 

CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. AUTHORITY FOR ADVANCE RULINGS ('AAR')

1. Consideration received for on-board fabrication and installation of Floating Production Storage and Offloading facility under Change order was taxable in India under section 44BB of the Act despite working performed outside India as the change order was a mere extension of the Original Contract and therefore warranted similar tax treatment. Entire consideration received was taxable under section 44BB without splitting the same on the basis of travel of FPSO outside or in India as section 44BB did not provide for such splitting up.

Aker Contracting FP ASA – AAR No 867 of 2010

Facts

1. Aker Contracting FP ASA ('the applicant'), was a company incorporated in Norway, engaged in the business of providing Floating Production Storage and Offloading ('FPSO') facilities (a floating production system used in the offshore oil and gas industry). It entered into a contract with RIL on May 9, 2007 ('Original Contract') to provide FPSO facilities at assigned oil and gas fields in connection with extracting, prospecting / production of mineral oil for which it was paid consideration on a day rate release rental basis. Further, as per the Original Contract, the applicant was to receive USD 18.79 million for mobilization of the vessel from Singapore to the offshore location in India. The applicant offered the FPSO and mobilization consideration to tax under section 44BB of the Act.

2. On July 27, 2008 the applicant signed a Change order amending the scope of work in the original contract and did not offer the consideration received as per the Change order to tax on the ground that the Change order provided for additional scope of work out of which a substantial portion was performed outside India. Accordingly, the applicant raised the following questions before the Authority for Advance Rulings:

- Whether the consideration received by the Applicant under the Change order for undertaking fabrication of new living quarters onboard the FPSO facility, expediting the delivery of topside modules and increasing productivity at the Singapore yard, performing scope of work to avoid the dry docking period and mobilizing its commissioning team was in the nature of business profits or fees for technical services ('FTS') under the Income-tax Act, 1961 ('the Act')?

- If the said sum was in the nature of business profits, whether the consideration would be taxable in India even though it pertains to work performed wholly outside India?
- Whether the consideration received by the Applicant for installation of the buoy and moorings was in the nature of business profits or FTS and whether it was to be computed with regard to section 44BB of the Act?
- Whether the amount received by the Applicant in Question 1 above was to be computed having regard to section 44BB of the Act?
- Whether the consideration received by the Applicant attributable to the mobilization of the FPSO to the extent of the distance travelled outside India was taxable in India?
- Whether the consideration received by the Applicant on account of insurance receipts for loss of hire were chargeable to tax in India?

Ruling

1. In regard to the contention of the applicant that the Change order was independent of the Original Contract and therefore to be considered on a different footing and that the consideration received pursuant to the Change order was capital in nature, the AAR noted that in the Original agreement "work" means the chartering out of the FPSO and all activities to be performed by the Contractor including the preparation of the FPSO for chartering and that clause 25 of the Original contract, pertaining to changes, provided that no change would impair or invalidate the contract and that the Change order had a direct relationship to the scope of work provided for in the Original contact. It also noted that the argument of the consideration received pursuant to the Change order being capital in nature was not taken in the application made and was a different stand taken for the first time. It held that the fabrication of new living quarters was a clause present in the Original contract, the consideration received for mobilization and commission was inextricably linked with the original contract as per which the contractor was to make the equipment suitably equipped with necessary tools etc and therefore the Change order did not alter the character of the consideration received by the Applicant and therefore originated from the Original Contract. Accordingly, the AAR held that the argument of the amount received being capital in nature was without any merit.

2. The AAR held that since the consideration received as per the Change order was similar to the consideration received as per the Original Contract (which was offered to tax under section 44BB of the Act), the applicant would be governed by section 44BB of the Act. Relying on the decision of the Court in *Sedco Forex Intentional (299 ITR 238)* and the AAR in Geofizyka Torun Sp zo (186 Taxman 213) and Bergen Oilfied Services AS (11 taxmann.com 96), it held that section 44BB, relating to non-resident assesses who provided services and facilities in connection with, or supply of plant and machinery on hire used for prospecting / extraction / production of mineral oils in or outside India, was a complete code in itself and that there was no scope to split revenue attributable to activities in India and outside India and therefore rejected the contention of the Applicant that consideration received outside India did not accrue or arise in India / was not deemed to accrue or arise in India and therefore not attracting section 44BB of the Act.

3. With regard to the contention of the applicant that the consideration received as per the Change order was not taxable under the DTAA between India and Norway, the AAR

held that since the scope of work under the Change order remained the same as the Original Contract and therefore was to be treated in a similar manner and offered to tax in the same manner as which the consideration received pursuant to the Original contract had been offered to tax.

4. The AAR held that the consideration received on account of loss of lease rentals on account of insurance policy signed outside India was not taxable in India.

5. Accordingly, it held that the consideration received pursuant to Change order and for installation of STP buoy and moorings in India was in the nature of business profits taxable under section 44BB of the Act.

2. Settlement amount for giving up right to sue is a capital receipt not chargeable to tax. Since the cost of acquisition of the said right was not determinable the computation mechanism failed and no income was chargeable to tax.

Lead Counsel of Qualified Settlement Fund (QSF), In re – [2016] 65 taxmann.com 197 (AAR – New Delhi)

Facts

1. The applicant is an Indian company whose shares were listed on Bombay Stock Exchange and the National Stock Exchange. Its American Depository Shares were listed in the New York Stock Exchange. Pursuant to an admission from its former Chairman regarding misstatements contained in the accounts of the applicant, the price of its shares took a fall. During 2009, a large number of suits were filed against the company as well as its Indian and Foreign Auditors, in various jurisdictions in the US, claiming damages. The class action suits were referred for mediation, under which the applicant proposed to pay USD 125 million to the Qualified Settlement Fund as a proposed settlement. The Indian and foreign auditors were to pay USD 15.5 million and USD 10 Million respectively.

