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By

SBS and Company LLP
Chartered Accountants

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Dear Readers,

Greetings for the season!

In this edition, we bring you, an article on the recent judgment of Honourable Madras High Court in the matter of Greenwood Owners Association, wherein the High Court has turned down the plea of tax authorities that the exemption notification has to be construed in a different manner than desired. This judgment brings a respite to the Resident Welfare Associations, who are often got caught up on what amounts tax has to be paid. This judgment brings more clarity and certainty.

The next article ison the recent judgment of Honourable Mumbai Tribunal in the matter of Morgan Stanley, where the tax treaties are called for interpretation. In his excellent analysis, Mr Pramod Kumar, has held that the treaty can be applied even though the resident of contracting state is not making the payment of income, as long as the income is subjected to tax in that state.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Founder & Chairman

INTERNATIONAL TAXATION

PAYMENT OF INCOME VS. TREATY PROTECTION - MORGAN STANELY - CLASSIC CASE OF TREATY INTERPRETATION OF DTAA

Contributed by CA Sri Harsha

In this article, we get to one of the recent interesting judgment in the arena of international taxation. The judgment is authored by Honourable Vice President, Mr Pramod Kumar of Mumbai ITAT[1] . As a student and learner of International Taxation, I would never miss reading a judgment of Mr Pramod Kumar. The way he interprets the law, the vast knowledge he possess and adequate application to the facts of the case, is no match. Let us proceed to understand the facts in the matter of Morgan Stanley Mauritius Co Limited vs. Deputy Commissioner of Income Tax, International Taxation Circle, 3(2)(2), Mumbai [2].

Morgan Stanely Mauritius Co Limited (for brevity 'MS - Mauritius') is a company incorporated and fiscally domiciled in Mauritius and has a tax residency certificate issued by Mauritius Revenue Authorities. The assessee is an investor in Indian Depository Receipts (for brevity 'IDR') issued by Standard Chartered Bank – Indian Branch (for brevity 'SCB – India'). The underlying assets of IDRs are the shares of Standard Chartered Bank Plc (for brevity 'SCB -UK'), held by the custodian Bank of New York (for brevity 'BNY-US'). SCB – UK is listed on London Stock Exchange and the IDRs so issued are listed on Indian Stock Exchange.

MS - Mauritius has received Rs 9,74,66,595 as dividend from SCB-India, in respect of dividends for the underlying shares relatable to IDRs in which the investment is made. The Assessing Officer (for brevity 'AO') was of the opinion that since the dividends were received by MS - Mauritius in India, the same would be deemed to accrue or arise in India and accordingly be subjected to tax in India. However, MS – Mauritius contended that just because the dividends are received in a bank account maintained in India, that alone, would not trigger taxation in India and the dividends were received outside India and thereby no income could be said to be accrued or arisen or deemed to accrue or arise in India. Further, MS – Mauritius has also contended that the right article in the current set of facts is Article 22 and not Article 10 of Indo-Mauritius Double Taxation Avoidance Arrangement (for brevity 'DTAA'). Accordingly, the AO has passed an order confirming the demand of tax @ 20% under Section 115A(1)(a) of Income Tax Act, 1961 (for brevity 'ITA').

