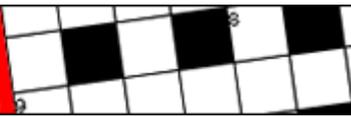


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## MNC income from services rendered abroad in tax net

*No Clarification On Composite Contracts May Result In Further Litigation*

Team ET

FOREIGN companies engaged in composite contracts that include supply of services, will have to pay tax in India even if they render these services outside the country.

The government has introduced a retrospective amendment in the finance bill 2007, overruling a recent Supreme Court (SC) judgement, which held that the income earned by foreign companies from off shore supply of services cannot be attributed to a permanent establishment in India and taxed here.

The amendment is with retrospective effect. The move could push up the tax liability of several foreign companies doing engineering procurement contracts here.

The Supreme Court's ruling was given to Japanese MNC Ishikawajima-Harima Heavy Industries, a partner in the Petronet consortium. The company had appealed against a verdict by the

authority for advance ruling (AAR). The project was in Gujarat and the contract was a composite one, entailing onshore and offshore supply of equipment and services. The dispute was on the taxation of offshore supply of equipment and services.

The essence of SC's verdict was that two conditions need to be fulfilled for levying a tax. One, the services should be used in India. Two, it should be rendered here as well.

However, the government has gone by the "source rule" in taxation. According to this, non-residents are taxable here on income sourced in India. Such income could be in the form of royalty, interest and fee for technical services. FTS is deemed to be sourced in India if it is paid by an Indian resident. In such cases, the non-resident does not have to prove any "territorial nexus". Simply put, tax will have to be paid even if he does not have a permanent establishment or a business connection here. The proposed amendment will bolster revenues of the exchequer given that huge remittances are made from India in respect of fee for technical services.

"While the government has reiterated the source rule, it has not clarified the tax treatment for composite contracts. This could continue to result in litigation", said **Shefali Goradia**, Head international Taxation, Nishith Desai Associates.



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