2. During 2011, the US Court approved the settlement. As per the terms of the settlement the applicant and the Indian auditors were to deposit the agreed amounts in a segregated account in India. The Foreign auditor was to deposit the agreed sum in an initial escrow account in New York. Post approval, the amounts had to be transferred from the initial escrow accounts to a final escrow accounts and treated as a Qualified Settlement Fund which was to be distributed to the claimants after deducting relevant expenses.

3. Prior to the transfer of funds, the applicant and the auditors approached the AAR to determine whether the amount payable was chargeable to tax in India and consequently liable to TDS under section 195 of the Act, and if so, at what rate.

4. Ruling in favour of the Revenue, the AAR held that the settlement amount constituted 'income from other sources' in the hands of the Qualified Settlement Fund under Article 23 of the India –US Double Tax Avoidance Agreement and therefore the applicants were required to withhold taxes under section 195 of the Act.

5. Against the Ruling, a writ was filed before the Honourable High Court wherein the Ruling was set aside and remanded the matter back to the AAR to examine whether the settlement payment were in the nature of revenue or capital and then determine chargeability.

Ruling

1. The AAR observed that the settlement amount was in lieu of surrender of right to sue against the applicant and the auditors. The right to sue amounts to a capital asset under section 2(14) of the Act and therefore it held that the settlement was a capital receipt. Since the cost could not be computed and the right could not be transferred owing to public policy, the AAR held that the settlement amount was not taxable under section 45.

2. The AAR, disagreeing with its earlier ruling held that the amount was neither taxable under section 45 or section 56 of the Act and held that since TDS was already deducted under section 195 of the Act pursuant to the earlier ruling, the payee was to claim a refund under the Act.

B. HIGH COURT JUDGMENTS

3. Purchase of software for onward resale to end users being a copyrighted article does not amount to royalty as it was in the nature of purchase of goods

Principal Commissioner of Income-tax v M Tech India Pvt Ltd – TS-19-HC-2015

Facts

1. The assessee, M Tech India Pvt Ltd, a Value Added Reseller ('VAR') entered into a VAR agreement with two entities viz. Track Health Pty Ltd, Australia and Speed Miners, Malaysia for the purchase of software related to healthcare and hospitality for the onward resale to end-users in India. At the time of making such payment, the assessee did not deduct any taxes at source since it was in the nature of purchase of goods. The AO disallowed the payment under section 40(a)(i) of the Act on account of such non-deduction of tax at source.

2. Aggrieved, the assessee filed an appeal before the CIT(A) and submitted that it had made similar purchases in the previous year without deducting taxes at source which were allowed as a deduction in computing its taxable income and that it was a reseller of products and therefore the payments for acquiring the products could not be considered as royalty. The CIT(A) accepted the contention of the assessee and deleted the disallowance made by the AO. Aggrieved, the Revenue preferred an appeal before the Tribunal wherein, the Tribunal upheld the order of the CIT(A) and ruled in favour of the assessee.

3. Accordingly, the Revenue filed an appeal before the Honourable High Court.

Judgment

1. The Court, after carefully analyzing the facts of the case, observed that the agreements entered into by the assessee expressly indicated that the assessee was appointed to market and sell the product in India and therefore was appointed as a reseller of the software. It also noted that the AO, in previous years, had accepted the transactions in question to be that of a purchase of software and that the only question relevant was whether the impugned amount could be taxed as royalty.

2. It held that where an assessee acquires the right to use a software, the payment so made would amount to royalty. However, in cases where the payment was for the purchase of software as a product, the consideration paid could not be considered to be for the use or right to use the software and that where software was sold as a product, it would amount to a sale of goods. Consideration paid for purchase of goods could not be considered as royalty and it was necessary to make a distinction between payment for the acquisition of a right to use a patent or copyright and a payment to acquire a patented or copyrighted product the latter being a purchase of product which was so in the given case. Reliance was placed on the decision of the Apex Court in *Tata Consultancy Services vs. State of Andhra Pradesh (2004) 271 ITR 401(SC)* and the decision of the Court in *DIT vs. Infrasoft Ltd. (2014) 220 Taxman 273 (Del).*

3. Further, the Court rejected the Revenue's reliance on the decision of the Court in *CIT vs Samsung Electronics Co Ltd (2012) 345 IR 494* (Kar) holding that the co-ordinate bench in *DIT v Infrasoft* had unequivocally dissented from the said judgment on the same issue.

4. Partnership firm is a 'person' under the India-UK DTAA. The firm being an enterprise of a Contracting state was taxable only in that State and therefore profits in India were not taxable. Accordingly, the reassessment proceedings were quashed.

Maersk Line UK Ltd & Anr v DDIT (IT) – TS-36-HC-2015 (Cal)

Facts

1. The petitioners, a UK based partner and a Netherlands based partner were two partners of a partnership firm known as P&O Nedllyod ('PONP') to whom notices under section 148 of the Act were issued which were the subject matter of the writ petition.

2. The Revenue was of the view that PONP being a partnership firm based in the UK was a fiscally transparent entity and hence outside the ambit of the India-UK Double Tax Avoidance Agreement ('DTAA') as a result of which its income was exigible to tax under the domestic laws whereas the income of the partners was exempt under section 10(2A) of the Act.

3. The Petitioners submitted that distinction made between a partnership and its partners regarding the same income could not be drawn for the purpose of taxing the partnership in India and that the subject income was already accepted as Nil in the hands of the partners which could not be taken to be income chargeable to tax in India in the hands of the firm. It also submitted that the partners had fiscal domicile offshore and the income of the firm was taxed in the hands of the respective partners in their respective countries of residence.

4. The Revenue contended that the writ petitions should be adjourned pending the decision of the Apex Court in the case of the Petitioners for previous years and that the partnership firm in the UK being transparent to the tax laws of that country should not be regarded as a person under the DTAA and therefore should be taxed as per the Act.

Judgment

1. The Honourable High Court referred to Article 3(2) of the DTAA wherein it was stated that a partnership which is treated as a taxable unit under the Act shall be treated as a person for the purposes of the Convention as well as Article 9(5) which provided that the provisions of taxability of income on shipping shall also apply to income derived from participation in a pool, a joint business or an international operating agency.

