Referral fees received by an overseas branch of the taxpayer is not taxable in India

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In brief

The Mumbai bench of the Income-tax Appellate Tribunal[1] (Tribunal) upheld the Dispute Resolution Panel (DRP) directions, concluding that the referral fee received by the Dubai branch of the taxpayer from the Indian company was not fees for technical services (FTS) and qualified as business income.

Further, since the Indian permanent establishment (PE) of the taxpayer played no role in the referral activity, the said business income could not be construed to be attributable to tax in India.

In detail

Facts

- The taxpayer was an entity incorporated in Switzerland and was engaged in providing various financial services in the field of investment and personal banking to its clients across the globe.
- The taxpayer had a bank branch office in India which was registered with the Reserve Bank of India and a branch in Dubai.
- The Dubai branch of the taxpayer received referral fees from an Indian company, which was an associate enterprise.
- The referral fee had been paid for referring an Indian resident client to the Indian Company for bringing out issue of convertible bonds.
- The taxpayer, while filing return of income in India did not offer the referral fee to tax in India, as the same was not in nature of FTS and the Indian branch of the taxpayer played no role in the referral activity.
- The tax officer (TO) held that the source of such referral fees (i.e., the Indian company and the referred client) was being located in India, the income was deemed to accrue or arise in India.
- The TO concluded that the impugned fees was in the nature of FTS, and taxed the same in the hands of the taxpayer.
- On appeal, the DRP held that said referral fees was not taxable in India.

Issue before the Tribunal

- Whether the DRP was right in holding that "referral fees" received by the taxpayer from the Indian company did not constitute "FTS"?
- Whether the "referral fees" was attributable to the PE in India and thus taxable in India?

Taxpayer's contention

- The referral fee was in nature of commission income and could not be construed to be FTS.
- The taxpayer's Indian branch had no role in the referral activity and the fees was not taxable in India as the same was in the nature of 'business income' as per Article 7 of the Double Taxation Avoidance Agreement (tax treaty) between India and Switzerland.
- The taxpayer relied on

[1] ITA No. 1247/Mum/2016 order dated 09 February 2018

various judicial precedents[2] in support of the aforesaid contentions.

Revenue's contention

- The DRP was wrong in holding that the referral fee received from Indian Company did not constitute "FTS".
- Further, the DRP also erred in holding that such fee could not be considered to be attributable to the taxpayer's PE in India.

Tribunal's decision

- The Tribunal observed that 50% of the fees earned by the Indian company was received by the Dubai branch of the taxpayer as 'referral fees' in accordance with the global policy of the group.
- The Tribunal observed that the referred client had no ground to determine the nature of the payment.
- The Tribunal observed that in a similar transaction, the Authority for Advance Ruling in case of Cushman & Wakefield (S) Pte. Limited[3] has treated the referral fees as 'commission income' and held that the same was taxable as 'business income' both under the provisions of the Income-tax Act, 1961 and under the tax treaty.
- Accordingly, the Tribunal held that referral fees could not be construed as FTS.
- In addition, the Tribunal also observed that the referral activity was undertaken outside India and the taxpayer's Indian branch had no role to play in performance of the referral activity. Hence, held that the referral fees could not be attributable to the taxpayer's Indian branch.

The takeaways

- The Tribunal reaffirms that referral fees received by an overseas branch of the taxpayer for referring a client in India is in the nature of the 'commission' and to be taxed as 'business income' and not as 'fees for technical services'.
- When a taxpayer's India branch has no role in the overseas referral activity, the referral fees received by an overseas branch cannot be attributed and taxed in the hands of such Indian branch.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

[2] Cushman & Wakefield (S) Pte. Limited *In re* [2008] 305 ITR 208 (AAR)
CLSA Limited *v.* ITO (International Taxation) [2014] 56 ITR 254 (Mumbai)
ADIT (IT) *v.* Star Cruise India Travel Services Private Limited [2011] 46 SOT 173 (Mumbai)

[3] Cushman & Wakefield (S) Pte. Limited *In re* [2008] 305 ITR 208 (AAR)

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