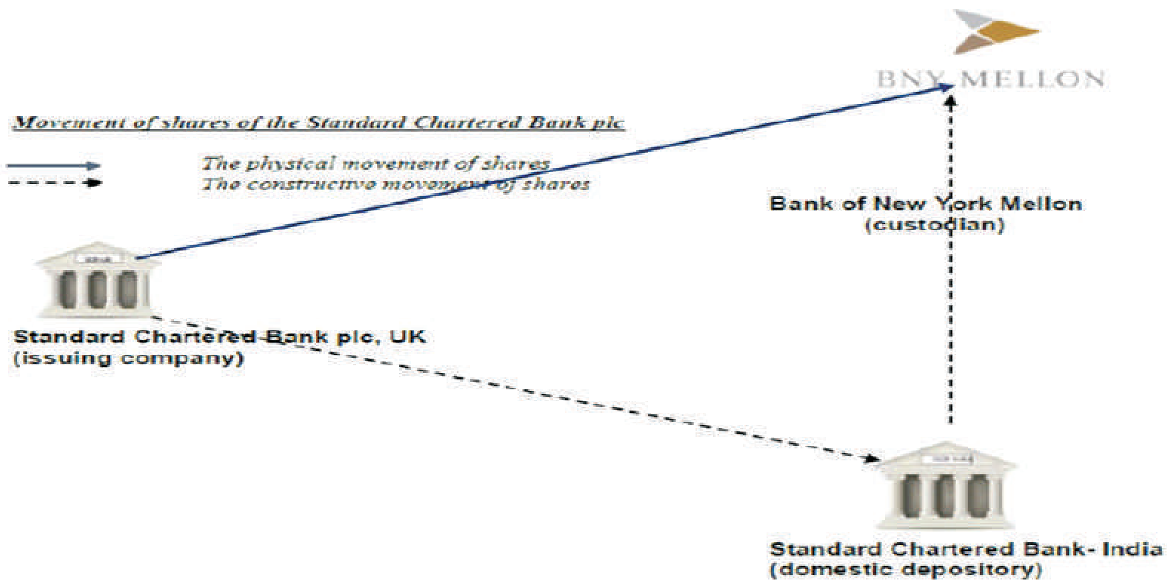
The main question that fell before the Honourable Tribunal is that, whether the dividends were received outside India and accordingly falling out of Section 9 of ITA and the appropriate article in terms of DTAA is Article 22 instead of Article 10?Now, let us proceed to understand, as to how the Tribunal analysed the above issue.

The Tribunal started with the understanding of IDRs, stating that IDR is a derivative financial instrument, i.e., a financial instrument that draws its value from the underlying asset and is tradable on or more approved stock exchanges. While the financial instrument, tradable in one or more of Indian Stock Exchanges, when issued by Indian Depository, the IDRs derive their value from the underlying asset in form of Equity Shares of a foreign company. Hence, the benefits accruing from the shares in question are, subject to the terms on which Depository issues IDRs are passed on to the IDR holders, and, in that sense, the IDR holders are beneficiaries of the underlying shares of foreign company. The Tribunal after making specific references to Companies (Issuance of Depository Receipts) Rules, 2004, stated that an IDR is an

