INTERNATIONAL TAXATION
Case Law Update

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A. Supreme Court

1 ***Principal Commissioner of Income-tax-10 vs. Krishak Bharti Cooperative Ltd. [2023] 154 taxmann.com 318 (SC) [15-09-2023]***

Where assessee, a cooperative society registered in India, received dividend income from its JV which was registered as company under Omani laws and the assessee had established a branch office in the form of a company in Oman which was treated as PE to invest in JV, it was held that assessee was aiding to promote economic development within Oman and thus achieved the objective of Article 8 (bis) of the Omani Tax laws. Thus, though Article 8(bis) exempted dividend tax received by assessee from its PE in Oman by virtue of Article 25 of the DTAA, assessee was entitled to claim credit in India for tax payable on the said dividend in Oman notwithstanding that the said tax was not paid due to the exemption granted under the Omani Tax laws.

Facts

i. The assessee was a multi-State Co-operative Society registered in India, under the administrative control of the 'Department of Fertilizers, Ministry of Agriculture and Co-operation, Government of India'.

ii. In the course of its business of manufacturing fertilizers, the assessee entered into a joint venture with Oman Oil Company to form the Oman Fertilizer Company SAOC (for short 'OMIFCO' or 'the JV'), a registered company in Oman under the Omani laws. The assessee had a 25% share in the JV.

iii. The assessee also had a branch office in Oman which was independently registered as company under the Omani laws having permanent establishment status in Oman. The branch office maintained its own books of account and submitted returns of income under the Omani income tax laws.

iv. The dividend income received by the assessee in Oman was simultaneously brought to the charge of tax in the assessment as per the Indian tax laws. However, under the Omani tax laws, exemption was granted to the dividend income by virtue of the amendments made in the Omani tax laws w.e.f. the year 2000. The AO allowed credit for the said tax, which would have been payable in Oman, but for the exemption granted.

v. Thereafter, the PCIT passed order u/s 263 of the Act and held that the reliance placed by the AO on Article 25(4) of the India-Oman DTAA was erroneous and that no tax credit was due to the assessee under section 90 of the Act as no tax had been paid by the assessee.

vi. The Hon'ble Tribunal held that the order passed by the PCIT u/s 263 of the Act was without jurisdiction and was not sustainable in law.

vii. The Hon'ble Delhi High Court upheld the order of the Hon'ble Tribunal.

viii. Aggrieved, the Revenue approached the Hon'ble Apex Court.

Decision

i. The Hon'ble Apex Court noted the provisions of Article 7 and 25 of the India–Oman DTAA as well as the provisions of Article 8 (bis) in the Omani tax law (which specifically exempts from tax – dividends received on equity shares).

ii. It specifically noted that Article 25(2) of the DTAA provides that where a resident of India derives income, which in accordance with this agreement, may be taxed in the Sultanate of Oman, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income tax paid in the Sultanate of Oman, whether directly or by deduction, and that Article 25(4) further clarifies that the tax payable in a Contracting State mentioned in clause 2 and clause 3 of the said Article shall be deemed to include the tax which would have been payable but for the tax incentive granted under the laws of the Contracting State (Oman) and which are designed to promote development.

iii. It noted the provisions of Article 11 relied upon by the revenue which provides that dividends paid by a company which is a resident of a Contracting State (Oman) to a resident of the other Contracting State (India) may be taxed in that other Contracting State unless the resident of India carries on business in Oman through a PE situated in Oman and the holding in respect of which dividend is paid is effectively connected with such PE as provided in Article 11(4) – which was not so in the instant case as according to the Revenue, the assessee did not have a PE and assuming it had, the PE was doing only preparatory work etc. Further, the Revenue argued that the dividend received by the assessee was taxable in India and was not exempt because the same was not designed as tax incentive in Oman to promote development in that country.

iv. The Hon'ble SC observed that the term 'incentive' is neither defined in the Omani Tax Laws nor in the Income-tax Act, 1961 and that consequently, the JV had addressed a letter in November 2000 to Oman Oil Company seeking clarification regarding the purpose of Article 8 (bis) of the Omani Tax Laws. The clarification letter dated 11-12-2000 addressed by the Secretary General for Taxation, Sultanate of Oman, Ministry of Finance, Muscat to Oman Oil Company

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SAOC was found to be significant, (and is extracted below):

"Under Article 8 of the Company Income-tax Law of Oman, dividend forms part of the gross income chargeable to tax. The tax law of Oman provides income tax exemption to companies undertaking certain identified economic activities considered essential for the country's economic development with a view to encouraging investments in such sectors.

