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Article

Limitation of Benefits clause in the India Singapore DTAA - An analysis of recent decisions

By **Gayatri Sridharan**

The Mumbai Bench of the Income Tax Appellate Tribunal had occasion to examine the India Singapore Double Taxation treaty in a recent judgment in the case of *Citicorp Investment Bank (Singapore) Ltd* v. *Deputy Commissioner of Income Tax (International Taxation) Mumbai***.**

Brief facts of the case

Citicorp Investment Bank (Singapore) Ltd [CIBL] a tax resident of Singapore was registered as Foreign Institutional Investor (FII) in Debt segment, with Security and Exchange Board of India (SEBI). In its return of income for the Assessment Year 2010-11, CIBL declared a Capital Gain of Rs. 86,62,63,158/- on sale of debt instruments and claimed exemption under Article 13(4) of India-Singapore Double Taxation Avoidance Agreement (DTAA or Treaty). This claim was resisted by tax authorities citing the Article 24[1] on limitation of benefits ('LoB') in the said treaty. As per that Article if the exemption under the treaty is qua an income which is taxable in other state only on receipt of income in that state then the exemption shall be allowed only when remittance of such income has been made. The dispute in this case really centered around whether the income in question was taxable in Singapore on receipt basis or on accrual basis. CIBL relied on the confirmation letter/Certificate issued by IRAS which confirmed the taxability of global income in Singapore on accrual basis. The contention of CIBL was not accepted by Assessing Officer for the following reasons:

(i) In order to avail any benefit under the tax treaty, one is bound by the provisions of the Articles in the said treaty.

(ii) Though the provisions of Article 13(4) allow exemption of capital gains in the source country i.e. India, the provisions of Article 24 restrict exemption of such capital gains to the extent of repatriation of such income to the other country i.e Singapore.

(iii) Section 10(1) relating to charge of income tax under the Singapore Income Tax Act, also provides that income is taxed on receipt basis in Singapore when arising from outside Singapore. In fact, there was no such repatriation of said income reflected in the bank statement furnished.

The Assessing authority therefore disallowed the exemption claimed by assessee under Article 13(4) of the India-Singapore DTAA and treated the capital gains as taxable in India as per the draft assessment order and the Dispute Resolution Panel upheld the same.

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[1] **Article 24** , reads as follows

1. Where this Agreement provides (with or without other conditions) that income from sources in a Contracting State <u>shall be exempt from tax</u>, or <u>taxed at a reduced rate</u> in that Contracting State and under the laws in force in the other Contracting State the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under this Agreement in the first-mentioned Contracting State shall apply to so much of the income as is remitted to or received in that other Contracting State.

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On further appeal before the Income Tax Appellate Tribunal, the Tribunal following its earlier decisions [2] held

1. that the limitation prescribed under Article 24 of the Treaty is not applicable in the present case as the income earned by assessee on sale of debt instrument is not taxable in India as per Article 13(4) of Treaty.[3]
2. the capital gain earned in India, not being remitted to Singapore has no relevance

The Reasoning of the Tribunal

The Income Tax Appellate Tribunal had in an earlier case [4]observed as under

> *……. as in the case of Singapore, the treaty protection must remain confined to the amount which is actually subjected to tax. Any other approach could result in a situation in which an income, which is not subject matter of taxation in the residence jurisdiction, will anyway be available for treaty protection in the source country. It is in this background that the scope of LOB provision in Article 24 needs to be appreciated.*

The Tribunal, then followed a decision of the Gujarat High Court[5] wherein the Hon'ble High Court relied on the confirmation letter/Certificate issued by IRAS which confirmed the taxability of global shipping income in Singapore on accrual basis.