2. With regard to the contention of the Revenue that the firm was a fiscally transparent entity in the UK, it relied on the decision of *P&O Nedlloyd & Ors vs. ADIT (2014) 269 ITR 282 (Cal)* dealing with the similar issue wherein it was held that the firm was a person covered under the DTAA being an enterprise of a Contracting state, taxable only in that state.

3. It held that the firm being an enterprise of the UK had fiscal domicile in the UK and therefore its income from operation of ships in international traffic was not exigible to tax under domestic law. Accordingly, the notices under section 148 of the Act were set aside.

5. Where TDS under section 195 of the Act becomes refundable to the resident payer on account of the non-resident payee waiving the payment, the payer will be entitled to refund as well as interest on refund from the date of filing the refund claim and not from the date of deposit of TDS.

Sunflag Iron & Steel Co Ltd vs. CBDT – (2016) 66 taxmann.com 50 (Bom)

Facts

1. The petitioner, a steel manufacturing company entered into an agreement with a

German company for transfer of technical knowhow, pursuant to which it was required to make a payment of three installments amounting to ` 76.45 lakhs and had deducted taxes at source. Subsequently, the German Company was not able to fulfil its obligation and therefore agreed to waive the payment of the third instalment. The Petitioner filed an application claiming refund of the amount of TDS. The CBDT authorized the CCIT to refund the TDS and accordingly the said sum was refunded to the petitioner. The Petitioner then filed an application for interest on amount of refund due under section 244A of the Act which was rejected by the DCIT.

2. The Petitioner submitted that in view of the provisions of Section 2(7) read with sections 195, 200 and 201 of the Act, it would be an assessee as provided under the Act and that in any case in view of Section 160 & 163 of the Act, it would be a representative assessee of the German company and therefore the application of refund as well as interest thereon would be tenable. It was further submitted that since the third instalment was paid and subsequently waived the Revenue had no authority to retain the TDS and that the petitioner would be entitled to refund from the date of deposit of TDS to the date of refund.

3. The Revenue contended that only the German company could be construed to be an assessee for the purposes of the Act and therefore only the German company was entitled to make an application for refund and that the CBDT gratuitously granted the prayer of refund independent of the provisions of the Act. However, the claim for interest was to be made under 244A of the Act and therefore the rejection of the said claim was correct.

Judgment

1. The Honourable High Court referring to the relevant sections of the Act held that section 2(7)(b) of the Act included within the definition of assessee every person who was deemed to be an assessee under the Act and that 2(7)(c) included ever person who was deemed to be an assessee in default under the provisions of the Act. It held that the petitioner would fall under the purview of Section 2(7)(b) as it was a representative assessee within the meaning of Section 163 since it had a business connection with the German company and the income received by the German company was directly through the petitioners.

2. Further, it held that had the petitioner failed to deduct tax at source on the payments made to the German company it would deemed to be an assessee in default and therefore satisfied Section 2(7)(c) of the Act as well. Accordingly, it dismissed the contention of the Revenue that the petitioner was not an assessee and not entitled to apply for refund or interest under the Act and that the refund granted by the CBDT was as per Section 240 of the Act which had a wide application and therefore dismissed the argument of the Revenue that the refund granted was not in accordance with the provisions of the Act. Accordingly, it held that the petitioner was entitled to both the refund and interest thereon.

3. With regard to the period for which interest on refund was payable, the Court held that the Petitioner was entitled to interest from the date of filing the claim of refund to the date of payment and not from the date of deduction of tax. It observed that the law comes to the assistance of the vigilant and diligent and therefore the Revenue could not be fastened with the liability for a period earlier to the date on which the petitioners filed the refund claim.

6. There is no obligation to deduct tax at source on the resident / Indian company making payments to non-resident covered under section 172 of the Act. Thus, no disallowance can be made under section 40(a)(i) of the Act in such a case

CIT vs. VS Dempo & Co Pvt. Ltd. – (2016) 66 taxmann.com 93 (Bom)

Facts

1. The assessee was a company engaged in the business of mining and export of processed iron ore as well as construction. The assessee charged demurrage charges under the head export expenses to the profit and loss account on which no tax was deducted. The AO disallowed the said charges paid under section 40(a)(i) read with section 195 of the Act.

2. Aggrieved, the assessee filed an appeal before the CIT(A) wherein the disallowance under section 40(a)(i) of the Act was deleted. Subsequently, both the assessee and Revenue filed appeals before the Tribunal wherein both appeals were partly allowed.

3. Aggrieved, the Revenue filed an appeal before the Honourable High Court.

4. In a similar case before the Division Bench of the Court in the case of Orient (Goa) Pvt Ltd. it was held that section 172 of the Act was only applicable in respect of a non-resident carrying on shipping business and not to the resident payer and therefore the provisions of section 172 of the Act were not applicable and the demurrage charges were not to be allowed in the absence of deduction of tax at source. However, during the current appeal, the Court expressed its dissent with the ruling in the case of Orient (Goa) Pvt Ltd but observing law of precedence held that it was not open for a Division bench to take a contrary view to the view taken by another Division Bench and therefore constituted a Larger Bench to adjudicate on the matter.

Judgment:

1. The Larger Bench held that section 172 of the Act had application to shipping businesses of non-residents and would have application notwithstanding anything contained in the other provisions of the Act for the purpose of levy and recovery of tax with regard to any ship, belonging to or chartered by a non-resident which carries passengers. Livestock, mail or goods shipped at a port in India. It further noted that section 44B of the Act provided for computing profits and gains for shipping businesses in the case of non-residents and therefore concluded that section 172 is referable to section 44B of the Act.

2. The Court held that both section 44B and 172 of the Act open with a non-obstante clause and that section 44B provides for the computation and section 172 provides for the recovery and collection of taxes. The provisions of section 172 of the Act clearly provide the mechanism for levy, assessment and recovery and therefore there is no warrant in applying the provision of section 195 to the assessee.