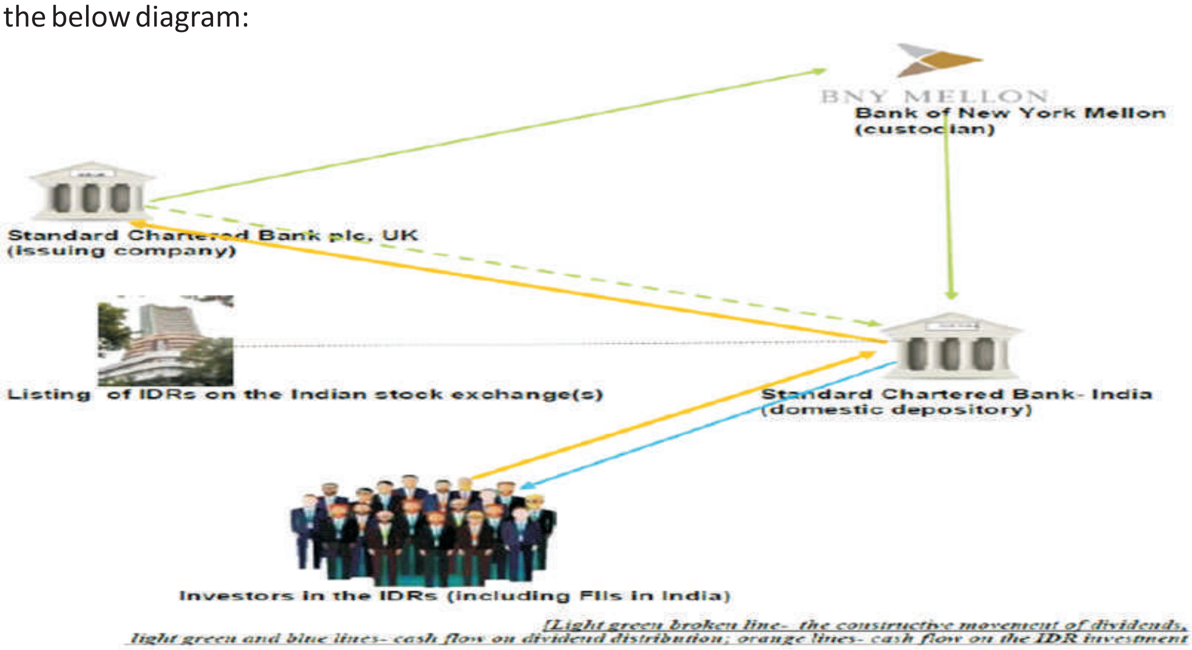
[1]Income Tax Appellate Tribunal

[2]2021 (5) TMI 968 – ITAT Mumbai

instrument issued by a custodian of underlying shares of foreign company, registered with Securities Exchange Board of India (for brevity 'SEBI'), and authorised by the foreign company in this respect. The said instrument is to be denominated in Indian Rupee, listed on or more stock exchanges and the money raised through the IDRs can be repatriated to the foreign company, as may be permissible under Foreign Exchange Management Act, 1999 and the IDRs can be freely tradable. Thus, the IDRs are means to tapping of India Investor market by the foreign companies, only difference being, that the investor would not be subscribing to the share capital of foreign company and the IDR holders cannot be said to be shareholders of foreign company (unless the IDRs are converted into Equity after a prescribed time period). Further, the foreign company issues the equity shares to the domestic depository on strength of which IDRs were issued, the equity shares would never reach the domestic depository and instead reach the custodian. The custodian actually holds the shares on behalf of domestic depository, which itself is the trustee of the issuing company. The Tribunal has explained the above through a diagram as under:



The flow of dividend, which is the subject matter of the current issue, is also explained by the Tribunal in form of the below diagram:



From the above, it is evident that the dividend physically flows from SCB – UK to BNY and then to SCB – India, since BNY is just a custodian and the shares are actually held by SCB – India. Further, on receipt of such dividend by SCB – India, as per the terms of agreements with IDR holders, the dividend gets distributed. This also gains strength from Rule 12 of Companies (Issuance of Indian Depository Receipts) Rules, 2004, wherein it states that on receipt of dividend or other corporate actions on the IDRs as specified in the agreement between the issuing company and the domestic depository, the domestic company shall distribute them to the IDRs in proportion to their holding of the IDRs. **The Tribunal made an important observation, which lays down the foundation for the entire adjudication of the litigation by stating that, the IDR holders are not entitled to the benefits of the shareholding related to IDR, and to the extent, they are entitled to get proportionate amount of cash dividends, as much as of any other receipts by the depository in respect of the equity shares of the foreign company, received by SCB – India.**

The issue before Tribunal is that, when is the amount, so distributed to IDR holders on account of dividend receipts, can be said to be received in the hands of IDR holders:

- at the point of time when the amount is received by BNY outside India, on behalf of SCB – India or
- at the point of time when the amount is received by IDR holders in India from SCB – India

The response to the above is critical and the moot point of the entire discussion. If the dividend is said to be received by IDR holders, that is, MS – Mauritius, at the time the same was received by BNY, then the dividend is out of scope of taxation. On the other hand, if the dividend is said to be received by MS – Mauritius at the time when the same is declared by SBC – India, on their receipt from BNY, then there would be a chance to say that the dividend has accrued or arisen or deemed to accrue or arise in India. Let us proceed to see, how the Tribunal tackled the subject issue.

