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International Tax Judicial Decisions

Date of OECD membership of a third country is not relevant for availing lower tax rate under Most Favoured Nation (MFN) clause of an India's tax treaty with Netherlands

Concentrix Services Netherlands B.V. (Delhi High Court) (W.P. (C) 9051/2020) (in favor of assessee)

Facts:

- The assessee was a tax resident of Netherlands holding 99.99% shares of its Indian subsidiary company. The tax rate on dividend under India-Netherlands tax treaty was 10%.
- The protocol to the India-Netherlands tax treaty states that the same "shall form an integral part of the convention". The MFN clause provides that:
  - Subsequent to signing the tax treaty with Netherlands;
  - if India enters into a tax treaty which another OECD member state/country where rate or scope of taxation of dividends, interests, royalties, fees for technical services or payments for the use of equipment is lesser than the tax treaty with Netherlands;
  - then such lower rate or scope will apply to the India India-Netherlands tax treaty.
- Subsequent to signing the tax treaty with Netherlands on 13 July 1988, India signed tax treaties with Slovenia, Lithuania and Columbia where tax rate on dividend income was restricted to 5%. These countries were not OECD members when they signed their tax treaties with India but became OECD members subsequently. The tabular depiction of the same is as under:

Particulars	India – Columbia	India – Slovenia	India – Lithuania
Date of Signing Tax Treaty	13 May 2011	13 January 2003	26 July 2011
Date of Entry into Force	07 July 2014	17 February 2005	10 July 2012
Date of Signing amendment in tax treaty	NA	17 May 2016	NA
Date of Entry into force - amendment in Tax Treaty	NA	21 December 2016	NA
Date ofecoming OECD Member	28 April 2020	21 July 2010	05 July 2018

- o Accordingly, the assessee applied for issue of lower withholding tax (WHT) certificate on dividend income from India at a rate of 5%. The assessee's view was that the MFN clause and lower rate of tax on dividend would automatically apply to India-Netherlands Tax Treaty and no fresh notification was required for the same. The fact that Slovenia, Lithuania and Columbia became OECD members after signing the tax treaty with India was not relevant.
- However, the tax authorities rejected the said application of the assessee on the ground that:
  - o To avail benefit of MFN clause, Slovenia, Lithuania and Columbia should have been OECD members at time of signing tax treaty with India.
  - o Though India – Netherlands tax treaty has been amended several times and ratified by both the countries, no specific amendment for lower withholding tax rate was carried out either by India or Netherlands.

Held:

- The Hon'ble High Court relying on its own decision of division bench in the case of Steria (India) Limited (386 ITR 390) held that the protocol is an integral part of the tax treaty and no separate notification is required for applicability of provisions of protocol.
- MFN clause incorporates principle of parity upon satisfaction of the following conditions:
  - o The third country with whom India entered into a Tax Treaty should be a member of the OECD.
  - o India should have, in its tax treaty, limited its rate of withholding tax at a rate lower than the one mentioned in the subject Tax Treaty with Netherlands.
- Once the aforementioned conditions are fulfilled, then:
  - o from the date on which the tax treaty between India and a third country comes into force; and
  - o on the date when third country becomes member of OECD,

  the same rate of withholding tax or scope agreed by India in that tax treaty would necessarily have to apply to India - Netherlands tax treaty.
- Even if the third countries were not members of OECD at the time of signing of their tax treaties with India, as long as they are OECD members when the MFN clause is sought to be invoked, the benefit of MFN clause should be available.
- It is pertinent to note the Decree (Decree of 28 February 2012, No. IFZ 2012 / 54M, Tax Treaties. India February 28, 2012 No. IFZ 2012 / 54M) issued by the Netherlands authorities states that the lower tax rate for dividend income under the India-Slovenia tax treaty would apply to India-Netherlands tax treaty. Therefore, India cannot have an understanding contrary to that of Netherlands basis the principles of interpretation and understanding of tax treaties.
- Therefore, the taxpayer is eligible for the benefit of 5% withholding tax rate on dividend income by virtue of the MFN clause in India-Netherlands tax treaty which relies on India's subsequent tax treaties with Slovenia, Lithuania and Columbia.

CNK Comments:

Relying on the above judgment, Delhi High Court in case of M/s Nestle SA (W.P. (C) 3243/2021) has granted benefit of lower tax rate of 5% on dividend income even under India – Switzerland tax treaty.

Since the dividend income is now taxable in the hands of recipient, aforesaid decision should help taxpayers of resident of Netherlands and Switzerland to apply lower tax rate of 5% on dividend income.

Foreign Nationals employed with and working exclusively for Indian Associated Enterprise do not constitute USA entity's supervisory or agency permanent establishment in India

Lubrizol Advanced Materials Inc [TS-433-ITAT-2021(Ahmedabad)]
(in favor of assessee)

Facts:

The assessee, was a company based in USA. Its Indian associated enterprise (Indian AE) was establishing a new manufacturing plant in India.