3. It noted that the Division bench in Orient (Goa) Pvt Ltd did not take into account the entire scheme of Section 172 of the Act and also held that there was no scope of escape from levy of tax under section 172 of the Act since the taxes were to be paid before the ship left the port in India or pursuant to an arrangement to pay such taxes.

4. The Court held that there was no obligation to deduct tax at source on the resident / Indian company making payments to non-residents covered under section 172 of the Act and thus the decision in the case of Orient (Goa) was overruled.

7. Payment for data transmission services through a transponder is not royalty under the India-Thailand and India-Netherlands tax treaties. The retrospective amendment to Section 9(1)(vi) of the Act could not be read into the DTAA as no corresponding amendment has been made to the definition of royalty therein.

DIT vs. New Skies Satellite BV & DIT vs. Shin Satellite Public Co Ltd – TS-64-HC-2016 (Del)

Facts

1. New Skies Satellite BV and Shin Satellite Public Co Ltd ('the assessees) incorporated in Netherlands and Thailand respectively, were engaged in the business of providing digital broadcasting services to customers being Indian residents as well as non-residents. During the relevant year, the assessees received income from the lease of transponders of the satellites and had filed Nil returns claiming that the income was not taxable.

2. The AO held that the income was taxable as royalty both under section 9(1)(vi) of the Act and Article 12 of the respective DTAAs as the income arose out of the 'use' of a 'process'.

3. Aggrieved, the assessee filed an appeal before the Tribunal wherein the Tribunal relying on the decision of the Court in the case of Asia Satellite Telecommunication Company Ltd v DIT – 322 ITR 340 (Del), and held that receipts from provision of data transmission services do not constitute royalty.

4. The Revenue filed an appeal before the Honourable High Court challenging the order of the Tribunal. It was contended that the ruling of the Court in the case of Asia Satellite was undone by the retrospective amendment to section 9(1)(vi) and therefore the sum received by the assessees were taxable considering the amended definition under the Act which was also applicable to the definition of royalty under the DTAA.

Judgment

1. The Court noted that the applicability of retrospective amendments were determined by the actual substance of the amendment and not merely by its language and that the language in Explanations 4 to 6 to section 9(1)(vi) of the Act had the apparent characteristics of a retrospective amendment. Referring to the judgment in the case of TV Today Network Ltd – 221 Taxman 123 (Del) the Court held that the income received by the assessees was taxable under the Act. However, it observed that the issue of taxability of the assessees could be resolved without redressal of this issue in detail since the assessees did not press the line of argument as the ultimate taxability of the income would rest on the interpretation of the tax treaties.

2. The Court held that no amendment to the Act whether retrospective or prospective could be read in a manner so as to extend itself to the terms of an international treaty and that a clarificatory amendment which sought to overcome a judicial interpretation of law could not be allowed to have a retroactive impact on an international treaty between to sovereign states prior to the amendment. Referring to Article 39 of the Vienna Convention and Azadi Bachao Andolan, it held that unilateral amendment to treaties could not be entertained and that treaties were created via negotiation processes between sovereign states.

3. It held that mere amendment to Section 9(1)(vi) could not result in a change in the definition contained in the DTAA unless a similar amendment was brought about therein and that since the amendments vide Finance Act, 2012 would not affect Article 12 of the DTAA, the decision of Asia Satellite was still applicable. Accordingly, it held that the amount received by the assessees were not taxable under the respective DTAAs.

8. Under the India-UAE DTAA, permanent establishments ('PEs') specified in Article 5(2) would qualify as PEs only if the business of the enterprise is carried on partly or wholly through it – Fixed place of business carrying on auxiliary activities does not constitute a PE – In the absence of authority to conclude contracts no dependent agency PE could be constituted. Additionally, for the

purposes of determining installation PE, only the number of days of activities carried on by the assessee in India was to be considered and not the activities carried on by an independent contractor.

National Petroleum Construction vs. DIT (IT) – (2016) 66 taxmann.com 16 (Del.)

Facts

1. The assessee, a company incorporated in the UAE was engaged in the fabrication of petroleum platform, pipelines and other equipment as well as the installation of petroleum platforms, submarine pipelines at various sites. During the relevant year, it tendered and won a contract with ONGC for the design, engineering, procurement, fabrication of loaded offshore platform along with its installation and commission at ONGC's offshore facility. The activities relating to survey, installation and commissioning were performed entirely in India whereas the platforms were designed, engineered and fabricated in the UAE. For the purposes of conducting the pre-engineering and pre-construction surveys, the assessee appointed a third party viz. M/s Fugro Geonics Pvt Ltd. Acardia Shipping Ltd ('ASL') was appointed for providing technical and marketing support services. The assessee filed its return declaring its income on a presumptive basis by taxing gross receipts pertaining to its activities in India (net off verifiable expenses) @10 percent and the receipts pertaining to its activities outside India @ 1 percent.

2. The AO contended that the assessee had a fixed place PE in India in the form of a Project Office in Mumbai, that ASL was its Dependent Agent PE and that it also had an installation / construction PE in India. It was further contended that the entire contract was a turnkey contract which was not divisible and therefore the entire contract receipt was taxable in India and estimated the profits to be 25 percent of the consideration received from ONGC.

3. The DRP as well as the ITAT upheld the order of the AO. However, the ITAT held that the contract could be segregated into offshore and onshore activities and that the activities carried on outside India were not taxable in India.

4. Aggrieved, the assessee as well as the Revenue filed appeals before the Honourable High Court.

Judgment

1. The Court analyzed Article 5 of the India-UAE DTAA and held that the expression PE contained therein stipulated a fixed place of business from which the business of the enterprise was carried on. It noted that normally inclusive definitions are used to expand the width of the term defined but Article 5(2) specifically enlisted places of business that fall within the meaning of PE and that all classes of PEs in Article 5(2) would be construed as a PE subject to the fulfilment of condition in Article 5(1) i.e. the said classes of PE would be construed as a PE only if the business of the enterprise was carried on partly or wholly through it. In addition, the word permanent in the term 'Permanent Establishment indicates that there should be some degree of permanency attached to the fixed place of business before the same can be construed as a PE of an enterprise. Also, where Article 5(2)(h) and 5(2)(i) of the India-UAE DTAA are concerned, the permanence required is a specific period of 9 months. It also observed that Article 5(4) providing for a deeming fiction whereby dependent agents would be deemed to be PEs even though they do not fall under Article 5(1) / 5(2).

