12 August 2022

EY Tax Alert

Mumbai Tribunal rules MAT provisions are not applicable to foreign bank despite having branch in India

Executive summary

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

This Tax Alert summarizes a ruling of the Mumbai Income Tax Appellate Tribunal (Tribunal) dated 3 August 2022 in the case of Credit Suisse AG[1] (Taxpayer), wherein one of the issues was whether minimum alternate tax (MAT)[2] provisions under the Indian Tax Laws (ITL) will be applicable to a foreign company having permanent establishment (PE) in India and also independently earning incomes not attributable to such PE.

Pursuant to recommendations of an expert committee, MAT provisions were amended in 2016 with retrospective effect from 2001 to, *inter alia,* provide that they shall not apply to foreign companies not having PE in India.

[1] [TS-630-ITAT-2022(Mum)]
[2] Section 115JB- Special provision for payment of tax by certain companies contained in the Income Tax Act, 1961

Building a better working world

The Tribunal's ruling is based on a conjoint reading of the explanatory memorandum to Finance Bill, 2015, that gives purposive interpretation to MAT provisions and the intent behind introducing the same. The ruling also considers the fact that the accounts of foreign companies are not prepared in accordance with Indian Corporate Laws (ICL) and their accounts are not laid in an annual general meeting (AGM) before the shareholders of the company for approval. The Tribunal ruled that MAT provisions were always intended to be made applicable only in case of domestic companies and not foreign companies. Hence, specific exemption granted from MAT to foreign companies not having PE in India cannot be interpreted to mean that other foreign companies are automatically covered within the scope of MAT.

Furthermore, under the ITL, MAT provisions cannot apply where tax treaty is invoked as ITL provisions are subordinate to tax treaty provisions. As per the applicable India-Switzerland tax treaty in the Taxpayer's case, while income which is attributable to PE in India can be subjected to tax in India as per the domestic laws, incomes which are not attributable to the PE in India cannot be taxed at a rate higher than those provided in specific articles of the tax treaty. Hence, higher MAT rates cannot be applied to such non-PE incomes.

Accordingly, MAT cannot be applied to foreign companies which have PE in India as it would be contrary to the intent of MAT provisions and the basic scheme of the applicable tax treaty.

Background

- Currently, a company is liable to pay MAT at the rate of 15% (plus applicable surcharge and education cess) on its "book profits", if the same is higher than the tax calculated under the normal computational provisions. For the purposes of calculating book profits, a company is required to prepare its profit and loss account (P&L) in a prescribed manner.
- The start point of book profits is profit as shown in P&L, as prepared in compliance with applicable accounting standards under the ICL. MAT provisions further provide that while preparing such P&L for MAT purposes, the accounting policies, the accounting standards and method and rates for calculating depreciation should be the same as have been adopted for the purposes of preparing P&L that is laid before the company in its AGM in accordance with the relevant provisions of the ICL. The profit as per P&L is then subjected to specified upward and downward adjustments prescribed in MAT provisions.
- The intention of introduction of MAT provisions was to tax companies which, on account of various tax incentives and allowances, did not pay any taxes but earned book profits and distributed dividends to its shareholders (popularly known as "zero tax" companies). The scope of the provisions was explained in a circular[3] by the Central Board of Direct Taxes (CBDT)[4], which stated that the provisions would apply only to companies preparing their accounts as per the ICL. Furthermore, the effective tax rate comparison in this circular was with reference to tax rate applicable to domestic companies only.
- Conventionally, foreign companies (including FIIs/FPIs[5]) have been taking a stand that MAT provisions should not be applicable on Indian incomes where they do not have a place of business in India or in cases where the tax treaty benefit is available in terms of exemption from tax or lower tax rates. However, in 2012, the AAR[6], in the case of Castleton Ltd. In re[7] held that MAT provisions are applicable to foreign companies. The AAR also ruled that MAT provisions override the tax treaty provisions. Later, the Delhi Tribunal, in the case of Bank of Tokyo Mitsubishi UFJ Ltd.[8], ruled that MAT provisions cannot be made applicable to foreign companies, and the same was affirmed by the Delhi High Court[9].
- Thereafter, the legislature stepped in to provide relief from MAT to foreign companies through amendments made by the Finance Acts of 2015 and 2016.
- The Finance Act, 2015 provided for exclusion of certain incomes of foreign companies (capital gains, interest income, royalty/FTS[10])[11] from "book profits", with effect from tax year 2015-16 onwards[12]. Furthermore, the finance minister also clarified in the parliament that assessments for past years will be concluded as per the outcome of the judicial process.
- An expert committee headed by Justice (Retd.) A.P. Shah recommended that MAT provisions may be amended to clarify inapplicability of provisions to FIIs/FPIs having no PE in India, for the periods prior to 1 April 2015.
- Pursuant thereto, the CBDT issued an instruction[13] and advised its officers that the

[3] Circular No. 794 dated 9 August 2000
[4] The apex administrative body of direct taxes in India
[5] Foreign Institutional Investors or Foreign Portfolio Investors
[6] Authority for Advance Ruling (now replaced by Board for Advance Ruling)
[7] [348 ITR 537]
[8] [2014(49 taxmann.com 441)]
[9] ITA Nos. 604 and 605 of 2015 dated 8 April 2016
[10] Fees for technical services
[11] Dividend income also added to the exclusion list by Finance Act, 2021
[12] The tax year involved in the present case was 2014-15 and, hence, this amendment was not applicable
[13] Instruction No. 9/2005 dated 2 September 2015

government has accepted the recommendations of the expert committee and the appropriate amendment will be carried out in the Finance Bill and that, accordingly, for the time being, the pending assessment proceedings in cases of FIIs/FPIs involving the above issue should be kept in abeyance.