Before the recent amendments to the Profit Tax Law on Commercial and Industrial Establishments, Article 5 of this law provided for exemption of dividend income in the hands of the recipients if such dividends were received out of the profits on which Omani income tax was paid by distributing companies. It meant that Omani income tax was payable by the recipients on any dividend income received out of the exempt profits from tax exempt companies. As a result, investors in tax exempt companies that undertake those activities considered essential for the country's economic development suffered a tax cost on their return on investments the tax treatment under the above-mentioned Article 5 had the negative impact on investments in tax exempt project.

The company Income-tax Law of 1981 was, therefore, recently amended by Royal Decree No. 68/2000 by the insertion of a new Article 8 (bis) which is effective as from the tax year 2000. As per the newly introduced Article 8 (bis) of the Company Income-tax Law, dividend distributed by all companies, including the tax-exempt companies would be exempt from payment of income tax in the hands of the recipients. In this manner, the Government of Oman would achieve its aim objective of promoting economic development within Oman by attracting investments.

We presume from our recent discussions with you that the Indian investors in the above Project would be setting up Permanent Establishment in Oman and that their equity investments in the Project would be effectively connected with such Permanent Establishments.

On the above presumption, we confirm that tax would be payable on dividend income earned by the Permanent Establishments of the Indian Investors, as it would form part of their gross income under Article 8, if not for the tax exemption provided under Article 8 (bis).

As the introduction of Article 8 (bis) is to promote economic development in Oman, the Indian Investors should be able to obtain relief in India ITA Nos. 6785 & 6786/Del/2015 (Ayrs. 2010-11 & 2011-12) ***Krishak Bharati Co-Operative Limited vs. ACIT*** *under Article 25 (4) of the Agreement for Avoidance of Double Taxation in India. All other matters covered in our letter No. FT/13/92 dated 6th August 2000 remained unchanged."*

v. The Hon'ble Apex Court held that it was clear from the above letter of the Omani Finance Ministry that the dividend distributed by all companies, including the tax-exempt companies would be exempt from payment of income tax in the hands of the recipients. By extending the facility of exemption, the Government of Oman intend to achieve its object of promoting development within Oman by attracting investments. Since the assessee had invested in the project by setting up a permanent establishment in Oman, as the JV was registered as a separate company under the Omani laws, it was aiding to promote economic development within Oman and achieve the object of Article 8 (bis). The Omani Finance Ministry had concluded by saying that tax would be payable on dividend income earned by the permanent establishments of the Indian Investors, as it would form part of their gross income under Article 8, if not for the tax exemption provided under Article 8(bis).

vi. It was further held that a plain reading of Article 8 and Article 8 (bis) of the Omani Tax laws would manifest that under Article 8, dividend is taxable, whereas Article 8(bis) exempts dividend received by a company from its ownership of shares, portions, or shareholding in the share capital in any other company. Thus, Article 8(bis) exempts dividend tax received by the assessee from its PE in Oman (and by virtue of Article 25, the assessee is entitled to the same tax treatment in India as it received in Oman).

vii. Insofar as the argument concerning that the assessee was not having PE in Oman, the Hon'ble Apex Court observed that it was significant to note that from the year 2002 to 2006, a common order was made under Article 26(2) of the Income-tax Law of Oman holding that Kribhco Muscat was a PE supported by the assessee and was in receipt of dividend income from Omifco which was however, exempt from tax in accordance with Article 8 (bis) (1) of the Company Income-tax Law and that the said tax exemption on dividend was granted with the objective of promoting economic development within Oman by attracting investments. The Hon'ble Apex court thus concluded that it was apparent that the assessee's establishment in Oman had been treated as PE from the very inception up to the year 2011 and that there was no reason as to why all of a sudden, the assessee's establishment in Oman would not be treated as PE when for about 10 years it was so treated, and tax exemption (credit) was granted based upon the provisions contained in Article 25 read with Article 8 (bis) of the Omani Tax Laws.

viii. As regards the Revenue's argument that the letter dated 11-12-2000 issued by the Secretary General of Taxation, Ministry of Finance, Sultanate of Oman had no statutory force as per Omani Tax Laws and that the same could not be relied upon to claim exemption, the Hon'ble SC held that the above letter was only a clarificatory communication interpreting the provisions contained in Article 8 and Article 8 (bis) of the Omani Tax Laws and that the said letter itself had not introduced any new provision in the Omani Tax Laws.

ix. The Hon'ble SC thus dismissed the Revenue's appeal by concluding that the Revenue had not been able to demonstrate as to why the provisions contained in Article 25 of DTAA and Article 8 (bis) of the Omani Tax Laws would not be applicable in the instant case.

