INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 ***Larsen & Turbo Ltd. vs. DIT (International Taxation)- 136 taxmann.com 7 (Bombay)***

Charter Hire Charges received by non-residents from ONGC's contractor (L&T) chartering out barges and tugs for towing Compressor module of Platform, would not be Royalty, since Section 44BB applies to these Charter Charges

Facts

i) The Petitioner i.e. Larson & Turbo ('L&T'), a public limited company, was an engineering conglomerate and carried out varied business activities through independent divisions.

ii) On 6th February 2006, the Petitioner entered into a contract with the Oil and Natural Gas Corporation Ltd. ('ONGC'), where the Petitioner was awarded the contract for the survey (pre-engineering pre-construction pre-installation and post-installation), design engineering, procurement, fabrication, load out, tie-down/seas fastening tow out/sail out, transportation, installation, hook-up modifications of existing facilities, testing, pre-commissioning, commissioning of the BCP Booster Compressor Platform Project situated at an offshore location on Bombay High. Subsequently, on 28th February 2006, the Petitioner along with Samsung Heavy Industries entered into another agreement with ONGC to execute the work of survey, design engineering etc. under the Vasai East Development Project.

iii) Further, in order to fulfil the contractual obligations, the Petitioner had to transport certain equipment from its yard to offshore sites. For the said purpose, the Petitioner had to take on hire barges and tugs from six non-resident assessee's namely: Offshore Charters Pte. Ltd., Tickwink Pte. Ltd., Girino Enterprises Pte. Ltd., Airmat Singapore Pte. Ltd., Ellisons Imexports Pte. Ltd. and Atlantic Off-shore Services LLC.

iv) Since the barges and tugs were to be used for transportation of equipment from the Petitioner's yard to the offshore site, where the platform was to be erected, the Petitioner was of the view that if the income that accrued to the vessel owner would be chargeable to tax in India, the same would have to

be computed in accordance with the methodology provided for in Section 44BB of the Income-tax Act, 1961 ('the Act').

v) Accordingly, the Petitioner filed an application under section 195(2) of the Act with DDIT(IT) and sought permission to remit the charter hire after deducting tax at source at the rate of 4.223%, on the income component of the charter hire, which was estimated at 10% of the gross amount.

vi) The AO had accepted the contention of the assessee and had directed the Petitioner to deduct tax at source @4.223% on the entire payment to the Offshore Charters Pte. Ltd ('OCL') as section 44BB had clear application.

vii) However, the AO issued an order dated February 15, 2008, under section 195 of the Act, after seeking clarification from the Petitioner on January 28, 2008, wherein he held that according to him, the assessee was making payment for the hire of barges and tugs i.e commercial equipment and hence the same would constitute Royalty as per Clause (iva) of Explanation 2 of section 9(1)(vi) of the Act along with Article 12 of the India-Singapore DTAA and consequently the assessee was liable to deduct tax @11.729% applying the provisions of section 195 and section 115A of the Act.

viii) It was further observed by the AO that Section 44BB was inapplicable as the same was applicable only to a person, who renders services or supplies plant and machinery to a party in the business of actual exploration of mineral oil and since the Petitioner was not engaged in the business of exploration of mineral oil and was only assisting ONGC in the said business, the provisions of Section 44BB were inapplicable to a sub-contractor or service provider, as the Petitioner.

ix) Aggrieved, the Petitioner filed an application before DIT(IT) under section 264 of the Act. However, placing reliance on the decision of the Hon'ble ITAT (Delhi) in ***O.N.G.C. vs. Inspecting Assistant Commissioner [1989 (29) ITD 422 Del],*** DIT(IT) held that Section 44BB of the Act was not applicable where equipment was used merely for transport men and material to transport sites.

x) Aggrieved, the Petitioner filed a writ petition before the Hon'ble High Court challenging the order of the DIT(IT) under section 264 of the Act (as there was no other alternative remedy available).

Decision

i) The sections involved in the said issue are mainly Explanation 2 to Clause (iva) to section 9(1)(vi) of the Act and section 44BB of the Act. The relevant extracts of the same are as under:

Section 9(1)(vi) -

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head ("Capital gains") for.....

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB."