MS – Mauritius's plea is that, since SCB – India is acting as a bare trustee, the dividend declared by SCB – UK is deemed to be received by MS – Mauritius, when the same was received by custodian, BNY. The subsequent physical cash flow cannot be used to interpret that the dividend is received in India. Since the income which can be taxed in the hands of MS – Mauritius, is only which is falling under the scope mentioned in Section 5(2) and the subject dividend, being received outside India, the same would not be taxable in India. They have also pleaded that in terms of Section 9(1)(iv), the dividend paid by Indian Company outside India shall be deemed to be an income accruing or arising in India, but since, in the instant case, the dividend is declared by foreign company, the said provision does not apply.

However, the Tribunal has not accepted the above arguments by stating that BNY is only a custodian and the shares are actually owned by SCB – India. Hence, any receipt of amount from SCB – UK by BNY is only in the capacity of custodian of SCB – India. The Tribunal stated that SCB – India is Indian depository of the underlying shares in question, the IDRs, in respect of which dividend is received, are issued by SCB – India. Hence, in terms of Section 9(1)(i), all incomes accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any assets or source of income in India, will be deemed to accrue or arise in India, and accordingly, the dividends declared has a clear connection with the property, the shares of SCB – UK, though held by the custodian BNY. The Tribunal stated that, the subject income is not a dividend simplicitor from a foreign company. It has a clear, significant, and crucial business connection with India. The Tribunal further confirmed that, just because a dividend income other than that from an Indian company, which cannot be taxed in Section 9(1)(iv), it cannot escape the rigour of Section 9(1)(i). Further, the Tribunal stated that what is received by MS – Mauritius is the net dividend amount as declared by SCB – India and not the dividend of foreign company, despite of the fact that dividend declared by SCB – India could be and indeed is, on the basis of dividend declared by SCB – UK , but then what MS – Mauritius is entitled to are the benefits flowing from the shareholdings in SCB – UK as an underlying asset of IDRs. What is rightfully due to MS – Mauritius in income character is the net amount received from Indian Depository and not the dividend simplicitor as declared by SCB – UK. Hence, the income accrues to IDR holder, MS – Mauritius at the point of time when the Indian depository works out the amount payable to IDR holders and then pays it accordingly. The point of time when income accrues to IDR holder is when the Indian depository declares the outgo and is received when the Indian depository pays the money. The Tribunal further not accepted the plea that SCB – India is a bare trustee by stating that if BNY was acting as bare trustee, then the dividend may be said to be received outside India. Since, that was not the facts of the subject matter, the plea that SCB – India acts as a bare trustee is not accepted by Tribunal. Accordingly, the Tribunal concluded that dividends received by MS – Mauritius are deemed to accrue or arise in India in terms of Section 9(1)(I).

The pleas put forward by MS – Mauritius in the context of DTAA are in fact the basis for coming up with this article. MS – Mauritius has taken a plea that, since they are tax resident of Mauritius, Article 10 comes into play only when one of the residents of contracting state, India or Mauritius pays the dividend. However, in the instant case, the dividend was declared by SCB – India, which is a branch of SCB – UK, the dividend declared by the former, does not fall under the scope of Article 10. Since the same does not fall under Article 10, the taxing rights have to be determined based on Article 22, which states that income is taxable only in the state of residence, that is Mauritius.

The Tribunal has accepted the above plea of MS – Mauritius. In coming to the said conclusion, the Tribunal held that what the treaty protects is the taxes covered in Article 2 and thus the fact of these tax levies in India which are sought to be protected by the treaty. ***The Tribunal held as under:***

As to who made the payment of income in question, i.e., a resident of the other contracting state or any other person, is not relevant so far as the treaty protection is concerned. What essentially flows is that when the person making the payment of income in question is not resident of one of the contracting states and yet such an income has tax implications in one of the contracting states, the person resident in the other contracting state will nevertheless, therefore, have treaty protection in the contracting state where the income is being subjected to the taxes protected by the treaty. What is thus relevant is the fact of taxation in the other contracting state.