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B. High Court

2 ***Principal Commissioner of Income-tax-7 vs. Polyplex Corporation Ltd. [2023] 152 taxmann.com 479 (Delhi) [18-07-2023]***

Held that in view of the concept of tax sparing embedded in India-Thailand DTAA to incentivize investment for economic development, I Co. would be eligible for tax credit qua tax payable on income by the way of dividend received from its subsidiary in Thailand notwithstanding that the said tax was not paid due to exemption granted under the Thai law

Facts

i. In its ROI, the assessee, an Indian Co. had claimed tax credit amounting to ₹ 1.60 crores in respect of tax, which it would have to ordinarily pay in Thailand on dividend received from its Thai subsidiary, but for the statutory regime in Thailand, which exempted levy of tax in that country.

ii. AO denied the tax credit sought in the ROI (on the ground that no tax had actually been paid by the assessee in Thailand on the dividend income earned there.)

iii. The CIT(A) upheld the stand of the AO.

iv. The Tribunal having regard to the tax sparing concept, which is embedded in several DTAAs, including the subject Indo-Thai DTAA, held that the assessee was entitled to tax credit at the rate of 10%, on the dividend income received from the Thai subsidiary.

v. The Revenue filed an appeal before the Hon'ble Delhi High Court.

Decision

i. The Hon'ble HC observed that it was quite evident that the controversy veered around the interpretation of Article 23 of the Indo-Thai DTAA. It noted that Paragraph 2 of Article 23 allows tax credit against tax payable in India under the Indian Income Tax Act, qua "Thai tax payable" under the laws of Thailand, and in accordance with the provisions of Indo-Thai DTAA, whether directly or by deduction, by a resident of India concerning profits or income arising in Thailand, which is subjected to tax both in India and in Thailand. It further noted that Paragraph 2 specifies the caveat that tax credit cannot exceed the amount of tax payable under the Indian Income Tax Act (as computed before allowing any such credit), which is appropriate to the profits of income, arising in Thailand.

ii. It observed that Paragraph 3 of Article 23 of the Indo-Thai DTAA which defines the term "Thai Tax Payable" provides that it shall deem to include any amount which will have to be payable as Thai tax for any year, but for exemption or reduction of tax, for that year or any part thereof, under the provisions of the Investment Promotion Act, or of the Thai Revenue Code, which are designed to promote economic development in Thailand, or which may be introduced hereafter, for modification or in addition to the existing law, for promoting economic development in Thailand. That Paragraph 3 of Article 23, thus, by employing a device of deeming fiction, includes in the expression "Thai Tax Payable" as adverted to paragraph 2 of the very same Article, that tax which would have been otherwise payable, but for an exemption or reduction of tax granted for that year or any part thereof, under the two statutory enactments referred to therein. It held that Para 3 also alludes to the fact that the said statutes are designed to promote economic development in Thailand and that clearly, the provision was configured to incentivize investments in Thailand, by granting tax credit for that amount which, otherwise, would have been payable as tax to the Thai state, but was not paid due to exemption or reduction granted under the said enactments.

iii. It further noted that Paragraph 6 of Article 23 provides a clue as to the rate at which tax credit can be accorded by, inter alia, providing that it would be that rate of tax which would have been applicable, if income exempted from tax in accordance with the provisions of Indo-Thai DTAA, had not been so exempted. It held that ordinarily the term “tax payable” would mean tax, which is owed or due, although not paid. However, the meaning of the expression has to be found in the treaty executed between two Contracting States. The treaties/ DTAAs often (as in the instant appeals) define the term “tax payable”. The intent of the Contracting States has to be, thus, ascertained from the term, as contained in the DTAA, and not what would ordinarily be the meaning of a given expression or term. Therefore, the meaning of the expression “Thai tax payable” or “Indian tax payable” has to be found in the definition embedded in the DTAA/treaty.

iv. It further observed that tax sparing as a concept exists and the same was also discernible from the commentary of Klaus Vogel on Double Taxation Conventions.

v. The Hon’ble HC thus concluded that the assessee was entitled to claim tax credit on dividend income received from its Thai subsidiary, in respect of "Thai Tax Payable", which it would have to pay @ 10%, but for the exemption accorded to it under the provisions of Section 34 of the Investment Promotion Act.

vi. Accordingly, the Hon’ble HC dismissed the Revenue’s appeals.

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3 ***Commissioner of Income-tax-4 vs. GE India Business Services Pvt Ltd. [2023] 152 taxmann.com 517 (Delhi) [18-07-2023]***

Held that where in period under consideration, an extraordinary event had taken place in the case of a company by way of amalgamation, such company could not be considered as a valid comparable.

Held that where in the period under consideration, a company which had acquired another company could not be considered as a valid comparable.

