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TAX FLASH NEWS

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Agency commission earned outside India is not taxable in the absence of territorial nexus with India

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Fox International Channel Asia Pacific Ltd[1] (the taxpayer) dealt with the issue of taxability of agency commission relating to the services rendered outside India.

The taxpayer is a foreign company engaged in the distribution of satellite television channels and sale of advertisement air time for the channel companies at a global level. The taxpayer is not a channel owner but a service provider to group companies owning various television channels. Further, the channel companies had appointed the taxpayer as an agent to sell the advertisement air time on the channels, to distribute the channels in the territories where the channels are being broadcast and to procure syndication revenues in respect of the contents of the channels. The taxpayer has not maintained India specific financial statement or any India specific account. The taxpayer originally filed its tax return on the basis of unaudited global financial statements which was subsequently revised on the basis of audited global financial statements of itself and channel companies.

The Assessing Officer (AO) referred the matter to the Transfer Pricing Officer (TPO). The TPO held that the taxpayer and the channel companies had bench-marked the international transaction by adopting the profit split method (PSM) as the most appropriate method. Insofar as agency commission is concerned, the global profitability percentage as per the audited financial statements of channel companies has been applied to the Indian revenues and global revenues earned by the channel companies and the overseas merged entities respectively to arrive at the profit/loss earned by each of the channel companies.

The TPO observed that out of the global commission received by the taxpayer from the overseas merged entities, commission received for the services rendered outside India was not offered to tax by the taxpayer in India and only the balance commission was offered to tax in India. The TPO observed that while in TP analysis the taxpayer determined the Arm's Length Price (ALP) profit at INR2525 million under PSM, however, in the computation of income, it offered to tax in India an amount of INR2278 million. Therefore, the differential amount of INR247 million should be treated as an adjustment to the ALP. In pursuance to the order passed by the TPO, the AO made an addition to the income of the taxpayer.

The Dispute Resolution Panel (DRP) held that since the taxpayer itself had admitted that ALP is attributable to India, no fault can be found with the TPO in making the adjustment. While holding so, the DRP rejected the taxpayer's contention that the part of commission income does not fall within the purview of Section 9 of the Act as the services related to such commission income were provided outside India and the payment was also received outside India. The DRP held that Section 9 of the Income-tax Act, 1961 (the Act) being a deeming provision, it brings to tax any income accruing or arising whether directly or indirectly through or from any business connection in India. Section 9 of the Act can even bring to tax income which does not accrue or arise in India but accrues or arises outside India. Explanation below Section 9(2) of the Act was relied upon.

[1] Fox International Channel Asia Pacific Ltd v. DCIT (ITA No. 1947/Mum/2015) – Taxsutra.com

The Tribunal rejected findings of the DRP and observed that if the provisions of Section 9 of the Act are read as a whole, it would be clear that as per the Explanation 1 to Section 9(1)(i) of the Act, in case of the taxpayer whose business operations are not exclusively carried out in India, the amount of income which will be deemed to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. Therefore, the income which is deemed to accrue or arise in India must have a territorial nexus with India.

As per various judicial precedents[2], agency / marketing commission paid to non-residents agent outside India and for services rendered outside India is not taxable in India. Moreover, if one carefully reads the provision contained in the Explanation below Section 9(2) of the Act, it indicates that it would not be applicable to the agency commission earned by the taxpayer. Accordingly, it was held that the income accruing or arising outside India would not be taxable under the Act.

The Tribunal held that since the actual profit attributable to India is a purely factual issue which has to be demonstrated by the taxpayer through proper documentary evidence/books of account. The Tribunal restored the issue to the AO to examine the taxpayer's claim. In the event, the claim of the taxpayer that actual profit attributable to India is INR2278 million is found to be correct, no further adjustment can be made to the ALP since the TPO himself has concluded that the profit margin of the international transaction shown by the taxpayer is higher than the average margin of the comparable.

Our comments

The existence of nexus between income and the taxing state is a prerequisite for the right to tax. The Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd.[3] held that the concept of territorial nexus is fundamental in determining the taxability of any income in India and that the income from offshore services would not be taxable in India merely because the activities are rendered in relation to an Indian turnkey project. After this decision, an Explanation under Section 9 was specifically amended to provide that interest, royalty and FTS income of a non-resident shall be deemed to accrue or arise in India whether or not the non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India.

The Supreme Court in the case of Vodafone International Holdings BV[4] held that the Indian tax authorities did not have territorial jurisdiction to tax the offshore transaction, and therefore, the taxpayer was not liable to withhold Indian taxes. The Supreme Court observed that in the absence of nexus of the transaction with India, provisions of Section 195 of the Act would not apply. In order to overcome the impact of the Supreme Court's decision, the Finance Act, 2012 amended Section 9 with retrospective effect to provide that if an asset, being a share or interest in a company or entity registered or incorporated outside India, derives its value, directly or indirectly, substantially from an asset situated in India, the gains arising from the transfer of such share or interest would be taxable in India. Further, Section 195[5] of the Act was also amended retrospectively to clarify that it extends to all persons including non-residents, irrespective of whether or not the non-resident has any presence in India.

No such amendment has been made with respect to commission income earned from services rendered outside India. The Mumbai Tribunal in the present case while dealing with the taxability of agency commission under the provisions of the Act held that the taxpayer is not liable to pay tax on agency commission in the absence of territorial nexus with India. Agency/marketing commission was paid to non-resident agent outside India and for services rendered outside India. The Tribunal clarified that Explanation under Section 9 of the Act would not be applicable to the agency commission.

In the instant case, the taxpayer had not maintained India specific accounts and based on audited global financial statements, the taxpayer had filed its tax return. However, this was not an issue raised before the Tribunal and accordingly, the Tribunal has not dealt with the issue of compliance requirement of the taxpayer.

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[2] CIT v. Toshoku Ltd., [1980] 125 ITR 525 (SC), UTS SCS (Asia) Ltd. v. ADIT [2012] 18 taxmann.com 302 (Mum), ITO v. Indo Industries Ltd., [2018] 94 taxmann.com 180 (Mum), ACIT v. Nuova Shoes, [2918] 91 taxmann.com 354 (Agra)

[3] Ishikawajima-Harima Heavy Industries Ltd. v. DIT [2007] 288 ITR 408 (SC)

[4] Vodafone International Holdings BV v. UOI [2012] 341 ITR 1 (SC)

[5] Dealing with withholding tax on payments made to non-residents

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