- Furthermore, in a Press Release dated 24 September 2015, it was stated that MAT shall not be applicable to foreign companies if the foreign company is a resident of a country having a tax treaty with India and such foreign company does not have a PE within the definition of the term in the relevant tax treaty.

- Separately, on the Taxpayer's SLP[14] filed with the Supreme Court (SC) against the AAR ruling in the case of Castleton Investment Ltd. (*supra*), the SC took note of the above instruction issued by the CBDT and discharged the matter on the government's undertaking that it would abide by the instruction issued by the CBDT that withdrew the applicability of MAT to FPIs not having PE in India.

- In deference thereto, the Finance Act, 2016 (2016 amendment) introduced an explanation to MAT provisions, with retrospective effect from 1 April 2001, to, *inter alia*, provide that MAT provisions shall not apply to a foreign company which does not have a PE in India as per the applicable tax treaty.

Facts

- The Taxpayer is a tax resident of Switzerland, principally carrying on banking business and has multiple branch offices in Singapore (Singapore Branch), Mumbai (Mumbai Branch), Dubai etc. The Taxpayer is eligible to claim benefits of the India-Switzerland tax treaty.

- The Singapore Branch is registered as an FII/FPI with the Securities and Exchange Board of India (SEBI) and undertakes investment in Indian securities and has no presence in India, whereas the Mumbai Branch has obtained banking license from Reserve Bank of India (RBI) and carries on banking business in India and constitutes a PE in India.

- All India-sourced incomes are reported in the consolidated financial statements (CFS) of the Taxpayer. Furthermore, the Mumbai Branch draws up its financials wherein the income and expense with reference to the Mumbai Branch is accounted for in accordance with the Banking Regulation Act, 1949.

- For tax year 2014-15, the Taxpayer earned business income from the Mumbai Branch and the Singapore Branch earned capital gains income on sale of securities, interest income and FTS from India. The incomes earned by the Singapore Branch were not included in the books of account maintained by the Mumbai Branch.

- The tax authority sought to levy MAT on the income earned by the Singapore Branch and contended that foreign companies (including FPIs/FIIs) having PE in India are required to be taxed as per Article 7 of the tax treaty, which requires PE's income to be taxed as per domestic laws (which include MAT provisions). It is relevant to note that such incomes were specifically excluded from MAT from next tax year 2015-16.

- The first appellate authority ruled in favor of the Taxpayer, directing the tax authority to delete the income of the Singapore Branch while computing book profits for the purpose of MAT.

- Aggrieved, the tax authority filed an appeal with the Mumbai Tribunal, *inter-alia,* taking the ground that the income of the Singapore Branch should be included while computing book profits. On the other hand, the Taxpayer filed cross contentions stating that MAT provisions are not applicable to a foreign company.

Issue

Whether MAT provisions are applicable to a foreign company having PE in India with reference to its PE and non-PE incomes.

Tribunal's ruling

After taking note of the legislative history of MAT provisions with reference to foreign companies, as also various circulars and directions issued by the CBDT and judicial decisions, the Mumbai Tribunal ruled that MAT provisions are not applicable to foreign companies which have PE in India. The reasoning for arriving at such a conclusion is summarized below:

- The SC decision in the case of Castleton had not affirmed the AAR ruling (*supra*) and merely ruled that tax authorities should abide by the instruction issued by the CBDT that withdrew the applicability of MAT to FPIs not having PE in India. However, it would still not mean that all other cases of foreign companies would fall within the purview of MAT.

- From a conjoint reading of the explanatory memorandum to Finance Bill, 2015 that gives purposive interpretation to MAT provisions and the intent behind introducing the same, and also considering the fact that the accounts of

[14] Special Leave Petition

foreign companies are not prepared in accordance with the ICL and their accounts are not laid in an AGM before the shareholders of the company for approval, it can be concluded that MAT provisions were always intended to be made applicable only in case of domestic companies and not foreign companies. Reliance was placed on the Delhi Tribunal ruling in the case of Tokyo Mitsubishi UFJ Ltd.(*supra*), which ruled that MAT is applicable to domestic companies only.

- It is true that the Tokyo Mitsubishi ruling was rendered prior to specific amendments in MAT to carve out exclusion for certain incomes earned by foreign companies and retrospective amendment to clarify non-applicability to foreign companies not having PE in India. However, it cannot be inferred to mean that MAT is otherwise applicable to foreign companies.

