India desk news alert

News Alert

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External Commercial Borrowing Policy – Liberalisation

Cross Border Borrowings in Foreign Exchange by Indian entities

The External Commercial Borrowing (ECB) policy is regularly reviewed by the Government of India in consultation with the Reserve Bank of India (RBI) to keep it aligned with the evolving macroeconomic situation, changing market conditions and sectoral requirements. To boost inflows and help corporates raise funds for projects, the Government and the RBI have eased norms on overseas borrowings for Indian companies. Pursuant to such review, the ECB policy has been partially modified.

Amendments to the ECB policy

RBI has made the following amendments in the ECB policy:

(i) Amendments for rupee expenditure and foreign currency expenditure borrowings

- ECB up to US$500 million per borrower per financial year would be permitted for Rupee expenditure and/or foreign currency expenditure for permissible end - uses under the Automatic Route.
- The requirement of minimum average maturity period of seven years for ECB of more than US$100 million for Rupee capital expenditure by the borrowers in the infrastructure sector has been dispensed with.
- In order to further develop the telecom sector in the country, payment for obtaining license/permit for 3G Spectrum will be considered an eligible end-use for the purpose of ECB.

(ii) Amendments for rupee expenditure and foreign currency expenditure borrowings

At present, ECB proceeds are required to be parked overseas until actual requirement in India, and such proceeds can be invested in the specified liquid assets. It has now been decided that henceforth the borrowers will be extended the flexibility to either keep these funds offshore as above or keep it with the overseas branches/subsidiaries of Indian banks abroad or to remit these funds to India for credit to their Rupee accounts with AD Category I banks in India, pending utilisation for permissible end-uses. However, the rupee funds will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

(iii) Increase in all-in-cost ceilings

Considering the increase in the cost of funds in the international markets, the all-in-cost ceilings on raising ECBs have been raised as under:

Average Maturity Period	All-in-Cost ceilings over 6 Months LIBOR*	
	Existing	Revised
Three years and up to five years	200bps	300bps
More than five years and up to seven years	350bps	500bps
More than seven years	450bps	
* for the respective currency of borrowing or applicable benchmark		

All-in-cost includes interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees.

All other aspects of the ECB guidelines remain unchanged.

The above amendments to the ECB policy will come into force with immediate effect.

Source: A.P. (DIR Series) Circular No. 26 dated October 22, 2008

Payment of ALP to Dependent Agent PE would extinguish tax liability of foreign enterprise

Background

The Mumbai High Court, in a landmark judgement dated 22 August 2008, has held that in the case of a foreign enterprise having an agent in India, if correct arm's length price is applied and paid, then the foreign enterprise will not need to be taxed. While deciding so, the Mumbai High Court relied on the Supreme Court judgement in the case of Morgan Stanley & Co.[1] This case is expected to have far reaching implications.

The issue of whether a foreign company having an agency permanent establishment (PE) in a host country is taxable in that country where it has remunerated the dependent agent on an arm's length basis has been hotly debated. The crux of this debate lies in the wordings of Article 7(2) of Tax Treaties and the taxpayers and tax authorities' contradictory views of its interpretation.

Interestingly, the Organization for Economic Cooperation and Development (OECD) has adopted the view that mere arm's length payment by a foreign enterprise to its dependent agent carrying out significant functions in the host country does not necessarily lead to extinguishment of the tax liability of the foreign enterprise in the host country.

Key facts of the case

The assessee, a foreign telecasting company, is a tax resident in Singapore. It is engaged in the business of broadcasting various television channels, inter alia, into the Indian territory from Singapore. It had appointed an agent in India, to market the advertisement airtime slots to various advertisers in India.

The agent constituted a Dependent Agent PE (DAPE) (i.e. Agency PE) of the assessee in India. The services of the agent were remunerated by the assessee at arm's length price.

The assessee took a stand that since it had paid an arm's length remuneration to the dependent agent, it extinguished its tax liability in India. The Commissioner of Income tax (Appeals) [CIT(A)] decided the matter in favour of the assessee. However, the CIT(A) held that since the assessee had itself offered the income to tax in its Tax Return, there was no reason to interfere with the income offered by the assessee.

