Tax Return Mandatory Even When No Tax Is Payable In India (OTHER)

Story URL: http://www.vccircle.com/500/news/tax-return-mandatory-even-when-no-tax-is-payable-in-india

April 29, 2011 | ADITI MUKUNDAN & ABHAY SHARMA

The recent ruling not only burdens foreign investors but also calls for a higher court to settle the issue for good.

In the VNU International B.V. versus Director of Income Tax (International Taxation), (Mumbai1) case, the Authority for Advance Rulings has recently opined on an important practical issue faced by foreign investors in India, namely, whether a tax return needs to be filed in India even where no tax is payable in India on account of the beneficial provisions of a tax treaty. The Authority in VNU International answered the question in the affirmative and held that a tax return is required to be mandatorily filed even in cases where no tax is liable to be paid in India.

Relevant Legal Provisions

The relevant provisions of the domestic tax law i.e. Income Tax Act, 1961, cast a duty on every person, even a foreign company, to furnish a return of income with respect to his/her income (in case of a foreign company its India-sourced income) earned in a financial year in the prescribed form, duly verified in the prescribed manner. However, the Act provides for an exception inter alia in case of individuals, who are not required to file an income tax return if their total income assessable to tax under the Act is below the taxable threshold.

Case Analysis

Applicant VNU International B.V., a company incorporated and a tax resident of the Netherlands, transferred 50 per cent shares of ORG-IMS Research Pvt Ltd, an Indian company, to IMS-AG & Interstatistik AG, a company incorporated in Switzerland.

The issues raised by the Applicant from the above sale of shares to IMS-AG were, firstly, the tax treatment of any capital gains earned by the Applicant; secondly, if such gain is not taxable in India, whether the Applicant has to file a return under Section 139 of the Act; thirdly, the applicability of Indian transfer pricing provisions to such a transfer and lastly, whether INS-AG would be liable to withhold taxes under Section 195 of the Act?

The Authority ruled in favour of the Applicant on three issues applying the beneficial provisions (Article 13(5) – taxation of capital gains) of the India-Netherlands Tax Treaty ('Treaty'). The Authority held that the capital gains would arise only in the Netherlands and that the Indian transfer pricing provisions (Section 92-92F of the Act) would not be attracted as the sale and purchase of shares is between non-resident companies. Further, since no income is chargeable to tax in India, there would be no liability to deduct tax under Section 195 of the Act.

However, the Authority, on the issue of filing a return, decided in favour of the Revenue and held that even though the said gain was not taxable in India, the Applicant would be required to file a tax return as per the provisions of Section 139 of the Act. The Applicant contended that since the income

was not taxable in India, they were under no obligation to file any return, given that Section 139(1) was merely a machinery provision.

The Applicant cited previous rulings (Veneburg Group B.V., AAR No. 727of 2006,2 Dana Corporation, AAR No. 788 of 2008 3 and Amianit Int. Holdings Ltd. AAR No. 879 of 2009 4) to substantiate this point. Further, the Applicant stated that the very purpose of coming to the Authority would be defeated if the Applicant was faced with the hardship of filing returns. In response, the Revenue argued that the step-wise exercise to determine whether the Applicant was liable to file a return is carried out under the Act and while doing so, the machinery provisions of Section 139(1) assumes importance, especially when the non-resident Applicant raises the question on the basis of single transaction. The Revenue stated that merely because the filing of returns was a burdensome task for the Applicant, the same cannot be the justification for not filing the same.

The Authority rejected the contention that when the resulting income is nil, there is no obligation to file return of income, and emphasised that as per the third proviso to Section 139(1) of the Act, every company is required to file its return of income, whether it has an income or a loss, and due consideration should be given to the fact that the legislature, in its wisdom, has not provided any exception to this rule in case of companies unlike other categories of taxpayers such as individuals who are not required to file an income tax return, if their total income assessable to tax under the Act is below the taxable threshold.

Further, the application of Section 139(1) would extend to the Applicant, a foreign company, which is covered within the definition of a ‘company’ under Section 2(17) of the Act. The Authority highlighted that the Applicant has accepted that the income arising from the sale of shares is liable to be taxed in India by virtue of Section 5(2) of the Act, although the same is not payable in India due to the application of the Treaty. The Authority concluded that in spite of specific legislative exclusion where it is not necessary for a non-resident to furnish return, as is the case under section 115AC(4) of the Act, a return has to be filed. The Authority observed that instead of causing inconvenience to the Applicant, the process of filing of return would only facilitate the Applicant in all future interactions with the Income Tax department.

Conclusion

This ruling is likely to come as a disappointment to foreign investors who in numerous cases, in spite of not being liable to pay tax in India, would be burdened with the requirement to file a tax return in India in accordance with Section 139 of the Act. A contrary view has been endorsed by the same Authority in the case of Veeburg Group B.V. In light of the apparently contradictory rulings, it is essential that a higher court settle the issue at hand conclusively, so that taxpayers may carry out their affairs with a greater degree of certainty. Further, it should be noted that while an advance ruling is binding only on the applicant and the tax department with respect to the transaction in whose relation it has been sought, it does have persuasive value in case of other taxpayers with similar facts. Thus, the possibility of the tax authorities using this ruling as a basis for insisting that similarly situated foreign companies file tax returns in India cannot be discounted. Till such time as the issue is laid to rest by a higher court, the seemingly prudent option would be for foreign companies, who earn any kind of income in India, to file a tax return in India.

(Aditi Mukundan & Abhay Sharma work with Nishith Desai Associates, a Legal & Tax Counsel firm).