Section 44BB -

".....in the case of an assessee, being a non-resident, engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax...."

ii) The Hon'ble High Court observed that a conjoint reading of Section 9(1)(iv) with Clause (iva) of Explanation 2 and Section 44BB of the Act, 1961, would indicate that any income by way of royalty, payable by a person, who is a resident, includes consideration for the use or right to use any industrial, commercial or scientific equipment but does not include the amounts referred to in Section 44BB and such royalty shall be deemed to be the income accruing or arising in India.

iii) The Hon'ble High Court further noted that the view of the AO that the benefit of Section 44BB would be admissible only to the person directly using the services/plants and machinery for exploring, extracting or producing mineral oils and not to the entity which executes the contract for such person was not borne out by the text of Section 44BB.

iv) The Hon'ble High Court noted that there was material to indicate that the Petitioner had grossed up the profits by 10% and thereafter had paid the taxes.

v) The Hon'ble High Court while deciding whether a connection existed between the hiring of the tugs & barges by the Petitioner and the exploration, extraction or production of mineral oils, placed reliance on the contract between the Petitioner & ONGC and concluded that the use of the expression 'in connection with' in Section 44BB is of significance. It further held that the said expression, expands the horizon of the services or facilities, provided by a non-resident assessee, which falls within the ambit of the said provision, provided they have a connection with the exploration, extraction or production of mineral oils.

vi) The Hon'ble High Court further held that as per section 44BB of the Act, the emphasis was not as much on the service, facility or plant & machinery. It was the proximity or connection of the service, facility, plant or machinery with the process of exploration, extraction and production of mineral oils, that was of determinative significance.

vii) Applying the test of pith and substance as laid down by the Hon'ble Supreme Court in the case of ***Oil and Natural Gas Corporation Limited vs. Commissioner of Income Tax and another [(2015) 7 Supreme Court Cases 649]*** to the facts of the current case, the Hon'ble High Court held that as there was no qualm over the fact that the Petitioner had entered into a contract with ONGC on turn-key basis for enhancing the exploration/production capacity of the platform at Bassein field offshore site and, for the said purpose, the Petitioner had hired the tugs and barges from the non-resident assessee, the authorities were not justified in arriving at the conclusion that the use of the tugs and barges were in the nature of a mere transportation facility.

viii) The Hon'ble High Court noted that the DIT(IT) had recorded that the tugs were hired by the Petitioner to transport the Compressor Module from the yard to the offshore platform and the said

compressor as per the records was an integral part of the execution of the contract by the Petitioner.

ix) The Hon'ble High Court thus concluded that the hire of the tugs and barges, to transport an integral part of the equipment to enhance the exploration/ production capacity, was inextricably connected with the extraction and production of mineral oil.

x) The Hon'ble High Court finally concluded that the payments made by the Petitioner to the non-resident assessee in the execution of the contract with ONGC were properly assessable under the provisions on Section 44BB of the Act and hence the impugned order of the DIT(IT) deserved to be quashed and set aside.

Tribunal

2 *FCC Co Ltd vs. ACIT [[2022] 136 taxmann.com 137] (Del - Trib.)*

Rendering of agreed engineering services not of supervisory nature by the Japanese Company in the premises of its Indian JV was not considered as having a Fixed place PE/Supervisory PE of the Japanese Company in India, under Article 5 of the India-Japan DTAA, as the Japanese Company had no control over the Indian premises [AY 2015-16]

Facts

i) The assessee, a tax resident of Japan, was engaged in the business of manufacturing clutch systems and facing for cars, motorcycles, utility vehicles, specialized tools and dies and moulding. The assessee, being a non-resident in India was thus governed by the beneficial provisions of the India-Japan DTAA.

ii) The assessee had entered into a joint venture agreement with Rico Auto Industries Limited ('Rico Auto') and formed a JV company in India, namely FCC Rico Limited ('FRL') in the year 1997. The assessee had further incorporated a wholly-owned subsidiary in India known as FCC Clutch India Private Limited ('FCC Clutch') in the year 2014. FRL and FCC were both engaged in the business of manufacturing and supply of automobile clutch assemblies.

iii) In 2015, Rico Auto exited from the FRL and had transferred all its stakes to FCC Clutch and thereafter FRL got merged into FCC Clutch w.e.f. January 01, 2015. Thus, FRL now ceased to exist after the merger.

