KPMG

#KPMG josh

TAX FLASH NEWS

11 August 2021

Re-domiciliation of the company does not affect tax treaty entitlement. A foreign telecasting company earning revenue from advertising time and subscription through its Indian agents does not constitute a PE in India

Executive summary

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Asia Today Limited[1] (the taxpayer) dealt with the issue of eligibility of India-Mauritius tax treaty (tax treaty) benefits on re-domiciliation of the taxpayer. The Tribunal held that a re-domiciliation of the company by itself could not lead to the denial of treaty entitlements of the jurisdiction in which the company is re-domiciled. The Tribunal observed that the re-domiciliation could at best trigger a detailed examination of the re-domiciled company being fiscally domiciled in that jurisdiction.

The Tribunal also dealt with the issue of the existence of Permanent Establishment (PE) in India. The Tribunal held that the taxpayer did not have any place at its disposal in India and its presence in India was only through its agents. With respect to agency PE, it was held that once an arm's length remuneration is paid to the agent, nothing further survives for taxation in the hands of the agency PE. Thus, the question regarding the existence of dependent agency PE (DAPE) under Article 5(4) of the tax treaty, was an academic question.

Facts of the case

On 15 November 1991, the taxpayer company was registered in the British Virgin Islands (BVI). Subsequently, the company being a foreign telecasting company, re-domiciled in Mauritius on 29 June 1998 when the Registrar of Companies issued a 'certificate of incorporation by continuation'. The Tax Residency Certificate (TRC) was issued by the Government of Mauritius on 6 July 1999.

The taxpayer sells advertising time and collects subscription revenues through its Indian affiliates. The taxpayer claimed that since it did not have any PE in India, no part of its income was taxable in India.

The Assessing Officer (AO) denied the tax treaty benefits to the taxpayer, as it was originally a BVI company. Further, the AO did not accept the claim and held that the taxpayer's Indian agent constitute a virtual projection of the foreign company, and, therefore, it had a PE in India. The AO referred to the Andhra Pradesh High Court decision in the case of Vishakhapatnam Port Trust[2].

The Commissioner of Income-tax (Appeals) [CIT(A)] held that the taxpayer does not have any PE in India. Therefore, the taxpayer cannot be taxed in respect of its income from Indian operations.

Tribunal's decision

Domiciliation

Due to business, and even legal circumstances, the offshore entities are sometimes faced with a situation where the rules and regulations then prevailing in the current 'domicile' (place of incorporation) of the company no longer fit the company's purpose or the prevailing rules and regulations of its current jurisdiction of domiciliation are in some way inhibiting future business or prospects. For these reasons and a multitude of others, the possibility of transferring the domicile of a company by way of continuation from one place to another, may be the preferred option.

[1] ADIT v. Asia Today Limited (ITA no 468 and 4629/Mum/2006) – Taxsutra.com

[2] CIT v. Vishakhapatnam Port Trust [1983] 144 ITR 146 (AP)

The Tribunal observed that the company ceases to 'live' in one jurisdiction and is deregistered there, but via a transfer by way of the continuation process, it is alive and well in another. To effect a re-domiciliation, both the existing jurisdiction (where the company is currently registered) and the target jurisdiction (where the company is to be 'continued') need to be on the list of countries where re-domiciliation is possible. Not all countries allow re-domiciliation, but many popular offshore centers do permit and even facilitate the re-domiciliation. BVI and Mauritius are such jurisdictions. Therefore, re-domiciliation of corporate entities in the offshore world is a fact of life.

The taxpayer was re-domiciled in another sovereign jurisdiction, and TRC was issued even before the re-domiciliation process was complete. The re-domiciliation was completed on 30 June 1998, and TRC was issued on 29 June 1998 itself.

There was nothing more than the fact of registration of a company which has been taken as tax treaty entitlement. The attachment with the jurisdiction of incorporation in these cases appears to be as ephemeral as required by the exigencies of treaty shopping, and this concept of re-domiciliation of the companies also appears to be an antithesis of the very justification of the situs of incorporation of a company being linked with the treaty entitlements.

It is almost after the end of two decades from the relevant financial period that the issue regarding treaty benefit entitlement is being raised for the first time, and that too without any specific ground of appeal in that respect. Such an inordinate lapse of time does extend finality to the findings of such foundational aspects. The AO himself had granted the tax treaty benefits to the taxpayer and it cannot be open to the tax department to wake up today to revisit this foundational aspect. In any case, given the ground realities of the offshore world, re-naming, re-structuring and even re-domiciliation of offshore companies are facts of life.

A re-domiciliation of the company by itself cannot lead to denial of treaty entitlements of the jurisdiction in which the company is re-domiciled, though, of course, the fact of re-domiciliation of the company could at best trigger detailed examination or the re-domiciled company being actually fiscally domiciled in that jurisdiction.