Hence, the Tribunal lays down the interpretation that, the person who is making the payment need not be one of the residents of the contracting state but can be a third person also, but still the subject payment would be covered under the treaty protection, ifsuch payment has tax implications in the hands of one of the residents of contracting states. Accordingly, SCB – UK, though not resident of either India or Mauritius to invoke the India - Mauritius DTAA, the MS – Mauritius, can still invoke the India – Mauritius DTAA, since the income has reached India and subjected to taxes covered under the Article 2 of India – Mauritius DTAA, despite being paid by SCB – UK.

Basis above, the Tribunal concluded that MS – Mauritius can invoke the Article 22 and since the taxing rights for the incomes which do not fall under any of the article, rests with Mauritian Tax Authority and SCB – India need not hold any tax, when such income are further paid.

This article is contributed by CA Sri Harsha. The author can be reached at harsha@sbsandco.com

GST

RESIDENT WELFARE ASSOCIATIONS – EXEMPTION UNDER GST – MADRAS HIGH COURT RULES IN FAVOUR OF RWA

Contributed by CA Sri Harsha

The birth of Resident Welfare Association (for brevity 'RWA') is guided by Section 11(4)(e) of Real Estate (Regulation & Development) Act, 2016. The said section mandates that promoter should enable the formation of RWA under the local laws. In absence of such local laws, the section mandates that RWA must be formed within 3 months from the majority of allottees having booked their apartment.

RWAs are formed primarily with an objective to protect and upkeep the welfare of all the members who are the owners of apartments forming part of such residential complex. All RWAs are incorporated with intention of 'no profit no loss' and guided by bye-laws which are agreed at the time of incorporation.

Basis such bye-laws, different RWAs collect different types of fees from members for provision of certain services. The most common fees are corpus, admission fee, transfer fee, No-Objection Certificate fee and other similar items. Majority of RWAs in their bye-laws have modus operandi which must be adopted for each type of fee charged by them. The bye-laws would also contain provisions dealing with accounting treatment of such fee, purposes for which a particular fee can be used, purposes for which a particular fee cannot be used, the timing of usage, the necessary approval for such usage, the nature of investments into which the idle funds of RWAs can be made into and various other aspects. Apart from the said fee, RWAs will also collect monthly maintenance charges from all the members against provision of specific services. The services will include the upkeep of common area, common amenities, security services and various others.

In our previous article, we have dealt with certain challenges faced by RWAs from the income tax perspective and deal with exemptions available to such RWAs from goods & services tax (GST) perspective. The same is available at https://www.sbsandco.com/blog/sbs-wiki-e-journal-aug-2019.

In the above piece, we have authored certain FAQs under GST laws qua RWAs and answered them. One of the FAQ was relating to the exemption available to RWA, wherein we have stated that the exemption was available upto Rs 7,500, but the circular stated otherwise. For immediate reference, the FAQ #9 and our response is as under:

S No	FAQ	Response
9	We are RWA, where we collect monthly contribution of Rs 10,000/- from each member. In this situation, should we charge GST on Rs 10,000/- or Rs 2,500/- (after taking exemption of Rs 7,500/-)?	• In our view, it should be after taking an exemption of Rs 7,500/-, that is tax to be paid on Rs 2,500/-. The reason being that exemption entry under Entry 77(c) of Exemption Notification provides ***exemption upto Rs 7,500/-***. Hence, upto Rs 7,500/- an exemption can be taken. • However, Circular 109[1] clarifies that tax must be paid on Rs 10,000/- and not on Rs 2,500/-. In simpler words, the circular clarifies that tax has to be paid without taking an exemption of Rs 7,500/-.