iv) The assessee during the year under consideration had received the following incomes from FRL:

i. Royalty income under a license agreement (offered to tax @ 10% on a gross basis as per the provisions of the India-Japan DTAA.

ii. Fees for Technical Services ('FTS') as per the Agreement for Dispatch of Engineers (offered to tax @ 10% on a gross basis as per the provisions of the India-Japan DTAA).

iii. Income from the supply of raw material, components and capital goods under the Master Sales Agreement ("MSA"). Receipts from transactions under MSA were not offered to tax as the assessee treated them to be in the nature of business profit not taxable in India in the absence of a PE under the provisions of India-Japan DTAA.

v) The AO held that FRL's premises in addition to hosting the business activities of FRL served as a branch and an office to the assessee. Further, the assessee had also deputed professionally qualified employees to the factory site of FRL in India and hence the AO concluded such a factory site to be a Fixed Place Permanent Establishment ('PE') of the assessee in India.

vi) The AO further held that the employees deputed in India also helped FRL in setting up a new product line in India for which end-to-end supervision was required. As the period of stay of such employees also exceeded six months, the AO concluded that the assessee had a Supervisory PE in India as per Article 5(4) of the India-Japan DTAA.

vii) The AO further taxed the receipts from the sale of raw materials and capital goods by attributing 50% of the profits to the alleged PE.

viii) The DRP relied on the judgement of the Hon'ble ITAT in the case of HUAWEI TECHNOLOGIES CO LTD, China, V. AD1T (ITA Nos. 5253/Del/2011, 5254/Del/2011, 5255/Del/2011 & 5256/Del/2011 dated 21/03/2014) - Del ITAT and upheld the order of the AO.

ix) Aggrieved, the assessee filed an appeal before the Tribunal.

Decision

i) The Tribunal noted that as per Article 5(1) of the India-Japan DTAA a PE of a foreign enterprise may exist in India when a foreign enterprise has a Fixed Place in India through which the business of the foreign enterprise is wholly or partly carried out. In order to constitute a fixed place PE under Article 5(1) of the India-Japan DTAA, the following conditions need to be satisfied:

   (i) the existence of a 'place of business', i.e. a facility such as premises;

   (ii) the place of business must be at the disposal of the enterprise;

   (iii) this place of business must be 'fixed', i.e. it must be established at a distinct place with a certain degree of permanence; and

   (iv) the 'carrying on of the business' of the enterprise through this fixed place of business.

ii) The Tribunal observed that the premises of FRL were alleged to be a place of business from which the business of the assessee was being carried out. The Tribunal further mentioned that it was a settled position that in order to constitute a Fixed Place PE it is a prerequisite that the alleged premise must be at the disposal of the enterprise.

iii) The Tribunal relying on the judgement of the Hon'ble Supreme Court in the case of ***Formula One World Championship vs. CIT [Civil Appeal No. 3849 of 2017***] held that merely giving access to the premise to the enterprise for the purposes of the project would not suffice and that the place would be treated as at the disposal of the enterprise so as to constitute a fixed place PE only when the enterprise had right to use the said place and had control thereupon.

iv) Thus, the Tribunal concluded that the assessee did not satisfy any of the conditions laid down for having a Fixed Place PE in India and the Hon'ble Tribunal further added that merely providing access to the premises

by FRL for the purpose of providing agreed services by the assessee would not amount to the place being at the disposal of the assessee.

v) The Tribunal negated the reliance placed by the Learned DR on certain clauses of the License Agreement and the judgement of Hon'ble Supreme Court in ***Mahabir Commercial Co. Ltd (1973 AIR 430)*** to contend that that title of goods supplied by the assessee to FRL passed in India and hence the assessee was carrying on business in India. The Tribunal concluded that since the goods were manufactured outside India, the sale of goods took place outside India, consideration was also received by the assessee outside India and title was passed outside India, the assessee had not carried out any operation in India in relation to the supply of the raw material and capital goods. Thus, the assessee had no Fixed Place PE in India.