The assessee entered into an agreement with its Indian AE for providing engineering, technology, design and project supervisory service for the new plant, for a consideration of cost plus 10% mark-up. The assessee sent its personnel in India for supervision of the new plant. As per clause 5(2)(k) of the India-USA tax treaty, assessee considered that it has a supervisory permanent establishment (PE) in India and accordingly filed its tax return in India.

Since, Indian AE also required high skilled and experienced personnel, assessee deputed two foreign nationals (deputed personnel) to Indian AE, who were appointed as managing directors of Indian AE.

It was agreed between assessee and Indian AE that:

- these deputed personnel will be the employees of Indian AE and will work under the supervision and guidance of Indian AE.
- The Indian AE will pay salary to deputed personnel and bear the cost of all the benefit provided to them.
- Part of the salary will be paid in foreign currency to deputed personnel for the purpose of convenience but the quantum of same would be decided by India AE as per rules and regulation applicable in India.

Subsequently, Indian AE entered into employment agreement with each of the deputed personnel.

During the year, the assessee also sold some goods to its Indian AE, under a purchase agreement which was signed by the deputed personnel on behalf of Indian AE.

During scrutiny proceedings, the assessing officer (AO) observed that:

- Deputed Personnel were highly skilled, professional and specialized in supervising the growth and expansion of plant. These employees were working on different projects at different locations throughout the globe as employee of the assessee. Thus, these employees were working in supervising capacity on behalf of the assessee and constituted the part of the activities carried on with respect to supervisory PE in India.
- the deputed employees were working on behalf of the assessee in India and concluding sale contracts in India as agents of the assessee.

Based on the above observations, AO passed an order holding that the activities of deputed personnel working as Managing Directors of Indian AE, constituted both supervisory PE and dependent agent PE (DAPE) as per Article 5 of India-USA tax treaty.

Aggrieved, the assessee approached the dispute resolution panel (DRP). The DRP confirmed AO's order but held that only 10% markup on the salary shall be considered as income from supervisory PE as against the entire salary.

Aggrieved by the order of DRP, the assessee approached the Ahmedabad Tribunal and contended following:

- Deputed personnel were not the employees of the assessee and worked exclusively for Indian AE as Managing Directors and their salary was paid by Indian AE after deduction of Indian tax at source, for which Form 16 was issued.

- Deputed personnel signed the purchase agreement on behalf of the Indian AE in capacity of Managing Directors of the Indian AE. The conditions for constituting a DAPE were not satisfied as they were not working on behalf of the assessee, did not maintain any inventory on behalf of the assessee and the transaction was at arm's length price. Also, the sale of goods was carried out by the assessee itself, outside India.

Held:

The Ahmedabad Tribunal on perusal of relevant agreements and records held that:

- Supervisory PE
  - The deputed personnel were working exclusively for Indian AE which was substantiated by employment agreement and issue of Form 16.
  - The deputed personnel were working solely under control, direction, and supervision of Indian AE. Thus, their services cannot be attributable to the assessee's supervisory PE in India.

- DAPE
  - The transaction for purchase of goods was executed and completed outside India.
  - The risk and tittle of the goods were transferred outside India and payment was also made outside India.
  - Mere signing of purchase contract by deputed personnel in capacity of managing director of the Indian AE would not trigger any DAPE in India of the assessee
  - None of the conditions for forming DAPE in India is satisfied by the deputed personnel i.e. they are not concluding contracts, securing orders or maintaining stock of goods in India on behalf of the assessee.

Accordingly, the assessee did not have a DAPE in India.

CNK Comments:

While the decision is fact specific and does not refer / discuss any other precedents on the issue, it provides insight on what points are considered by authorities while determining PE in cases of deputation of expatriates to India. To mitigate PE risk, it is important that the deputation arrangements and agreements are carefully implemented and backed-up by robust documentation to demonstrate that in practice the expatriate employees are not employees of foreign companies working in India.

Limitation of benefits clause under India-UAE tax treaty cannot be invoked merely because majority stake and profits of UAE tax resident corporate entity were held by a Greek national

Interworld Shipping Agency LLC [TS-321-ITAT-2021(Mumbai)]
(in favor of assessee)

Facts:

The assessee is a limited company incorporated in, and tax resident of, the United Arab Emirates (UAE). It was engaged in the business of ship chartering, freight forwarding, sea cargo services and shipping line agents. The business of the assessee was managed and controlled from UAE by a Greek National who was resident in UAE for approximately 300 days in a year.

During the year under consideration, the assessee had claimed all its freight income from operation of ships in international traffic within India, as exempt from tax in India by applying Article 8 of the India-UAE treaty.

