Mumbai Tribunal rules on non-taxability of offshore commission income in the Credit Suisse case

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In a recent ruling, the Mumbai Bench of the Income-tax Appellate Tribunal (the "**Tribunal**") has held that commission income earned by a non-resident distributor of mutual fund schemes of an Indian company cannot be taxed in India, if all the business operations are carried out by the non-resident distributor outside India.

Background

Credit Suisse (Singapore) Limited (the "**Taxpayer**") is a tax resident of Singapore and entitled to the beneficial provisions of the India-Singapore double taxation avoidance agreement (the "**Singapore DTAA**"). The Taxpayer is registered as a Foreign Institutional Investor ("FII") with the Securities and Exchange Board of India (the "**SEBI**") and conducts portfolio investments in Indian securities. The Taxpayer and HDFC Asset Management Company Limited ("**HDFC India**") entered into an offshore distribution agreement (the "**Agreement**") dated September 6, 2011, pursuant to which the Taxpayer agreed to distribute mutual fund schemes launched by HDFC India to procure subscriptions from investors outside India.

During the assessment year 2014-15, the Taxpayer, *inter alia*, earned commission income of ~ INR163 million from HDFC India. This income was considered tax exempt in the tax return under Article 12 of the Singapore DTAA on the basis that the Taxpayer did not provide technology to HDFC India or make available any technical knowledge, experience, skill, know-how or process. Further, the Taxpayer submitted that even if the commission was regarded as business income of the Taxpayer in India, such income could not be taxed in India under Article 7 of the Singapore DTAA, because the Taxpayer did not have a permanent establishment in India. The tax assessing officer disagreed and held that the Taxpayer was carrying out distribution of HDFC India products controlled and regulated by the SEBI and the Reserve Bank of India, and hence, there was a business connection and/or sufficient nexus of the source of income to India, which made the income taxable in India. The Commissioner of Income-tax (Appeals) held that while the commission income was not in the nature of fees for technical services, it was in the nature of business income, but given that the Taxpayer did not have a permanent establishment in India, the commission income was not taxable in India. The tax department went in appeal to the Tribunal.

Decision of the Tribunal

Based on facts and an analysis of the submissions made by the Taxpayer, the Tribunal held that:

- Section 5(2) of the Income-tax Act, 1961 (the "**IT Act**") provides that the total income of a person who is a non-resident includes all income from whatever source derived, which is received or deemed to be received in India; or accrues or arises or is deemed to

accrue or arise in India to the assessee.

- Section 9 of the IT Act elaborates that all incomes accruing or arising, whether directly or indirectly, through or from:

  - any business connection in India,
  - any property in India,
  - any asset or source in India, or
  - the transfer of a capital asset situated in India

  shall be deemed to accrue or arise in India. Further, explanation 1 to section 9(1)(i) of the IT Act provides that in case of a business whose entire operations are not carried out in India, only such part of the income as is reasonably attributable to the operations carried out in India shall be deemed to accrue or arise in India.

- The Taxpayer being a distributing agent of HDFC India's products outside India did not carry on any business operations in India. The commission was earned purely for services rendered outside India (in Singapore), and therefore, it cannot be said by the tax officer that such income is reasonably attributable income because it neither accrued nor arose in India.

- The Tribunal followed the *Toshoku Ltd* case rendered by India's Supreme Court (follow this link for a copy of the decision) in which it was held that commission amounts earned by a non-resident for services rendered outside India cannot be deemed to be income that has accrued or arisen in India.

Our Comments

This Tribunal ruling is a welcome ruling for taxpayers engaged in litigation on similar issues. Having said that, the issue with respect to taxability of offshore services and income earned abroad has been a subject matter of debate before various Indian courts.

In the *Ishikawajima-Harima* case (our update on a similar article here), India's Supreme Court held that the concept of territorial nexus is fundamental in determining the taxability of any income in India. Thus, income from offshore services conducted outside India will not be taxable in India merely because the activities are rendered in relation to an Indian project. After this decision, explanations for the purposes of section 9(1)(v) of the IT Act (dealing with interest income), section 9(1)(vi) of the IT Act (dealing with royalty income) and section 9(1)(vii) of the IT (dealing with fees for technical services) were specifically added to provide that interest income, royalty income and fees for technical services of a non-resident shall be deemed to accrue or arise in India whether or not the non-resident has a residence, place of business or business connection in India, or whether the non-resident has rendered services in India.

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In the *Vodafone* case too (read more), the Supreme Court 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, the provisions of section 195 of the IT Act relating to tax withholding compliance obligations would not apply. In order to overcome the impact of the Supreme Court's decision, the Finance Act, 2012 amended section 9 of the IT Act 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 will be taxable in India. Further, section 195 of the IT 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 as yet been made with respect to commission income earned from services rendered outside India. In the circumstances, it is likely that the tax department may prefer an appeal before the Mumbai High Court against the Tribunal ruling.

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