Held that where a company was engaged in the business of rendering software development services as per requirement of users, said company could not be comparable to assessee company providing non-development software services, which involved purchase of software for provisioning services.

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C. Tribunal

4 ***SanDisk International Ltd. vs. Assistant Commissioner of Income Tax [2023] [TS-540-ITAT-2023(Bang)] [25-08-2023]***

Held that SanDisk Ireland's Indian AE did not constitute an Agency PE as the contracts were concluded by the independent distributors

Facts

i. The assessee, a company incorporated in Ireland had entered into a market research and support services agreement with its AE i.e., San Disk India Device Design Centre Private Limited ('SanDisk India'), whereby SanDisk India would assist the assessee in promoting its products by, inter alia, conducting market research, gathering data, and performing other support services.

ii. A survey was conducted in the premises of SanDisk India which allegedly revealed that the nature of activities performed by SanDisk India were beyond what was prescribed under the aforesaid agreement. This led to a formation of belief by the Assessing Officer of the assessee that income chargeable to tax had escaped assessment for the year under consideration. A notice u/s 148 of the Act was issued consequent to which the assessee filed a Nil return of income.

iii. The AO relying on the statements of the employees of SanDisk India recorded in the course of the survey held that the activities of SanDisk India created an 'Agency permanent establishment' and thus the appropriate portion of the business profits were liable to be taxed in India. Accordingly, adopting the global gross profit rate of 4.19% and after reducing admissible expenditure, a sum of ₹ 27.26 crores were brought to tax in the draft assessment order.

iv. The DRP upheld the AO's order consequent to which the assessee filed an appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal noted the definition of 'business connection' provided in the Explanation 2 of section 9 of the Act and observed that the definition of permanent establishment under Article 6 of the India-Ireland Treaty was similar. It further noted that the agreement between SanDisk India and the assessee prohibited the former entity from negotiating, concluding, signing, executing or in any other manner, accepting sales or other contracts in the name of or on behalf of the latter entity. SanDisk India did not or more particularly, could not engage in securing, negotiating, or concluding contracts on behalf of the assessee. It was also evident from the agreement and the statements recorded from the employee of SanDisk India that the orders were secured by the independent distributors and not by SanDisk India. Therefore, clauses (a) and (c) of *Explanation* 2 to sec 9 were not attracted. Also, as the AO had recorded that SanDisk India did not procure goods, nor delivered them, nor collected the payments, clause (b) of Explanation 2 was also not applicable.

ii. On perusal of all the above statements of the employees, the Hon'ble Tribunal held that, it was clear that sales of the assessee in India were effected through its distributors. The sales and marketing team of SanDisk India engaged in educating the customers about SanDisk products. Once the customer was interested in a product, the distributors of the assessee were notified who would then negotiate the price and place the purchase orders with the assessee. Therefore, it was not forthcoming from the statements recorded that SanDisk was totally responsible for concluding contracts on behalf of the assessee. The AO had not brought on record any other material to support his case. Therefore, reliance on the statements of employees of SanDisk India were not conclusive of existence of permanent establishment of the assessee in India.

iii. It further relied on the decision in the case of ***Net App B.V vs. DCIT (2017) 78 taxmann.com 97 (Del)*** wherein under similar facts and circumstances, the Tribunal held that the Indian company engaged in providing marketing support services with no authority to conclude contracts, did not constitute a permanent establishment of the foreign entity.

iv. As regards the judgement of the Hon'ble Karnataka High Court in ***Jebon Corporation Ltd. vs. CIT [(2012) 10 taxmann.com 119 (Kar)*** relied upon by the Revenue, the Hon'ble Tribunal held that the said decision was not applicable in the present case as it had not dealt with the concept of agency PE. Further, this decision had also been distinguished by the Mumbai Bench of the Tribunal in ***Swiss re-insurance company ltd. vs. DDIT [ITA No. 1667/Mum/2014]*** for similar reasons.

v. In view of the above, the addition made by the Assessing Officer was deleted by the Hon'ble Tribunal.

vi. Further, the Hon'ble Tribunal also clarified that the explanation 2 to section 9(1)(i) of the Act which was amended vide Finance Act, 2018 (to include within the definition of business connection an agent who habitually plays the principal role leading to conclusion of contracts by that non-resident) was only w.e.f. 01-04-2019. It further noted that similar amendments were also proposed to DTAA through MLI, which was not effective for the years under consideration and concluded that even otherwise, it is settled principle that amendment to Act cannot be directly imported to the treaty, unless treaty itself is modified though protocol or MLI.

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"Neither seek nor avoid,take what comes"

— *Swami Vivekananda*

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