With reference to Article 24, the Tribunal held that the expression "**only** in that state" in Article 13.4 debars the other contracting state from taxing the income, that is, India is precluded from taxing the gains on alienation of debt instruments even if it is sourced from India. India does not have any taxation right on gains on alienation of debt instruments of non- resident entity, which is the exclusive domain of the resident state. Thus there is no question of any kind of exemption or reduced rate of taxation in the source state. There is no stipulation about exemption under Article 13.4 of the gains on alienation of debt instruments. Articles 20, 21 & 22 of the DTAA contains specific exemptions.

Some unanswered questions

Section 10(1) of the Income Tax Act of Singapore reads as follows;

> Charge of income tax
>
> **10.**— (1) Income tax shall, subject to the provisions of this Act, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from Singapore or <u>received in Singapore from outside Singapore in respect of—</u>
>
> (a)……………..;
>
> (b)…………
>
> (d)………………..
>
> (e)…………………………..;
>
> (f)rents, royalties, premiums <u>and any other profits arising from property</u>; and
>
> (g)<u>…………………………..</u>

The Tribunal has not discussed on what basis it treats such gains as Singapore Income [ostensibly the company being an investment company the gains are taxable as revenue by

[2] *SET Satellite Singapore Pte Ltd.* v. *ADIT* [M.A. No. 520 (Mum.) of 2010 dated 11-2-2010] (para 4) and in *APL Company Pte Ltd.* v. *ADIT* [2017] 78 taxmann.com 240 (Mum. -Trib)

[3] **Article 13(4)** which reads as follows;

13.4. Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of this Article <u>shall be taxable only in that</u> State.

[4] ***Alabra Shipping Pte Ltd. V. Income-tax Officer - International Taxation, Gandhidham**, **62 Taxmann.com 185***

[5] *CIT vs Venkatesh Karrier Ltd. reported in 349 ITR 124(Guj)*

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virtue of Section 10A of the Income Tax Act of Singapore]. It is not clear if the circular was issued under Section 10 or 10A.

Interestingly, as per the definition adopted by the BEPS committee in its final report in 2015 on Action Plan 6, the term "benefit" also includes limitations on the taxing rights of a contracting state over a capital gain derived from the alienation of movable property located in that state by a resident of the other state under Article 13. The fact that India does not have any right of taxation on gains on alienation of debt instruments of a non- resident entity, which is the exclusive domain of the resident state can be construed as a benefit.

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Notification & Circular

Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports signed by India comes into force

The Central Government has issued Notification No. 75/2017 dated 28th July 2017 to bring the Multilateral Competent Authority Agreement ('Agreement') on the Exchange of Country-by-Country Reports ('CbC Report') into force. The Agreement will come into effect in terms of Section 8 of the Agreement from the date of the signing of the Agreement i.e. 12th May 2016. The Agreement aims at increasing international tax transparency and improving access to global allocation of income, taxes paid and other economic activities of Multinational Enterprises ('MNE') through automatic exchange of annual CbC Reports with a view to assess transfer pricing and base-erosion risks with respect to MNE's.

The Agreement requires that the domestic laws of the signatories to such agreement should provide that the MNE's should file CbC Report. It is worth mentioning that the Finance Act, 2016 had inserted Section 286 to Income-tax Act, 1961 with effect from 1-4-2017 to mandate the MNE's and their constituent entities to file CbC Reports along with their Return of Income.

Section 2 of the Agreement mandates that the Competent Authorities (notified authorities of each jurisdiction) will automatically share CbC Reports received from each reporting entity in its jurisdiction including reports received from entities which are subject to tax in respect of its business carried out in its jurisdiction through a permanent establishment while Section 3 of the Agreement provides the time and manner exchange of information. Section 4 empowers the Competent Authority to notify another Competent Authority which will take appropriate measures to address the errors and incompleteness in the reports received. Section 5 provides that the information exchanged will be subject to confidentiality rules and other safeguards provided in the Agreement. Section 6 provides that the Competent Authorities of jurisdictions will consult each other in case the additions to total income of the Reporting Entity on the basis of the CbC Report leads to undesirable economic outcomes.

