India:
AAR ruling provides some comfort to foreign companies concerned about Minimum Alternate Tax liability

In a ruling dated 23 July 2010, India's Authority for Advance Rulings (AAR) confirmed that the Minimum Alternate Tax (MAT) is not applicable to a foreign company that has no presence or permanent establishment (PE) in India (*Timken Company* (AAR No. 836/2009)). The AAR reached a similar conclusion in another ruling issued that same day (*Praxair Pacific Limited* (AAR No. 855/2009)).

The MAT was introduced in India to ensure that certain profitable, dividend-declaring companies that benefit from various incentives and exemptions under the tax rules still contribute a minimum tax (as a fixed percentage of book profits) to the exchequer. Under section 115JB of the Income-tax Act, 1961 (ITA), a company is liable to MAT if the tax payable under the normal provisions of the ITA is less than 18% of its book profits. If MAT applies, the tax payable will be 18% of book profits. For the purpose of determining book profits, a profit and loss account must be prepared in accordance with Parts II and III of Schedule VI of the Indian Companies Act, 1956. The accounting policies and standards adopted for preparing the annual accounts should be the same as those adopted by the company at its annual general meeting in accordance with section 210 of the Companies Act.

The applicability of MAT to foreign companies has long been a controversial issue. Because MAT liability is computed as a percentage of book profits determined by reference to a profit and loss account drawn up in accordance with section 210 of the Companies Act, a question arises as to whether a foreign company, which evidently does not prepare accounts in accordance with section 210, is liable for MAT. If the tax were to apply, the consequence would be that every foreign company would be required to compile its financial accounts in accordance with the Companies Act, 1956.

Facts of the case

The ruling involved a U.S.-based applicant (Timken US) that holds a significant equity stake in Timken India, an Indian company listed on the Bombay stock exchange. As part of a global restructuring plan, Timken US has proposed transferring via the stock exchange its stake in Timken India, which it has held for more than 12 months, to another group company in Mauritius. Timken US has taken the position that any capital gains arising from the proposed transaction would qualify for an exemption from withholding tax under ITA section 195 because Timken US does not have a presence or a PE in India and that an exemption from the Securities Transfer Tax (in ITA section 10(38)) also would be available. Timken US sought a ruling from the AAR on whether the MAT provisions in the ITA are applicable to foreign companies that have no physical business presence in India.

Although, the actual language of ITA section 115JB refers to "an assessee, being a company" and "[e]very assessee, being a company," and section 2(17) defines a "company" as including "(ii) any body corporate incorporated by or under the laws of a country outside India," Timken US argued that, taking into account the intent of the MAT provisions, MAT should apply only to Indian, and not to foreign, companies.

Timken US argued that the definition of "company" under ITA section 2(17) is qualified by the phrase "unless the context otherwise requires." Given that a foreign company without a PE in India is not required to draw up financial statements (upon which a determination of MAT liability is dependent) for Indian-source income in accordance with Schedule VI of the Companies Act, 1956, or to hold annual general meetings, the MAT provisions cannot be intended to apply to foreign companies. In support of this proposition, Timken US relied on speeches made by the Finance Minister to Parliament, the legislative history of the MAT (e.g. Notes on Clauses, a Memorandum explaining the provisions of the relevant Finance Bill) and various circulars issued by the tax authorities making it clear that the MAT is a levy on domestic companies.

The Indian tax authorities, on the other hand, argued that there was no basis for excluding Timken US from the MAT because ITA section 115JB does not distinguish between an Indian company and a foreign company. Also, Indian tax law does not preclude Timken US from preparing Indian financial statements in accordance with the Companies Act or from computing its book profit.

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Ruling of the AAR

The AAR concluded that the MAT is not applicable to a foreign company that has no presence or PE in India. In reaching this conclusion, the AAR made it clear that the definition of a "company" in ITA section 2 must be read in conjunction with section 115JB, since every clause of a statute must be construed with reference to the context of other clauses to ensure a consistent interpretation of that statute. On this basis, the AAR ruled that section 115JB is not designed to apply to a foreign company that has no presence or PE in India. Since a foreign company's annual accounts cannot be prepared in respect of its worldwide income applying the accounting policies and standards as adopted at the annual general meeting in accordance with the provision of section 210 of the Companies Act, the MAT provisions should not automatically apply to every foreign company.

The AAR distinguished a previous ruling in which it held that MAT applies to foreign companies. In the case addressed in that ruling, however, the applicant was carrying on business and had a PE in India. Foreign companies that have an established place of business in India are required to prepare balance sheets and profit and loss accounts under section 591 of the Companies Act for MAT purposes.

Comments

Although the AAR clarified to a certain extent the non-applicability of the MAT to foreign companies, there still may be situations where liability to MAT may be triggered for foreign companies:

- Presumptive provisions in Indian tax law deem the income of a nonresident to be a certain percentage of gross receipts. For example, ITA section 44BB presumes the income of a nonresident from the exploration, exploitation, etc., of mineral oils to be 10% of receipts. Under section 44BB, an assessee claiming profits and gains lower than the deemed 10% of receipts may opt to be taxed on such lower profits if it keeps and maintains books of account, has them audited and furnishes an accountant's report. As a result of these reporting obligations, a foreign company governed by the presumptive tax mechanism may not be precluded from liability to the MAT.
- As noted above, the AAR has held that the MAT is applicable to a foreign company that has a presence in India. According to the ITA, a business connection involves a relation between a business carried on by a nonresident that yields profits or gains and some activity that contributes to the earning of such profits or gains being taxable in India. The concept of a business connection in India could expose a foreign company to having a presence in India. A question may arise as to whether a foreign company that has a "business connection" in India would fall within the scope of the MAT. Based on the ruling of the AAR, it is possible to argue that the MAT provisions would apply only if a foreign company has a place of business in India.
- Under some of India's tax treaties, a service PE can arise where personnel are seconded to India for a certain period of time. In that case, the foreign seconding company could be said to have a presence or PE in India and could be liable to the MAT.
- An issue may arise as to whether the MAT would apply to a liaison office (LO) that merely carries out specified non-commercial activities. While an LO generally does not constitute a PE in India, if an LO is determined to have created a PE in India, it could be argued that the MAT provisions would apply even though under the Companies Act an LO is required only to prepare a statement of receipts and payments and a statement of assets and liabilities rather than a profit and loss account and balance sheet.
- A foreign company will be deemed to have a PE in India in certain situations, for example, if it carries on its business in India through a dependent agent. In such cases, the agent is required to comply with the filing of annual accounts in section 592 of the Companies Act, 1956. Thus, a foreign company that has a dependent agency PE in India could fall within the scope of the MAT.

Ultimately, it is clear that the crucial factor is whether a foreign company's activities relative to India fall within the scope of "a place of business." Although further clarification may be required as regards applicability of the MAT to foreign companies, the AAR's conclusion that a foreign company that has no presence or a PE in India is outside the scope of MAT still will benefit foreign companies that derive income from India but have no presence in India, such as foreign institutional investors earning income in India from dealing in securities on the Indian stock market.

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— Sunil Shah (Mumbai)
Partner
Deloitte Haskins & Sells
sunilshah@deloitte.com

Julius Cardozo (Mumbai)
Manager
Deloitte Haskins & Sells
jcardozo@deloitte.com

Shailendra Sharma (Mumbai)
Manager
Deloitte Haskins & Sells
shailsharma@deloitte.com

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