vi) The Tribunal further mentioned that as per the documents submitted by the assessee with respect to the employees that visited India to assist FRL, the employees only provided services like resolving problems relating to production, fixing machines, maintenance of machines; checking safety status at the premises and suggesting ways for enhancing safety; support in quality control; IT-related services; support for the launch of new segment line; etc. Further, none of the mentioned services were in the nature of supervisory or overseeing functions or watching over someone or something which was not reflected in the work done by the engineers in India for FRL.

vii) The Tribunal observed that FRL was in the existing business for many years and also that no new line of business was launched by FRL. The Tribunal further mentioned that as the activities rendered by these employees (who visited India on year to year basis under the contract) were not in connection with a building site or construction installation or assembly project, the issue of computation of a period of six months was academic.

viii) The Tribunal further mentioned that the employees had visited India to render certain technical services under the License Agreement read with Dispatch of Engineers Agreement which had already been duly offered to tax by the assessee as FTS as per the provisions of India-Japan DTAA.

ix) The Tribunal, thus concluded that the assessee had no Supervisory PE in India and also concluded that as there was no PE, the issue of attribution of profits would not arise further.

3 *Dy. CIT vs. Softdel Systems Pvt. Ltd – [2022] 136 taxmann.com 224 (Mumbai-Trib)*

TP Adjustment to be restricted to margin retained by captive service provider foreign AE, where the AE was remunerated by the assessee on cost-plus basis

Facts

i) The assessee was a domestic company having three AEs viz Softdel US and SoftDel Europe (which were wholly-owned subsidiaries) and SoftDel Japan which was a branch office.

ii) The assessee belonged to Softdel group which was engaged in software development solutions in the area of industrial automation, building automation, test and measurement and media electronics. The software was developed at the development centre of

the group in India. The group entities located in the respective countries entered into contracts on behalf of the assessee for the supply of software solutions. The onsite work was carried out by the AEs.

iii) The assessee had entered into a Master Service Agreement with US-based AE, under the said agreement AE was to procure clients for the assessee. AE also deployed personnel and infrastructure to provide Marketing and Support to the assessee in the USA, for which AE was entitled to reimbursement of cost along with a mark-up of 5% on such costs.

iv) In The TPSR (Transfer Pricing Study Report), the assessee had considered the US-based AE as a tested party as it was performing simple functions and was not owning any intangibles. The assessee adopted OP/TC as PLI and selected three comparables with an arithmetic mean of their margin on cost at 10.35% and claimed that the said transaction was at arm's length price.

v) The TPO rejected the transfer pricing analysis conducted by the assessee on the basis that the audit report of the tested party (i.e. foreign AE) and comparables were not filed by the assessee and therefore data considered for transfer pricing analysis was not reliable. The TPO conducted a fresh independent search for comparables (taking assessee as the tested party) and arrived at a set of 17 comparable companies having arithmetic mean margins of 24.05%.

vi) The CIT(A) directed the TPO/AO to restrict the adjustment to the extent of the margin retained by the AE if the computed adjustment was exceeding the said amount.

vii) Aggrieved, the Revenue filed an appeal before the Hon'ble Tribunal.

Decision

i) The Tribunal opined that if the mark up allowed by the assessee i.e. 5% was replaced with the margin proposed by the TPO i.e. 24.05%, in that case, it will result in a higher amount (i.e. cost component plus the ALP margin) being retained by the AE from the revenue received from the customers and corresponding total revenue both of the assessee and the AE would be much higher than the actual amount billed to the customer. Further, the Tribunal held that the ALP margin adopted by the TPO (i.e. 24.05%) over and above the markup allowed to the AE was neither received by the assessee nor by the AE from its customers.

ii) The Tribunal also relied on its coordinate bench rulings in the case of ***ITO vs. Omniglobe Information Technologies India Pvt Ltd-TS-311-ITAT-2019(Del)-TP*** and ***Fortune Infotech Ltd-TS-37-ITAT-2016(Ahd)-TP,*** wherein it was held that transfer pricing adjustment to be restricted to the amount of margin retained by the AE as the adjustment computed by the TPO in the order passed under section 92CA(3) of the Act at best could not exceed the net amount retained by the associated enterprises in respect of international transactions, i.e., gross revenue 'received from the end customers less amount paid' to the assessee and, other operating expenses

iii) The Tribunal thus upheld the order of the CIT(A) & dismissed the other grounds of the Revenue as they had become academic in nature.

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