AO while passing an assessment order denied the benefit of Article 8 of India – UAE tax treaty by invoking Article 29 "Limitation of benefits" (LOB) on the following grounds:

- The assessee was a partnership firm and 80% of its profits went to a Greek national. Therefore, the business was not managed or controlled wholly from the UAE, as required under India-UAE tax treaty for determining tax residency of a company.
- Tax residency certificate (TRC) is necessary but not sufficient condition for the grant of treaty benefits.
- Since the owner was a Greek national, only purpose of the assessee was to avail of tax exemption under the India-UAE tax treaty which was a case of using a colourable device for the avoidance of taxes.
- Aggrieved by the order of the AO, the assessee filed its objections before the DRP, who confirmed the order of the AO with the following observations:
    - Since there is no tax in UAE, there is no double taxation of assessee's profits.
    - Except for TRC, nothing was provided to prove that the Greek national (who is the sole effective manager and controller of the assessee) was in UAE for more than 183 days to exercise management and control of the assessee.
    - No crucial documents such as minutes of meetings, board resolutions were provided.
    - Although the assessee company was incorporated in UAE, the assessee failed to demonstrate that its place of effective management (POEM) was in UAE.

    Aggrieved by the order of DRP, the assessee approached Mumbai Tribunal

Held:

- <u>Tax residency of assessee based on control and management in UAE</u>
    - Though during initial proceedings, the AO noted that the assessee was a partnership firm, based on the documents submitted by the assessee subsequently, the assessee was a company incorporated in UAE which was duly established by its license, memorandum and articles of association.
    - The assessee had fourteen expatriate employees who were issued work permits by the UAE Government for working in the assessee company. Thus, it was being run from UAE itself.
    - Passport of the Greek national and beneficial owner clearly established that he was in UAE for 300 days - thus it would be reasonable to assume that he would be running the business from UAE. The mere fact, that he was a non-UAE national, did not establish any adverse finding, as UAE is a major financial hub where many foreign nationals work
    - Even if the main director of a UAE company stays in UAE for 180 days or less, it is immaterial if there is nothing to show, or even indicate, that the business was not carried on from the UAE. The requirement for presence in UAE for 183 days in a year for tax residence under the tax treaty applies only for an individual assessee and not the directors of the corporate assessees..
    - The assessee company had its office in UAE, was in business there since 2000, had expatriate employees on a work permit in UAE to work for the assessee company and the main driving force of the company and its director was an expatriate resident in the UAE.
    - The assessee has provided reasonable evidence in support of the stand that the business was wholly and mainly controlled from the UAE. Hence, the assessee is a tax resident of UAE.

- <u>Applicability of LOB clause under Article 29 of India-UAE tax treaty</u>
    - LOB clause states that a UAE tax resident entity shall not be entitled to the benefits of the India-UAE tax treaty if the main purpose or one of the main purposes of the 'creation' of such entity was to obtain the benefits of the said tax treaty, that would not be otherwise available.[1] The cases of entities not having bonafide business activities shall be covered by the LOB clause.

- The assessee was formed in the year 2000, and the relevance of the India-UAE tax treaty in case of the assessee came into play in India only in 2015. Given this time period, it could not be said that the main purpose of 'creation' of such an entity was to obtain the benefits of the India-UAE tax treaty as envisaged under LOB clause of the said tax treaty.
- Once assessee has submitted reasonable evidence, including the evidence in support of the existence of an office, and dedicated employees, in the UAE and the business being carried on from there, it cannot be said that the business activities of the assessee lacked bonafides, unless the revenue authorities bring on record some material to dispute this position.

Thus, based on the above observations, it was held by the tribunal that the assessee company was a tax resident of the UAE and eligible to claim beneficial provisions of Article 8. The tax treaty benefit could not be denied by invoking provisions of Article 29 of India–UAE tax treaty merely because the company was beneficially owned by a Greek National.

CNK Comments:

As UAE does generally levy corporate tax, it is preferred by many multinational companies for setting up trading, shipping or service entities having transactions across the globe, including India. India-UAE tax treaty requires that a UAE tax resident company be managed and controlled wholly from the UAE. Hence, where a UAE company has non-UAE shareholders or directors, a question arises on tax residency of such UAE companies and their eligibility to claim benefits of India-UAE tax treaty in India. This decision will provide guidance to such UAE companies and also provide insight on interpretation of LOB clause under India-UAE tax treaty. It may be noted that the Principal Purpose Test (PPT) has now replaced the LOB clause in the India-UAE tax treaty. The PPT seeks to deny tax treaty benefit in cases where it is reasonable to conclude on facts and circumstances that one of the principal purposes of the transaction or arrangement was to take tax treaty benefits in India. Whether the rationale of the above decision in context of LOB clause would continue to hold good in case of PPT needs further analysis based on facts of the case.

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1 For context, it may be noted that shipping profits are not completely tax exempt under the India-Greece tax treaty. The LOB clause was inserted in India-UAE tax treaty in 2007 i.e. after incorporation of the assessee. However, these aspects have not been discussed in the decision.

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