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TDS need not be deducted on the GST component - CBDT clarifies

By way of Circular No.23/2017 dated 19-7-2017, it has been clarified that since the rationale for excluding the tax component from purview of TDS continues to be valid, TDS need not be deducted on the component of Goods and Services Tax (GST) on Services. The Circular states that the earlier Circular No. 1/2014 which pertains to the clarification as regards service tax stands modified in this regard. According to the circular, wherever in terms of the agreement between the payer and the payee the component of GST on service comprised in the amount payable to a resident is indicated separately, tax may be deducted at source on the amount paid or payable without including GST. For purposes of deduction, GST will include CGST, SGST, IGST and UTGST.

Standard rate for granting stay of demand raised to 20% of disputed demand

CBDT vide Instruction No. 1914 dated. 21-3-1996 ("Instruction"), provided for procedure for recovery of outstanding demand, including procedure for grant of stay of demand. This Instruction was partially modified by the CBDT *vide* its Office Memorandum No. 404/72/93-ITCC dated 29-2-2016, wherein, *inter alia*, it was provided that where the outstanding demand is disputed by the assessee before the first appellate authority, the Assessing Officer shall grant stay of demand till disposal of first appeal on payment of 15% of the disputed demand, unless the case falls in category in para (B) of the Instruction which deals with cases where the administrative Pr. CIT/CIT will decide the quantum of demand to be paid. Now, *vide* the office memorandum dated 31-7-2017, the threshold rate for granting stay of demand has been increased to 20% of the disputed amount. However, other guidelines provided in Office Memorandum dated 29-02-2016 will continue to apply.

Ratio Decidendi

Bottling of LPG Gas in cylinders amounts to production

The issue in this case was whether bottling of LPG in cylinders amounts to manufacture for the purposes of eligibility to claim deduction under Section 80-HH, Section 80-I and Section 80IA of the Act. The Hon'ble Apex Court noted that aforesaid provisions use the expression manufacture or production and hence if the process amounts to either of these, the assessee would be entitled to benefits enshrined in those sections. Relying on the ruling in *Arihant Tiles and Marbles P Ltd* [2010] 320 ITR 79 (SC), the Apex Court noted that the term "production" is wider than the term "manufacture" and the interpretation in the context of *Central Excise Act* cannot be applied since the provisions relevant to the assessee under Income Tax Act covers even assessees who are engaged in the activity of production of goods. On the aspect of bottling of LPG, the Apex Court noted that the stages of activities involved in LPG bottling are: (i) receiving bulk LPG in the bottling plant through road tankers/rail wagons, (ii) unloading the LPG into spheres/bullets through compressors which use variable levels of pressure (iii)

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refilling/bottling of LPG in cylinders by compressing the same into liquid form (iv) capping, fixing of seals and safety valves prior to storage and loading of filled cylinders. The Court, thus opined that LPG obtained from refinery undergoes a complex technical process in the assessee's plant and is clearly distinguishable from the LPG bottled in cylinders and cleared from these plants for domestic use by customers. Hence, the activity falls within the ambit of production. Reliance was also placed on the definition of *manufacture of gas* in Rule 2(xxii) of the Gas Cylinders Rules, 2004 which treats gas distribution/bottling as manufacture or production of gas. [*CIT* v. *Hindustan Petroleum Corporation Ltd*., TS-314-SC-2017]

Onus on Revenue to establish that trading activity is carried out through LO in order to be considered a PE