The above Circular 109 was recently challenged in a writ petition before Honourable Madras High Court by Greenwood Owners Association& Others[2]. In this article, let us understand the issue involved and the judgment passed by Honourable High Court. Before proceeding further, a brief introduction of GST and its applicability on RWAs is pre-requisite and lets do the same.

Introduction:

Section 7 of Central Goods & Services Tax Act, 2017 (for brevity CT Act) deals with scope of 'supply'. As per the said section, supply includes all forms of supply of goods or services or both such as sale, exchange, barter, transfer, license, rental, lease or disposal made or agreed to made for consideration by a person in course or furtherance of business.

Thus, the services carried on by RWAs to its members for consideration, will fall under the ambit of supply. However, the question that has to be answered is whether such services are provided by RWAs can be called as in course or furtherance of 'business'. The phrase 'business' is defined vide Section 2(17). Sub-section (e) specifically categorizes provision by a club, association, society or any such body (for a subscription or any other consideration) of the facilities or benefits to its members as 'business'. Hence, the supplies made by RWAs can be called as 'business', for the purposes of GST laws.

Under the GST laws, the Principle of Mutuality is not recognised and the members and RWAs are treated as separate persons and the services provided by RWAs is considered as supply and taxed accordingly. However, the above view became questionable after the Honourable Supreme Court upheld the applicability of Principle of Mutuality in the context of pre- GST regime in the matter of Calcutta Club Limited[3] [also read our article on the said judgment Concept of Mutuality - A Real Concern].

[1] Circular 109/28/2019-GST dated 22 July 19
[2] 2021 (7) TMI 591 – Madras High Court
[3] 2019 (10) TMI 160 – Supreme Court

In order to put rests to such speculations, Section 7 of CT Act was retrospectively amended vide Finance Act, 2021, with effect from 1st July 17 to state that the activities or transactions, by a person other than an individual, to its members or constituents or vice-versa, for cash, deferred payment or other valuable consideration, constitutes supply. An explanation was also inserted to clarify that the person and its members or constituents shall be deemed to be two separate persons and the supply activities or transactions inter se shall be deemed to take place from one person to another.

The explanation states that the above is notwithstanding to anything contained in any other law for the time being in force or any judgment, decree or order of any court, authority or tribunal. The role of explanation is to take down the views that the rationale as stated in Honourable Supreme Court in the matter of Calcutta Club Limited (supra) is also applicable to GST laws and the recognition of principle of mutuality in the income tax law does not have any say in GST laws.

From the above retrospective amendment, it is clear that the intention of the legislature under GST regime, is to bring tax on the supplies between the associations and its members. Now that there is more clarity on the taxability, let us proceed further.

Since the supplies made by RWAs fall under the ambit of Section 7, the supplies would be subjected to tax under the charging section, Section 9. However, if the aggregate turnover of RWAs does not exceed Rs 20 lakhs during a financial year, then in terms of Section 22 of CT Act, RWAs are not obliged to register under GST laws.

The GST law also provide an exemption vide Entry 77 of Notification No 12/2017 – CT (R). Said Entry provides an exemption for services provided by an unincorporated body or a non- profit entity registered under any law for the time being in force, to its own members by way of reimbursement of charges or share of contribution upto an amount of Rs 7,500/- per month per member for sourcing of goods or services from a third person for the common use of its members in a housing society or a residential complex.

Issue:

The issue before the Honourable Madras High Court in the matter of Greenwood Owners Association & Others is the ruling of Advance Authority, which held that once the amount crosses Rs 7,500, the entire amount is taxable and the Circular 109.

Hence, the precise question involved in the matter is, whether the RWA is entitled for exemption upto the contribution from member of Rs 7,500 or once the contribution exceeds Rs 7,500, the said exemption is lost. In other words, taking clue from the FAQ #9 above, whether the RWA is entitled for exemption upto Rs 7,500 and be taxable only on Rs 2,500 or whether the entire amount of Rs 10,000 is taxable, since it crosses Rs 7,500. Circular 109 clearly states that once the contribution amount exceeds Rs 7,500, the entire amount would be taxable.