2. As regards the Revenue's contention that the Project Office in Mumbai constitutes a Fixed Place PE, the High Court held that since the Project office was used mainly as a communication channel the activities done therein would fall under the exclusionary clause under Article 5(3) as the activities were auxiliary

in nature. It held that there was no material to prove that the employees were engaged in the review of the engineering documents or had participated in the discussion or approval of designs submitted to ONGC.

3. The Honourable Court further held that the assessee did not constitute an installation PE in India since the duration of its activities in India did not exceed 9 months. It held that for the purpose of determining the existence of an installation PE, the actual activities carried on in India had to be considered and since the installation activities lasted from November 19, 2006 to April 27, 2007 it clearly did not satisfy the 9 month stipulation. Further, it held that activities at a site carried on by an independent contractor could not be considered while determining the activities of the assessee and that interruption in the activities exceeding substantial period representing a cessation of work was not to be included in the determination of the 9 month period.

4. With respect to ASL constituting a DAPE in India the Court observed from ASL's accounts that it carried on substantial business other than the services provided to the assessee and that it was not authorized to conclude contracts on behalf of the assessee and accordingly held that it did not constitute a DAPE of the assessee in India. It also held that the presence of the employees of ASL at a kick-off meeting with ONGC could not lead to the inference that it constituted a DAPE of the assessee.

5. The Court also pointed out that the computation mechanism adopted by the assessee was incorrect as there was no scope for allowing deductions while computing tax on a presumptive basis.

6. However, the Court held that since the assessee did not have a PE in India during the relevant years, no income of the assessee from the impugned projects could be attributed to the PE. Though academic, the Court upheld the finding of the Tribunal that the consideration of activities carried on outside India could not be attributable to the assessee's PE in India where the value of work done outside India was ascertainable.

9. Where in respect of marketing and administrative services rendered by AEs, the assessee adopted a revenue sharing model whereby assessee kept 75 percent of the revenue and paid 25 percent to its AEs, the upward adjustment was to be deleted since the model was supported by relevant documents.

CIT vs. ITC, Infotech India Ltd – (2016) 66 taxmann.com 106 (Cal)

Facts

1. The assessee was engaged in the provision of customized software solution development, IT facilities management and professional IT Services. During the year under consideration, it entered into international transactions with its wholly owned subsidiaries, namely 12A in the US and 12B in the UK, constituting its AEs, for which it adopted the cost plus method as the most appropriate method to establish the ALP choosing the wholly owned subsidiaries as the tested parties.

2. The business arrangement with its subsidiaries encompassed two revenue sharing models:

Model 1 – Wherein the agreements were executed between the assessee and its overseas customers for which the AEs provided the assessee with marketing and administrative support services. As per the agreement, the assessee retained 75 percent of the revenue and paid the subsidiaries the balance 25 percent for the said support services.

Model 2 – As per this model, the AEs entered into agreements with its customers and raised invoices directly on the customers and the assessee raised invoices on the AEs for 75 percent of the revenue being the delivery engine for the customers.

It both the aforesaid models, the assessee undertook and assumed significant functions and risks and consequently undertook full responsibility for the delivery of all IT Development services to the customer.

3. The TPO held that the functional and risk profile of the assessee and its AEs differed in both the business models and that the assessee bore a higher risk in contracts directly with its customers as opposed to the contracts entered into by its AEs and therefore adopted a 15 percent revenue sharing model as opposed to the 25 percent for Business Model 1. Additionally, the TPO provided a 2 percent ad hoc adjustment to management charges paid to 12A thereby adopting a 13 percent revenue sharing rate.

4. Aggrieved, the assessee preferred an appeal before the CIT(A) wherein the adjustment was deleted, pursuant to which the revenue filed an appeal with the Tribunal. The Tribunal upheld the order of the CIT(A) and held that even though the contracts in the two business models were optically different, the functional and risk profile of both the assessee and its AEs remained the same and that the conduct of the assessee and AEs were to be given due cognizance.

5. Aggrieved, the Revenue filed an appeal before the Honourable High Court.

Judgment

1. The Court upheld the order of the Tribunal and also noted that the fact that 25 percent was retained for the AEs was accepted by the CIT(A) and Tribunal based on the documents submitted.

2. It held that there was no illegality or infirmity in the orders of the Tribunal and CIT(A) which were adequately supported by relevant documents.

10. Where the assessee was not an eligible assessee under section 144C(15)(b) of the Act, the draft assessment order passed was to be quashed

Honda Cars India Ltd vs. DCIT – TS-51-HC-2016 (Del) – TP

Facts

1. The assessee, a subsidiary company of Honda Motors Company Ltd, Japan was engaged in the business of manufacture and sale of passenger cars for which it purchased raw materials, spare parts etc from its holding company. Under a technical collaboration agreement, the assessee paid royalty to its holding company.

2. The international transaction with its AE was referred to the TPO. However, no TP addition was made to the returned income. Subsequently, the AO disallowed the entire payment made by the assessee for purchasing raw materials, spare parts etc vide a draft assessment order.

3. Aggrieved by the draft assessment order, the assessee filed a writ petition before the Honourable High Court contending that

a. It wasn't an eligible assessee as defined under section 144C(15)(b) since the TPO had not proposed any variation in income and therefore the drat assessment order was invalid

b. As per Circular No 3 / 2015, the disallowance under section 40(a)(i) was to be restricted to the net amount and not taken at the gross amount of purchases made

c. The assessment would be time barred as it was to be completed by March 31, 2015 whereas only the draft order was passed which was invalid as contended in point (a) above.