Assessee, a non-resident had two projects and one liaison office in India. The assessee filed separate returns for the two projects. The department contended that the assessee liaison office was a PE as it helps them in finding new purchasers and sellers of goods and merchandise. Alternately the project offices should be treated as PE itself in terms of Indo-Japan DTAA. The High Court however observed that, before the CIT(A) Project Offices (POs) were treated as separate units and were brought to tax invoking Section 44BBB of Income Tax Act. The assessee had complied with the RBI conditions not to carry any trading, commercial or industrial activity from such LO, for over three decades. The High Court thus held that the mere fact that some expenses were attributable to the LO or that both the project offices and LO had a common manager was not sufficient to establish that the LO was being used to carry out the business of the enterprise. Thus, it held that the LO could not be construed as a permanent establishment. [*DIT* v. *Mitsui & Co. Ltd*., ITA 13/2005, Delhi High Court]

Capital Reserve on amalgamation not taxable as benefit or perquisite under Section 28(iv)

The assessee was amalgamated with its (100%) subsidiary. Since the amalgamation was accounted for under *'purchase method',* surplus of consideration over assets less liabilities was accounted for as '*capital reserve'* in the books of the assessee. This amount was sought to be taxed by the Assessing Officer under Section 28(iv) of the Income Tax Act. Following the decision of the jurisdictional High Court in *CIT* v. *Stads Ltd* [2015] 373 ITR 313, the Tribunal held that the said income was not taxable under Section 28(iv) since *reserves and surplus* cannot be treated as benefit or perquisite arising from business or profession and the transaction is question was of capital in nature.[*Sundaram Finance Ltd* v. *ACIT,* 2017-83 taxmann.com 133 (Tri-Che)].

Credit available to HUF for tax deducted on payments made in the name of Karta

The funds belonging to the Assessee being HUF were invested in RBI bonds in the name of the Karta, also quoting to the RBI, the PAN of the Karta. Tax was deducted in the name of the Karta and certificate was issued mentioning the Karta's PAN. The Hon'ble High Court referred to provisions of Section 199(3) of Income Tax Act and Rule 37BA of the IT Rules and noted that the statute itself permits credit to be granted to a

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person other than the deductee subject to three conditions, one of them being that an application is made to the deductor and a certificate is then issued in the name of the other person. The Hon'ble High Court opined that though this application could have been made to the RBI, from the provisions, it can be gathered that there is no dearth of power to grant credit of tax deducted at source in such a genuine case. It was further noted that this decision was given considering the lapse of time, the fact the HUF had offered income to tax and that the department had also accepted the same. The Hon'ble High Court specifically stated that the decision should not mean that the provisions of Rule 37BA with respect to declaration, etc., need not be complied. The High Court ordered credit to be allowed to HUF subject however to the Karta filing an affidavit that the investment was not made out of his own funds and that he not offered the income and he had not taken credit of the said tax. [*Naresh Bhavani Shah (HUF) v. CIT,* TS-296-HC-2017 (Guj)]

Payment for accessing database containing general information is not royalty

The assessee filed an application under Section 195(2) of the Income Tax Act, 1961, requesting the ITO to issue an order of NIL deduction of tax in respect of payments made to a Singaporean company for database access. The database maintained consisted of general information on share price, market, commodity price, currency exchange rate, etc. The assessee contended before the ITO that the payments are not in the nature of royalty as the payment are only in the nature of subscription fees and the information contained in the database are generally available. The ITO rejected the contention of the assessee and held the payment to be in the nature of Royalty and passed an order to withhold tax @ 20%, upon production of tax residency certificate, the TDS officer revised the order to withhold tax @ 10% as per the DTAA. The Tribunal held, on perusal of the master agreement between the Assessee and Thomson that payments are not in the nature of royalty since the database contains general information relating to share market which is neither relating to the provider's own experience, nor is it secret or undivulged information. There was no transfer of know-how or grant of any license for commercial exploitation. Placing reliance on the decision of the Hon'ble Delhi High court in the case of *DIT* v. *Infrasoft,* (2014) 264 CTR 329 wherein the Hon'ble Court dealt with the distinction between "copyrighted article" and "copyright" and it was held that in the present case the assessee only received access of "copyrighted material". Hence, appeal of assessee allowed. [*Mckinsey Knowledge Centre India Pvt Ltd* v. *ITO (TDS) Ward,* TS-285-ITAT-2017 (Del)]

