

TAX FLASH NEWS

Interest on tax refund is taxable as business income under the India-U.K. tax treaty since it is effectively connected with a PE in India. Section 44BB of the Income-tax Act dealing with the business of exploration etc. of mineral oil is not applicable to interest on tax refund

Background

Recently, the Uttarakhand High Court (High Court) in the case of B.J. Services Company Middle East Limited¹ (the taxpayer) held that the interest earned on income tax refund is taxable as business income under the India-U.K. tax treaty (tax treaty) since the debt claim in respect of which interest is paid, is effectively connected² with a Permanent Establishment (PE) in India.

The High Court also held that Section 44BB of the Income-tax Act, 1961 (the Act) is not applicable to interest on income tax refund since the amount of such interest is not on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire in the prospecting for, or extraction or production of mineral oils.

Facts of the case

- The taxpayer, a non-resident company, is engaged in the business of oil exploration. During the year under consideration, the taxpayer received interest on income tax refund. The tax refund was in respect of excess tax paid on behalf of the employees of the taxpayer.

- The taxpayer computed tax on such tax refund at the rate of 15 per cent under Article 12 of the tax treaty. However, the Assessing Officer (AO) treated such interest as business income and assessed that under Article 12(6)³ of the tax treaty.
- The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal (the Tribunal) upheld the order of the AO.

High Court's ruling

Taxability of interest under the tax treaty

- In the present case, the interest received in India can be taxed in England. However, Article 12(2) of the tax treaty provides that the said interest can also be taxed in India as tax was paid by the Government of India on the excess tax paid on behalf of the taxpayer's employees.
- If there was no other provision for taxability of interest on tax refund, the taxpayer would be justified in offering 15 per cent to taxation. However, on perusal of Article 12(6) of the tax treaty, it indicates that provisions of Article 12(1)⁴ will not apply, if the beneficial owner of interest is a resident of the contracting state which carries on business in another contracting state (in India) in which the interest arises through a PE situated therein.

¹ B.J. Services Company Middle East Limited v. ACIT (Income Tax Appeal No. 01 of 2010) –Taxsutra.com

² As per Article 12(6) of the India-U.K. tax treaty

³ The provisions of paragraphs 1, 2 and 3(a) of this Article shall not apply if the beneficial owner of the interest, being a resident of a contracting state, carries on business in the other contracting state in which the interest arises through a permanent establishment situated therein, or performs in that other state independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be shall apply.

⁴ Which provides beneficial rate of 15 per cent

- It was not disputed by the taxpayer that it was carrying on business through a PE in India. Since the word 'or' figures immediately thereafter, the High Court did not refer to other provisions as the requirement of the Article 12(6) of the tax treaty are fulfilled in this case.
- In the present case, the taxpayer paid excess tax on behalf of its employees. The AO, after assessment, apparently has ordered a refund. There was a delay and interest was paid under the Act at the statutory rate fixed. Therefore, there arises a debt claim, and the interest is effectively connected with the PE on fixed rates.
- Accordingly, Article 12(6) of the tax treaty which provides that the provisions of Article 7, which relate to business profits, or Article 15 (Independent personal services) of the tax treaty shall apply to the facts of the present case.
- Accordingly, it has been held that the income has to be assessed as business profits, and the rate of tax is 48 per cent.
- In the present case the words 'in connection with' are relatable to the provision of services and facilities of supply of plant and machinery. It will be impermissible being too farfetched to include the amount received from the income tax department as falling within the same.

Our comments

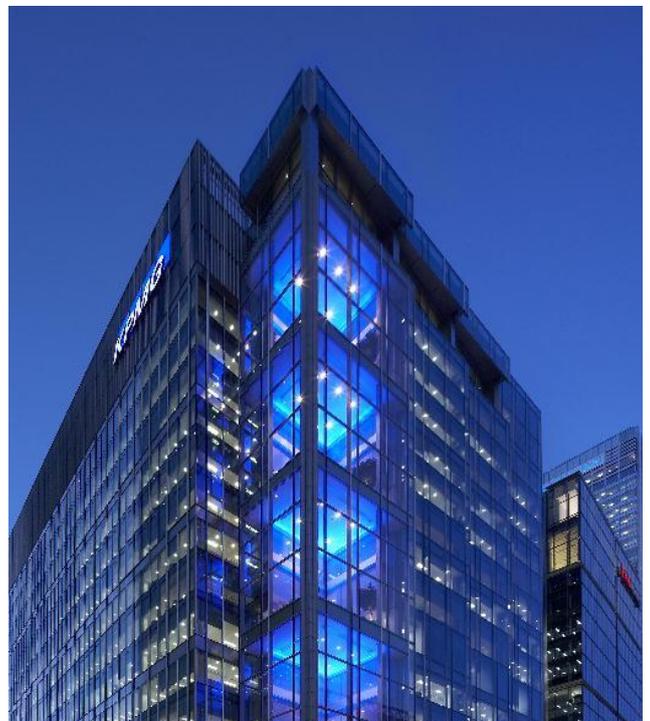
The Uttarakhand High Court in the present case has held that interest earned on tax refund is taxable as business income under the India-U.K. tax treaty since the debt claim in respect of which interest is paid, is effectively connected with a PE in India.

The Special Bench of the Delhi Tribunal in the case of Clough Engineering Ltd⁵ had held that interest on tax refund earned by a tax resident of Australia in India could not be treated as business income under Article VII of the India-Australia tax treaty since such refund was not effectively connected with the PE of the taxpayer either on the basis of asset test or activity test. Accordingly, it was held that such interest was taxable at a concessional rate of 15 per cent under Article XI(2) of the tax treaty.

The Uttarakhand High Court has also held that Section 44BB of the Act is not applicable to such interest since the amount of such interest is not on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire in the prospecting for, or extraction or production of mineral oils.

Taxability of interest under Section 44BB of the Act

- Section 44BB(2) of the Act provides for the method of computing the amount for the purpose of arriving at the profits from the business of extraction or production of mineral oil. It provides for including all amounts paid or which are payable (whether in India or outside India) to the taxpayer or to any person on its behalf. To this extent, the taxpayer is covered by the same and it has also been assessed in regard to other income also.
- The said Section further provides that the payment must be on account of the provision of services and facilities in connection with supply of plant and machinery on hire used, or to be used, in the prospecting for or extraction of mineral oil in India. In the present case, it cannot be held that the amount of interest paid by the tax department is on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.
- There is no provision which provides as to who is to make the payment to the non-resident and which is to be included. In other words, any payment by the tax department as such is not expressly excluded.
- On perusal of Section 44BB(2)(a) of the Act, what is contemplated is only the payments received actually or payable account of the provision of services and facilities in connection with, or supplying plant and machinery on hire used, or to be used.



⁵ ACIT v. Clough Engineering Ltd. [2011] 11 taxmann.com 70 (Delhi)

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2015 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International Cooperative ("KPMG International").

This document is meant for e-communications only.