Judgment

1. With regards to contention (a) above, the Court held that section 144C(1) of the Act

provided that a draft assessment order was to made only for an "eligible assessee". "Eligible assessee" was defined to mean any person in whose case the TPO had made a variation to the returned income vide an order under section 92CA(3) of the Act or a foreign company. Noting that the assessee was not a foreign company the Court considered the first part of the definition. Relying on the decision of the Apex Court in *P. Kasilingam & Others vs. PSG College of Technology & Ors,* it held that the word "means" indicates that the definition is a strict definition with no alternative meaning and since the definition of eligible assessee contains the term means it was to be strictly construed. The Court held that since no variation was proposed by the TPO, the assessee did not fall under the first part of the definition either and therefore the draft assessment order passed was invalid.

2. The Revenue conceded contention (b) above and therefore the Court did not adjudicate on the issue.

3. With regard to the third contention and in light of the fact that the Court quashed the draft assessment order, it noted that the question of the assessment being time barred was left open and both parties were open to take adequate recourse under the law.

C) TRIBUNAL DECISIONS

11. Transfer Pricing – Selection of Comparables – Whether a company in the business of merchant banker and investment banker, is functionally not similar to that of function of non-binding advisory services – Held : Yes, Whether a company engaged in rendering of services as Portfolio Manager, are intimately different from that of the functions of non-binding advisory services rendered by the assessee to its AEs – Held : Yes; in favour of the assessee

Sparkles Dhandho Advisors Pvt. Ltd. vs. ITO 2016-TII-63-ITAT-MUM-TP Assessment Year: 2010-2011

Facts

The assessee is engaged in the business of non-binding investment advisory services. It had entered into various international transactions and to benchmark the same it had applied TNMM. The assessee had computed the average arithmetic mean @15.68% of the comparables against the assessee's margin of 25.42% and claimed that the ALP of the transactions was in the accepted range. During assessment, the TPO included three other comparables and considered the same for determining the ALP. The the Arithmetic Mean was determine at 39.97% and accordingly, adjustment was made. The DRP confirmed the same.

Decision

On appeal, the Tribunal held in favour of the assessee as follows:

1. On perusal of the orders of the Tribunal in the case of Lehman Brothers Advisors Private Limited, wherein adjudicated a similar issue, it is evident that Motilal Oswal Investment Advisors Pvt Ltd is held as a "merchant banker and investment banker", which is functionally not similar to that of function of non-binding advisory services. Therefore, after hearing both the parties in this regard, we are of the opinion that Motilal Oswal Investment Advisors Pvt Ltd is not a good comparable in this case. Accordingly, AO is directed to exclude the same from the comparables;

2. Regarding IDFC, it is demonstrated before us that the said company is engaged in rendering of services as Portfolio Manager, whose functions are intimately different from that of the functions of non-binding advisory services rendered by the assessee to its AEs. The fact of rejection of the same as a good comparable to a case of similar services as in the case of the assessee, assessee was also demonstrated by relying on the decision of the Tribunal in the case of Bain Capital Advisors

(India) Private Limited. In view of the above, we direct the AO to re-compute the arms length adjustment after excluding IDFC from the list of comparables;

3. Regarding ICRA, we remand this issue to the file of the AO / TPO to re-examine the functions of the said company in depth after supplying the information so collected by them u/s 133(6) of the Act. For this limited purpose, we remand this comparable to the file of the AO for fresh examination.

Cases followed:

i) *Bain Capital Advisors (India) P. Ltd - 2015-TII-231-ITAT-MUM-TP,*

ii) *Lehman Brothers Advisors Private Limited - 2015-TII-437-ITAT-MUM-TP.*

12. India – Israel DTAA – Article 12(3) – Sale of Machinery with Software – Whether Software component taxable as "Royalty" – Whether if hardware and software constituted one integrated system, part of the payment thereof cannot be earmarked towards sale of hardware and the other part towards "Royalty" for use of software as such, the amount received by the assessee can be segregated for tax computation purposes – Held : No; Whether if the dominant character and essence of the transaction entered into by the assessee is sale of machine and the software, independently, had no value for the customer, the revenue from such composite product be taxed in the hands of assessee as Royalty – Held : No; Whether if the assessee cannot be fastened with the tax liability taking shelter of provisions of tax treaty, then the same cannot be imposed by applying the provisions of the Act by disregarding and overriding the provisions of the treaty – Held : Yes; Whether when there was neither any transfer of copyright or any rights therein nor there was any infringement of copyright, in such case amount of sales consideration received by the assessee on account of sale of machine along with it operating software would constitute "Royalty" – Held : No; In Favour of the assessee

Galatea Ltd. vs DCIT 2016-TII-40-ITAT-MUM-INTL Assessment Year : 2010-11

Facts

1. The assessee is a company incorporated under the laws of Israel and is tax resident of Israel for the purpose of Indo-Israel DTAA.

2. The assessee company was involved in the business of developing, manufacturing and servicing machinery, equipment, tools, supporting software, accessories, equipments, products, parts and materials for the diamond, gems and jewellery industry. It is 100% subsidiary of M/s Sarin Technologies Ltd., Israel.

3. As a part of its business, the assessee company sold to its customers machines and operating software. In the invoice issued by the assessee company, the consideration was mentioned separately for the machine and operating software. Some of the customers deducted tax at source @ 10% from the payments made by them towards operating software and application software, treating the same as "Royalty" under article 12(3) of the Israel tax treaty.

4. The assessee was of the view that the aforesaid payments made by the customers did not constitute "Royalty", under the Israel tax treaty and the tax was wrongly withheld by the customers, it filed its return of income for the impugned assessment year at nil and claimed refund of the tax withheld / deducted by its customers.

5. The Assessing Officer treated the same as taxable in the hands of the assessee in India. Being aggrieved, assessee filed its objection before the DRP wherein no relief was given and, therefore, being aggrieved, the assessee approached the Tribunal. Assessee had no business connection in India and it had no P.E. in as part of Fact(i) India.