Income credited directly to NRE account is not liable to tax in India if the services are rendered outside India

The assessee was a non-resident marine engineer who earned salary from two concerns, Great offshore limited and Bibby Ship Management (Singapore) Pte Ltd in the AY 2010-11. The Assessing officer added the above-mentioned amount as undisclosed income in scrutiny assessment. The issue before the Hon'ble High Court of Calcutta was whether the sum credited directly to the NRE account maintained by the Assessee in India is liable to

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taxation by virtue of Section 5 (2) (a) of the Income Tax Act, 1961. The Hon'ble High court by following the decision in the case of *Director of Income Tax (International Taxation)* v. *Prahlad Vijendra Rao* (IT Appeal No. 833 of 2009) and placing reliance on the Circular No. 13/2017 issued by CBDT held that income earned by the assessee for the services rendered outside India on a foreign ship shall not be included in the total income merely because the said salary has been credited in the NRE account maintained with an Indian bank by the seafarer. Hence, appeal was allowed in favour of Assessee. [*Sumana Bandyopadhyaya and Anr* v. *The Deputy Director of Income Tax (International Taxation*), TS-281-HC-2017 (Cal)] .

Forex gain on royalty or interest income received by a resident is taxable in India

The assessee, a public limited company derived income from business and from royalty and interest from a joint venture company in Malaysia. The assessee accounted the income by way of royalty and interest from the Malaysian Company on accrual basis. In the relevant assessment year the assessee received the royalty and interest which were accounted in earlier years on accrual basis. However, the assessee company received more than what was earlier accounted in Indian rupees due to difference in currency exchange rate. The Ld. AO treated the royalty and interest income as exempt as per India-Malaysia Double taxation avoidance agreement ('DTAA'). However, he did not agree with the contention of the assessee that the forex gain must also be treated as akin to royalty and interest income.

The contention of assessee that the treatment should not be met out differently because the assessee accounts as per mercantile system was not accepted by the Hon'ble High Court stating that even incase of cash system of accounting, though the income is recorded only on receipt, yet for the purposes of taxation the amount received from Malaysia would be split on account of royalty or interest income earned in Malaysia as one head of income and the income gain on account of exchange rate fluctuation as other head of income. Therefore, source of receipt is different and two fold.

As regards the contention of assessee that under Section 80HHC, amount gained on foreign exchange fluctuation is treated as part of export turnover and the same treatment must be given in the present case, the Hon'ble High Court held that Section 80HHC is a specific provision wherein it is specified that any gain or loss made on account to amounts in convertible foreign exchange is to be included as export turnover for the purposes of computing deduction. In the absence of specific provision, forex gain or loss will be brought to tax under the head, income from other sources. Thus the Hon'ble High Court held that the forex gain/loss would not bear the same character as royalty or interest income earned in Malaysia and it is taxable in India. [*Ballarpur Industries Ltd* v. *CIT, Nagpur,* TS-315-HC-2017(Bom)]

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News Nuggets

Mauritius signs the Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Sharing (“MLI Convention”)

The MLI Convention, which has been signed by 70 countries till 11th July 2017, inter alia, provides standards to counter treaty abuse and to improve dispute resolution mechanism. Mauritius signed the MLI on 5-7-2017. Tax treaties with 23 countries have been included by Mauritius as Covered Tax Agreements under MLI Convention and to be modified by the application of MLI Convention. However, it has excluded the Double Taxation Avoidance Agreement with India (“DTAA”) from its purview. On the other hand, India had signed the MLI Convention on 7th June 2017 and had included its DTAA with Mauritius as covered Tax Agreement under MLI. The MLI Convention provides for the minimum standards of Principal Purpose Test (PPT) which seeks to deny benefits in cases of treaty abuse cases. However, PPT is applicable to a tax treaty only if both countries agree.

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