The Tribunal observed that once a TRC was issued, it could not even be open to the tax authorities to make such investigations, but then it is not necessary to deal with these nuances of the law. There was not even a suggestion; leave aside any material to suggest so that the taxpayer is not now fiscally domiciled in Mauritius. There was nothing more than doubt in the mind of the tax department, but that cannot be reason enough to reject the treaty entitlement in question.

Fixed place PE

It is an admitted position that the taxpayer does not have any office or place of management of its own, and its presence in India is only through its agents.

The Andhra Pradesh High Court, in the case of Vishakhapatnam Port Trust, observed that 'permanent establishment' postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country and 'it should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.

What is equally important is in the fundamental analysis justifying the existence of PE under Article 5(1) and 5(2). In the instant case, there was not even a whisper of a mention about any fixed place of business.

It is only elementary that there cannot be a PE under the basic rule, i.e., Article 5(1) unless there is a fixed place of business. It is by now well settled in law that in order to constitute a fixed place PE under Article 5(1), there has to be a fixed place of business from which business of the foreign enterprise is carried out, and such a place of business should be at the disposal of foreign enterprise.

The Delhi Special Bench Tribunal in the case of Motorola Inc[3] and in the case of Airlines Rotables Ltd[4] observed that the physical test, i.e., place of business test, requires that there should be a physical location at which the business is carried out. However, the mere existence of a physical location is not enough.

This location should also be at the disposal of the foreign enterprise and it must be used for the business of foreign enterprise as well. This place has to be owned, rented or otherwise at the disposal of the taxpayer, and a mere occasional factual use of place does not suffice'.

There can be virtual projections even without a fixed place of business, such as in the case of a dependent agency permanent establishment, but such cases will be covered by agency PE under Article 5(4) rather than article 5(1) and 5(2).

Agency PE and Profit attribution

There is no conflict between 'virtual projection of a foreign enterprise' and the 'dependent agency permanent establishment'. There can be simple situations in which a foreign enterprise operates through an agent acting as a franchise, and such a franchise can virtually project the business of the foreign enterprise on the soil of another country.

---

[3] Motorola Inc v. DCIT [2005] 95 ITD SB 269 (Del)
[4] Airlines Rotables Ltd v. JDIT [1911] 44 SOT 368 (Mum)

In the light of jurisdictional High Court's decision in the case of Set Satellite[5], so far as profit attribution of a DAPE is concerned, the legal position is that as long as an agent is paid an arm's length remuneration for the services rendered, nothing survives for taxation in the hands of the dependent agency PE. Viewed thus, the existence of a dependent agency PE is wholly tax neutral.

In the present case, successive coordinate benches in the taxpayer's own case for different assessment years had upheld the contentions of the taxpayer and held that once an arm's length remuneration is paid to the agent, nothing further survives for taxation in the hands of the DAPE.

Whether there is a DAPE or not, the taxation is only of the agent's remuneration which is taxed anyway, dehors the existence of a DAPE.

Thus even if it was held that there was a DAPE, it was wholly tax-neutral inasmuch as the Indian agents were paid arm's length remuneration, and nothing further could, therefore, be taxed in the hands of the taxpayer.

Thus the question regarding the existence of dependent agency PE under Article 5(4) was a wholly academic question.

Our comments

A company may re-domicile for various reasons including non-favorable laws in a particular country, to align the place of registration with their shareholder base, to access capital markets or for other commercial reasons, etc.

In the present case, the taxpayer, a BVI-based entity, re-domiciled in Mauritius and it was discontinued in the BVI. The Tribunal held that this re-domiciliation of the taxpayer company does not affect tax treaty entitlements. The ground realities of the offshore world, re-naming, re-structuring and even re-domiciliation of offshore companies are facts of life.

However, the ruling emphasises that re-domiciliation may trigger detailed examination that the re-domiciled company is fiscally domiciled in that jurisdiction.

In a current scenario, taxpayers should analyse provisions of GAAR and Principle Purpose Test vis-à-vis its commercial reasons for the re-domiciliation.

With respect to fixed place PE, the Tribunal has held that the office of the Indian affiliate of the taxpayer does not constitute a fixed place of business since such place was not at the disposal of the taxpayer. With respect to agency PE, the Tribunal held that the existence of dependent agency PE was wholly tax-neutral since the agent had been paid an arm’s length remuneration.

Since the taxpayer was engaged in selling advertising time and collecting subscription revenues, it would be interesting to analyse the applicability of provisions of Equalisation Levy to such transactions.

.

[5] DDIT v. Set Satellite (Singapore) Pte Ltd [2007] 106 ITD 175 (Mum)

KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

---

home.kpmg/in

#KPMG josh

home.kpmg/in/socialmedia

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000