- The 2016 Amendment can be said to be clarificatory in nature to address the ambiguity raised by various AAR rulings, wherein it was ruled that FPIs are liable to MAT. Since FPIs do not have PE in India, the retrospective clarification was inserted in the ITL to address their concerns and allay their apprehensions that MAT provisions would be applied to them.

- The 2016 Amendment does not impose a charge of MAT on foreign companies having PE in India, as the amendment merely provides an exemption for a certain class. Furthermore, the 2016 Amendment does not imply that everyone outside the exemption class becomes liable to MAT, especially when they were not originally covered within the ambit of MAT provisions. This aspect is clear from the legislative history behind introduction of MAT provisions.

- Furthermore, under the ITL, MAT provisions cannot apply where the tax treaty is invoked, as ITL provisions are subordinate to tax treaty provisions. As per Article 7 of the India-Switzerland tax treaty, only income which is attributable to PE in India can be subjected to tax in India. The income earned by the Singapore Branch is not attributable to the PE constituted in India by the Mumbai Branch and, hence, MAT provisions cannot be invoked with reference to such income and the same is required to be taxed based on a specific article of the tax treaty. The tax rates cannot exceed tax rates provided in the tax treaty for such incomes. Accordingly, it is also clear that higher MAT rate cannot be applied as it would have the effect of not applying the tax treaty provisions. Accordingly, it is also clear that MAT could not be applied even to foreign companies which have PE in India as it would be contrary to the basic foundation of the applicable tax treaty.

- Furthermore, the accounts drawn up by the Mumbai Branch does not incorporate the incomes earned by the Singapore Branch. Reliance was placed on the SC decision in the case of Apollo Tyres Ltd.[15], which held that the tax authority cannot disturb the profit as per P&L which is approved by stakeholders under the ICL. Accordingly, once a particular income unrelated to PE is not included in the books of account drawn up in India with reference to PE income, it cannot be subjected to MAT provisions.

- Accordingly, the Mumbai Tribunal dismissed the tax authority's appeal and allowed the cross objections of the Taxpayer.

[15] [255 ITR 273]

Comments

The present Mumbai Tribunal ruling lays down a significant principle that MAT provisions are not applicable to foreign companies even if they have PE in India. This is despite the fact that MAT provisions specifically exclude only those foreign companies from tax treaty countries which do not have PE in India[16]. This ruling supports that such a specific exclusion cannot be interpreted in reverse gear to infer that MAT provisions get automatically triggered if there is a PE in India. For this principle, the Mumbai Tribunal relied upon the legislative intent of MAT provisions, the exclusion introduced for foreign companies and the fact that Indian PE accounts of foreign companies are not required to be placed before shareholders in an AGM.

It is significant to note that in addition to non-applicability to foreign companies not having PE, MAT provisions also provide a specific exclusion for specified incomes earned by foreign companies where tax rates as per other provisions (including tax treaty) are lower than the MAT rate. In particular, the non-PE incomes involved in the present case, like capital gains from securities, interest on debt instruments/external commercial borrowings and FTS, are excluded from MAT from tax year 2015-16 onwards (whereas the controversy in the present case pertained to tax year 2014-15).

Also, another explanation was added by Finance Act, 2018, with retrospective effect from 1 April 2001, to clarify that MAT does not apply to a foreign company where its total income solely comprises incomes liable to tax under special presumptive provisions. Hence, in the majority of cases, foreign companies are outside the scope of MAT provisions by virtue of specific exclusions.

From tax year 2019-20, Indian companies opting for lower tax rate[17], without availing various tax incentives, are excluded from MAT. But foreign companies are not provided such option. Hence, the present ruling becomes relevant for defending the MAT liability.

The ratio of the present ruling can be usefully relied upon by foreign companies having PE in India, which face higher taxation under MAT, for instance, 10-year tax holiday for units in IFSC[18] (where reduced MAT rate of 9% applies).

In the present case, the Taxpayer's Mumbai Branch was engaged in banking business. Companies engaged in certain regulated businesses like banking and insurance are required to prepare their accounts as per applicable regulatory laws. Hence, MAT provides that such companies have the option to prepare P&L for MAT purposes as per the ICL or as per the applicable regulatory laws. But the ratio of the present ruling may still apply for foreign companies since even such regulatory accounts are required to be placed before shareholders in an AGM for Indian companies.

However, the issue is not fully free of doubt. One may need to keep a watch on further judicial developments on the issue.

[16] For foreign companies from non-treaty countries, MAT does not apply if they are not required to seek registration under any law for the time being in force relating to companies

[17] Under Section 115BAA or 115BAB of the ITL

[18] International Financial Services Centre

Our offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur
1st Floor, Shantiniketan Building,
Holding No. 1
SB Shop Area, Bistupur
Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune
C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

Download the EY India Tax Insights App

Ernst & Young LLP

EY | Building a better working world

About EY

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata - 700016

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

ey.com/en_in

@EY_India EY YouTube EY India EY Careers India @ey_indiacareers