Decision

The Tribunal held in favour of the assessee as follows:

1. The Courts have held that where software is supplied predominantly as part of an equipment and if the software loses its identity and the equipment takes over the main objects of the transaction then it has to be treated as transaction of sale and purchase of machine and not as transaction for sale and purchase of software. It has already been established on the basis of facts before us that the transaction involved in this case was that of sale of diamond scanning machine. The customer had no interest in the software except to the extent of effective functioning of the machine. Thus, it has to be treated as transaction of sale of machine in the hands of the assessee and the amount bifurcated for software cannot be treated differently as consideration in the nature of "Royalty" as envisaged u/s 9(1)(vi) and since the assessee has no P.E. in India, as per admitted facts on record, the amount of profit arising on receipt of sale consideration of machine would not be liable to be taxed in its hands in India. We find that position of law on this aspect is clear. *Bombay HC in DIT vs. A.P. Mollar Maersk, 2015-TII-33-HC-MUM-INTL* reiterated the same position.

2. In terms of section 90(2), provisions of the Act or the treaty, whichever is more beneficial shall apply to the assessee. Further, amendment to the Act cannot be automatically read into the treaty unless the treaty is also amended. In the case of *CIT vs. Siemens Aktiongesellschaft*, this proposition has been reaffirmed by the Bombay HC after analysing the law in detail. The provisions of Indo-Israel treaty would be preferred over the provisions of the Act, since there is no amendment in the treaty and the Department is seeking to put more tax liability upon the assessee taking help of amendment made in section 9(1)(vi). The status of the provisions in the treaty is kept same as was in the pre-amended law as contained in the provisions of the Act.

3. According to the provisions of the treaty, as has been explained in various judgments, transfer of copyright is different from transfer of copyrighted article. Thus, in view of the facts of the case before us, even if payment for software is taxed separately from hardware, on a standalone basis, even then the same would not fall within the scope of Article-12(3) since there was merely transfer of a copyrighted article, and not the copyright or any rights contained therein. This position is substantially clarified once we go through various clauses of agreement entered into by the assessee with the customers called as End User License Agreement.

4. We can safely conclude that if the assessee cannot be fastened with the tax liability under the provisions of a tax treaty, then the same cannot be imposed by applying the provisions of the Act by disregarding and overriding the provisions of the treaty. In the case before us, it was the case of predominantly a transaction of sale of machine by the assessee to its customers and for the customers also it was in effect a transaction of purchase of machine only, and thus it was not a case of sale of software, as such. This issue was not there before the HC in these judgments. Therefore, this issue has not been addressed by the HC. Similarly, other case relied upon by the *CIT-DR of DDIT vs. Reliance Infocom*, it is noted that this judgment has based its decision mainly relying upon the aforesaid two judgments of Karnataka HC. Although, an argument was taken before the Bench in the said case that software was integral part of the hardware but on facts Bench held that the software supplied was not an integral part of equipment nor it was a case of embedded software. But in the case before us, we have

held on facts that it is a case of predominantly a transaction of sale and purchase of machine. The software had no independent identity. The substance of the transaction was supply of machine by the assessee and its usage by the customers in whatever manner it was possible i.e., with or without software. Thus, we find and respectfully state that all these judgments as have been relied upon by CIT-DR are not applicable on the facts of this case before us.

5. For the purpose of appreciating scope and meaning of Article 12(3) of Indo-Israel DTAA in the context of impugned transactions done by the assessee, we have also analysed the provisions of Copyright Act, 1957, in India to examine whether there was any transfer of copyright or rights therein, by the assessee to its customers in India. In this regard, we find that section 14 of the said Act explains and defines the meaning of term copyright. From the perusal of the above definition what we are able to gather is that none of the clauses is attracted when assessee has sold the machine along with its requisite software to operate and use the machine. The assessee has not given any right, whatsoever, to its customers to resell any copy of the software supplied along with machine, as has been discussed by us in detail in earlier part of this order. The other arguments made on behalf of the Revenue is that the Customers were supplied the software through email and other electronic medium and they has also made copies of the software programme for the purpose of loading it the machine and creating back-up files. It is noted that even this apprehension of the Revenue has been taken care of by the Copyright Act. Thus, it is clear that if customer makes requisite copies to enable it to use the software for exclusively its own purposes or makes back-up copies purely as a temporary protection against loss, in order only to utilize the computer programme for the purpose for which it was supplied, then section 52 clearly states that it shall not amount to infringement of the copyright. Thus, in the facts of this case which we have discussed in detail above, neither there was any transfer of copyright or any rights therein nor there was any situation giving rise to any type of infringement of copyright by the customers of the assessee. Thus, in our considered view account of sales consideration received by the assessee on account of sale of machine along with it operating software would not constitute "Royalty" within the meaning of article 12(3) of the Indo-Israel DTAA;

6. Apart from that, we find that SC has observed time and again in some of its judgments that where two views are available, then the view favourable to the assessee should be followed, in the interest of justice and harmony. We are reminded of a recent judgment of SC in *CIT vs. Vatika Township Pvt. Ltd., 2014-TIOL-78-SC-IT-CB,* wherein similar view has been reiterated by the SC by making the detailed observations on this aspect. Although, the stand of the Revenue has been that there were two views available on this issue but we find that in the facts of the case before us, the judgments quoted by the Revenue are not applicable and are distinguishable from the facts of the case before us. We further find that latest views coming from Delhi HC and other Courts are leaning more towards the views in favour of the assessee on the issue before us and, therefore, under such circumstances and in the interest of justice and fairness we have preferred to follow more recent judgments brought before us by the parties. Our approach is also in live with the guidance given by SC in the case of Vatika Township.

7. Before we part with, we shall like to clarify and reiterate at the cost of repetition that we have not examined the effect of subsequent amendment to section 9(1)(vi) and also whether the amount received for use of software would be "Royalty" in terms thereof for the reason that the assessee is covered by tax treaty the provisions of which are more beneficial and also for the reason that in this case transaction under consideration was predominantly and essentially of the character of sale and purchase of machine and not that of software. It is held that the amount received by the assessee was not liable to tax as "Royalty" and therefore addition made by the Assessing Officer is directed to be deleted.