Analysis by Honourable Madras High Court:

The petitioner's principal grievance is that the Circular 109 is contrary to the express language mentioned in Entry 77 of Notification No 12/2017 – CT (R). The petitioner stated that when the exemption entry clearly uses the phrase '***upto***', meaning that exemption shall be granted upto Rs 7,500 and balance would only be taxable (in cases where the contribution exceeds Rs 7,500), the Circular's interpretation that once the amount crosses Rs 7,500, the entire amount is to be taxed has to be quashed. The petitioner also referred to Article 13(3) of the Constitution of India to submit that 'law' would include any ordinance or bye law, rule, regulation, notification, custom or usage but does not include 'circulars'. Accordingly, the petitioner pleaded that Circular 109 which intends to withdraw the exemption granted in Entry 77 is required to be quashed.

The Counsel for Respondent pleaded that the tax has to be on the basis of Section 15 of Central Goods and Services Tax Act, 2017 (for brevity 'CT Act') and the amount collected constitutes the transaction value and therefore tax has to be paid on the entire amount. It is further pleaded that exemption under Entry 77 provides a range and once the same is exceeded, the entire amount becomes taxable. It was further pleaded that following the decision of Honourable Supreme Court in the matter of Dilip Kumar & Company[4] , since there is an ambiguity in the exemption notification, the matter should be settled in favour of revenue.

The Honourable Madras High Court after hearing to both the parties, stated that, since there is no ambiguity in the interpretation of exemption notification, the decision in the matter of Dilip Kumar & Company does not apply. The Court further held that the Entry 77 is clear that the exemption is available upto Rs 7,500.

The Court referring to the SSI Exemption under the excise laws, Entry 30 of Mega Exemption Notification under the service tax laws and other related entries stated that, in a case where legislature intends that the exemption shall apply only to cases where the amount charged does not exceed a specified limit, the language adopted is clear to mean that the 'exemption shall apply only where the gross amount charged for such service does not exceed'.

Further, by referring to Entry 78 of Notification No 12/17 – CT (R), the Court stated that the exemption is available for specified artist only when the consideration charged is less than Rs 1.5 lakhs. If the consideration is more than Rs 1.5 lakhs, the exemption is not available for the reason of the type of language used in Entry 78, which is as 'if the consideration charged for such performance is not more than one lakh and fifty thousand rupees'. Since, the language used in Entry 78 is different from Entry 77, the interpretation available for Entry 78 cannot be applied to Entry 77.

The Court stated that term 'upto' hardly needs to be defined and connotes an upper limit. It is interchangeable with the term 'till' and means that any amount till the ceiling of Rs 7,500 is exempted. The Court further rejected the contention that Rs 7,500 is slab for the reason that slab rate comes into play, only when an income upto certain slab is at lower rate and income above such slab, is another rate and since in the instant case there are no slabs, the concept of slab does not trigger. Accordingly, the Court held that Entry 77 provides for exemption till Rs 7,500 and only amounts post Rs 7,500 is only taxable, quashing the Advance Ruling and Circular 109.

[4]361 ELT 577

The above is a welcome judgment since it puts rests to unnecessary litigation and burden on RWAs. Already, RWAs are constrained by lot many other issues under various other laws, the Circular 109 created an additional burden on them. Hence, the judgment arrived in right time putting an end to unwanted protracted litigation.

By

Team SBS

Hyderabad: 6-3-900/6-9, Flat No. 103 & 104,Veeru Castle, Durga Nagar Colony,Panjagutta, Hyderabad, Telangana – 500 082.India.
Sri City (Tada): Suite No. 306, 2nd Floor, Arcade 2745,Central Expressway, Sri City, Andhra Pradesh - 517 646. India.