In an appeal filed before the Tribunal, it was held[2] that a dependent agent is distinct and separate from a DAPE and accordingly, the dependent agent and the DAPE are to be treated as two distinct taxable units. The Tribunal held that that mere payment of arm's length remuneration to the dependent agent does not extinguish the tax liability of the assessee in India. While arriving at this conclusion, the Tribunal consented with the view expressed by the Australian Tax Office and the OECD Report that payment of arm's length remuneration to a dependent agent does not necessarily extinguish the tax liability of the non-resident in the host country.

An appeal was filed by the assessee before the High Court against the order of the Tribunal.

Issues before the High Court

The following issues arose for consideration of the High Court:

- Whether having taxed the agent on the fair value of the activities in India, the same could be taxed all over again in the hands of the assessee as being income attributable to the deemed permanent establishment?

- Whether the assessee is debarred from contending that its income is not liable to tax as per the law, solely on account of the fact that without prejudice to such contention, it had offered the income in its Tax Return?

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[1] DIT v. Morgan Stanley & Co. [2007] 292 ITR 416 (SC)
[2] DDIT v. SET Satellite (Singapore) Pte. Ltd. (2007) 106 ITD 175 (Mum)

Payment of ALP to Dependent Agent PE would extinguish tax liability of foreign enterprise *(continued)*

Assessee's contentions

The assessee contended that as per Article 7(2) of the India-Singapore Tax Treaty ('the Treaty'), the profits attributable to the PE are the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a PE. This corresponds to the arm's length principle. Accordingly, the assessee argued that since the dependent agent has been remunerated on arm's length basis, it extinguishes the tax liability of the assessee in India.

In support of the above proposition, the assessee relied upon the decision of the Supreme Court in the case of **Morgan Stanley & Co. Inc.** (supra), which has accepted the principle that payment of arm's length remuneration to an associated enterprise (which also constitutes PE) would extinguish the tax liability of the foreign enterprise in India.

Revenue's contentions

The Tax Department relied upon the Tribunal decision and argued that the compensation payable to the dependent agent represents only remuneration for the services rendered by it and does not take into account the profit or any part thereof, arising to its nonresident principal based on the functions performed, risks assumed and assets used. If the dependent agent performs functions on behalf of the foreign principal that causes attribution of risks or assets of foreign principal to host country, profits (or losses) may be attributed to DAPE in the host country based on those assets used, risk assumed and functions performed.

As to the decision of the Supreme Court in the case of Morgan Stanley (supra), it was argued that the decision would not have the effect of setting aside the order of the Tribunal in the case of the assessee.

High Court Ruling

Considering the provisions of Circular No. 23[3], Circular No. 742[4], Article 7 of the Tax Treaty and the order of the Supreme Court in the case of Morgan Stanley & Co. Inc., the High Court held as under:

- If the correct arm's length price is applied and paid, then nothing further would be left to be taxed in the hands of the Foreign Enterprise.
- Having regard to the CBDT Circular No. 742[4], it would be fair and reasonable that the taxable income of the foreign telecasting company is computed at 10% of the gross profits. In the instant case, so far as marketing services are concerned, by the arm's length principle, what has been paid is more than 10%.
- The CBDT Circular No. 23 read with Article 7(1) would result in holding that the advertisement revenues received by the assessee are not taxable in India as long as the Treaty and the Circular stands.
- Merely because tax on income was paid for some assessment years, it would not stop the assessee from contending that its income is not liable to tax.

Conclusion

After the decision of the Supreme Court in the case of Morgan Stanley, this is a welcome decision of the High Court accepting the principle that payment of arm's length remuneration to dependent agent in India would extinguish the tax liability of the foreign enterprise in India.

This judgment will have far reaching implications vis-à-vis foreign enterprises carrying on business in India through agents or associated enterprises constituting PE and would provide much needed certainty and relief to the tax payers.

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[3] Circular No 23 / 1969 dated July 23, 1969
[4] Circular No 742 / 1996 dated May 2, 1996 - 132 CTR (St.) 9

For further information, please contact PricewaterhouseCoopers' India Desk in Singapore.

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