for entire Zee group. The Taxpayer earned income from sale of advertising time and the advertisements were solicited by its Indian affiliate. The advertisers booked the advertisement slots pursuant to discussion with the employees of the Indian affiliates. The other income stream in the nature of subscription revenue was also collected by the Indian affiliates on behalf of the Taxpayer.

The tax authorities alternatively argued that the Taxpayer had an agency PE in India on account of its Indian affiliates acting as dependent agents.

Tribunal ruling

The Tribunal agreed with the contention of the tax authorities that the Taxpayer had a PE in India but not on account of having any fixed place at its disposal but on account of Indian affiliates acting as dependent agents of the Taxpayer. Some of the key aspects dwelled upon by the Tribunal are as under:

- The Taxpayer did not have any office or place of management in India and its presence in India was only through the agents in India.

- In order to constitute a fixed place PE under Article 5(1) of the Tax Treaty, there has to be a fixed place of business from which the business of the Taxpayer is carried out and such place of business should be at the disposal of the Taxpayer. However, the tax authorities could not demonstrate that these conditions were met in the present case and therefore, PE, if at all, in the instant facts could be established only under Article 5(4) ie Agency PE.

Attribution of profits to Agency PE

Background

During the proceedings before the tax officer as well as the Tribunal, the Taxpayer argued that even if there is a PE in India, the Indian agents are remunerated on an arm's length basis and therefore, considering the well settled judicial position as well as the orders passed in Taxpayer's own case for the preceding years, no further profits can be attributed to the PE in India.

Tribunal ruling

The Tribunal extensively discussed the tax implications of a foreign entity having a PE in India on account of having an Agency PE in India. Some of the key observations are outlined as under:

- The Tribunal referred to its own ruling in the case of Set Satellite (Singapore) Pte Ltd [2007] (106 ITD 175) to explain that it is not the dependent agent that constitutes a PE of the foreign entity, but it is by virtue of the dependent agent, the foreign entity is deemed to have a PE. Further, the dependent agent is taxed in India on the remuneration received from the foreign entity independently (whether or not the foreign entity has a PE in India) and therefore, it has no relevance to the tax payable by the foreign entity on its profits attributable to Agency PE in India.

- In the context of the principle that a PE is to be considered as a separate and distinct enterprise dealing wholly independently with the foreign entity of which it is a PE, and related argument that taxability of a foreign entity should be limited to the profits of the dependent agent on that basis, the Tribunal mentioned that such a position will result into a situation where taxability of the dependent agent would extinguish the taxability of the foreign entity and therefore, it is incongruous with the scheme of taxation.

- The Tribunal referred to the commentary of Late Prof. Klaus Vogel which states that a foreign entity may be taxed in the source country on the surplus profits derived by employing the agents in such country. However, the Tribunal also noted comments of Philip Baker (an international tax expert) supporting the view that if the agent is remunerated on an arm's length basis for the functions he performs, risks he assumes and the assets he employs, there is no basis for attributing any further profits to tax in the source country.

- Subsequently, the Tribunal referred to the Bombay High Court ruling in the case of Set Satellite Pte Ltd Vs CIT [2009] (307 ITR 205) which overturned the ruling of the Tribunal (referred above) and upheld the position of no further attribution of profits where the agent is remunerated at arm's length. Also, the Tribunal considered the binding ruling of the Supreme Court of India in the case of Morgan Stanley & Co Inc. [2007] 162 Taxman 165 and eventually, ruled the

aforesaid issue in favour of the Taxpayer and held that no further profits are to be attributed to tax in India as the Indian entities are remunerated at arm's length.

- While the Tribunal has mentioned that this approach makes the situation of a foreign entity having an Agency PE in India wholly tax neutral and seems incompatible with the scheme of taxation, it held that this alternative view cannot dilute the binding nature of the judicial precedents and is necessary to be followed by the Tribunal.

Comment

At the outset, this is a first of its kind ruling on the issue of tax treaty entitlement of an entity that has re-domiciled from its place of incorporation to another jurisdiction having a favourable tax treaty with India. The observation that re-domiciliation could be on account of various business considerations and legal factors is welcome and shows the open-mindedness of the Tribunal while approaching this issue. In absence of any material or even a suggestion that the Taxpayer is not fiscally domiciled in Mauritius, the Tribunal viewed tax authorities stand as nothing but driven by a doubt, not supported by any material.

The Taxpayer holding a valid TRC coupled with absence of any findings suggesting anything contrary to Taxpayer's treaty eligibility was the key driver here, and the fact of re-domiciliation was not considered as reason enough for denial of treaty benefits.

Separately, on the issue of attribution of profits to a PE, the Tribunal followed binding judicial precedents. At the same time, it has also deliberated strongly on the alternate view that in case of a foreign entity having an Agency PE in India, attribution of profits to a PE in India may not be limited to the profits earned by the dependent agent in India. It is noteworthy that similar observations were made in the Tribunal's past ruling in the case of Set Satellite (supra) which was overruled by the Bombay High Court. Also, given the Supreme Court ruling in the case of Morgan Stanley (supra), the alternative view may not find favour, unless there is a larger bench ruling considering these aspects or a legislative amendment.

In the draft profit attribution rules issued by the CBDT for comments from the stakeholders, the position laid down by the Supreme Court is proposed to be made applicable only where the revenue earned by a taxpayer from the activities carried on by an Indian agent does not exceed INR 1 million. That said, there has been no update yet on the draft rules.

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