13. India – Mauritius DTAA – Buyback transaction taxable as capital gains, exempt under India-Mauritius Tax Treaty; even if considered as dividend, tax withholding does not apply. In favour of the assessee

Goldman Sachs (India) Securities Pvt. Ltd. vs. ITO (International Taxation) [TS-72-ITAT-2016(Mum)] Assessment Year: 2011-12

Facts

1. The Taxpayer, an Indian resident company, is a wholly-owned subsidiary of a Mauritian company (Parent Co). The Taxpayer undertook a buyback on account of which shares of face value of INR10 per share were bought back at INR46.79 per share.

2. The Assessing officer considered the excess payment over face value value of share as distribution of accumulated profits to its only shareholder i.e., Parent Co and, hence, taxable as dividend. The Taxpayer did not pay DDT on such payment. It also did not pay DDT on such payment. It also did not withhold taxes on such payment.

3. Therefore, the Assessing officer considered this buyback transaction as a colorable transaction to avoid payment of DDT. Accordingly, the Taxpayer was treated as a TID (i.e., assessed in lieu of Parent Co) and was held liable to pay tax at the rate of 5% on gross payment under Article 10 of the DTAA, plus applicable interest. Since the Taxpayer had not paid any taxes, interest was also levied for delay in withholding taxes.

4. The CIT (Appeals) observed that :

a) The assessee had not distributed dividend in past years, despite having profits after tax. Also, the Board of Directors did not provide any justification for not recommending dividend.

b) By undertaking buyback, the Taxpayer had, in effect, remitted the accumulated profits to its sole shareholder, without paying DDT. A buyback transaction is normally contemplated for achieving consolidation of shareholding and change in value of holdings. Since, in this case, the Taxpayer had only a single shareholder, the buyback did not serve any commercial purpose. Accordingly, the CIT(A) stressed on the inclusive definition of dividend and stated that buyback transaction, in this case, should be brought under the scope of dividend and subjected to tax as deemed dividend.

c) The payment of dividend was given an artificial color of capital gains to enable evasion of taxes by taking the benefit of Article 13(5) of the DTAA, which provides for taxability in Mauritius and exemption in India. Accordingly, the CIT (Appeals) brought the amounts remitted into the ambit of income by construing that such income arises from shareholding or participation of profits of subsidiary.

d) Further, on buyback, the share capital of the Taxpayer h ad reduced, such transaction was construed as capital reduction. Exemption from dividend on capital reduction could only be availed of on payment of DDT. Since the Taxpayer had defaulted in payment of DDT, the Taxpayer was a TID and was subject to interest on non-withholding of tax.

Decision

On appeal, the Tribunal held in assessee's favour follows:

1. Buyback of shares cannot be equated with capital reduction as they are two entirely different concepts. This is a finding on perusal of the provision of the Companies Act, that deals with capital reduction and buyback. This has also been discussed and so held in the Bombay High Court (HC) decision of Capgemini India Pvt. Ltd Company Scheme Petition No. 434 of 2014.

2. On tax treatment of buyback of shares, the Finance Minister's speech in 1999, that led to an amendment of the Income Tax Act and also

the CBDT Circular No. 779 dated 14 September 1999 issued by the Central Board of Direct Taxes (CBDT), specifically states that shareholders would not be subjected to dividend tax but taxed under capital gains provisions.

3. On account of the 2013 amendment, buyback transactions are subjected to DDT. However, as the transaction under consideration pertained to a period prior to this amendment, there is no ambiguity about the provisions that would govern taxability for buyback. Hence, the said transaction could not be regarded as deemed dividend. It should be subjected to tax as capital gains.

4. Since Article 13 of the DTAA specifically exempts such transaction from tax in India, the Taxpayer is not liable to withhold tax under the ITL. Accordingly, the Taxpayer cannot be considered to be a TID. Even if the payment was considered as dividend, the requirement to pay DDT would make the payment exempt in the hands of the shareholder. Accordingly, withholding tax provisions should not apply.

5. By placing reliance on the observations of the Bombay HC ruling of Capgemini (supra), the Tribunal ruled that if the Taxpayer entered into a transaction which did not violate any provision of the Income Tax Act, the transaction cannot be termed as a colorable device just because it results in non-payment or lesser payment of taxes in that particular year. The whole exercise should not lead to tax evasion. This is relevant. Non-payment of taxes by a taxpayer in certain circumstances could be a moral or an ethical issue. However, the taxpayer cannot be penalized for it.

14. Whether the income to the foreign branch from the credit given to its card holders outside India cannot be taxed in the hands of the Indian branch, since it is not arising in India and also it cannot be attributed to the assets and activities of the Indian branch – Held : Yes; Whether the fees in respect of such transaction are not taxable in India – Held : Yes – In favour of the Assessee.

ADIT vs Hong Kong and Shanghai Banking Corporation Ltd. 2016-TII-38-ITAT-MUM-INTL Assessment Year: 2000-2001, 2001-2002, 2003-2004

Facts

The assessee is a non-resident company, engaged in the business of banking. After the assessment order was passed, the assessment was reopened u/s 147. In assessment, the AO observed that the assessee had paid an amount to Visa Card and Master Card and that foreign banks earns substantial amount of discount/commission/inter change merchant establishment discount (ICMED). The AO held that the assessee had not offered the said discount in the return and that the ICMED towards the use of credit cards had deemed to accrue or arise in India. Therefore, the AO estimated the total inter change fees received by the non India branches/HO of the assessee on account of use of cards in India @1% of the interchange received and made an addition to the total income of the assessee.

Decision

The Tribunal held in favour of the assessee as follows:

We find that in the matter of Standard Chartered Grindlays Bank Ltd., the issue of taxability of commission with regard to Credit Cards was deliberated upon and decided by the Tribunal. As the issue is squarely covered by the decision of the above referred order of the Tribunal, so, we hold that the order of the CIT (Appeals) does not suffer from any legal or factual infirmity as far as issue of taxability of ICMED is considered. Confirming his order, we decide the effective ground of appeal against the AO.

Case followed:

Standard Chartered Grindlays Bank Ltd. – 2008-TII-62-ITAT-DEL-INTL.