INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 *M/s Flipkart Internet Private Limited vs DIT (International Taxation)- [(2022) 139 taxmann.com 595 (KAR)]*

Karnataka HC held that there is no bar on applying for nil TDS certificate u/s 195(2) or u/s 197, even in respect of tax-exempt payments. Accordingly, it directed Revenue to grant Nil TDS Certificate under section 195(2) and further held that reimbursement of salary of seconded employees, in the facts of the given case could not be taxed as FTS

Facts

i) The Petitioner i.e. Flipkart Internet Private Limited ('Flipkart') was incorporated on October 1st ----------and engaged in the business of providing Information Technology Solutions and Support Services for the e-commerce industry.

ii) Subsequently, in 2018, Walmart Inc., Delaware, USA ('Walmart Inc.') acquired the majority shareholding in the Petitioner Company. Walmart Inc. and Flipkart Singapore entered into an Inter-Company Master Services Agreement (M.S.A) on May 28th,2019, for the secondment of employees and provision of services. In terms of the agreement, either of the parties or its affiliates could use the seconded employees.

iii) The M.S.A had two distinct parts: a) relating to the provision of services and b) secondment of employees. The matter of concern in the given scenario was the secondment of employees.

iv) Clause 4.2 of the M.S.A mentioned that the party placing the secondees will invoice the compensation and the wage cost of secondees incurred in the Home Country.

v) In terms of the M.S.A, Walmart Inc. had seconded four employees to the Petitioner and at the same time entered into a 'Global Assignment Arrangement' with the seconded employees which provided that the seconded employees would work for the benefit of the Petitioner.

vi) The Petitioner had also issued appointment letters to the seconded employees, confirming their appointments and at the same time mentioning the details of their responsibilities.

vii) The Petitioner made contribution to the Provident Fund Authorities in the capacity of 'employers of the seconded employees' and also mentioned that the said employees were working in India on an 'Employment Visa' where the Petitioner was declared to be the employer.

viii) The Petitioner, in the course of business, had made payments in the nature of "pure reimbursements" to Walmart Inc. for the Assessment Year 2020-21 in response to the invoices raised as regards the payment made towards salaries of the seconded employees by Walmart Inc. for administrative convenience.

ix) Further, in that regard, the Petitioner filed an application under section 195(2) of the Income-tax Act, 1961 ('The Act'), requesting for allowing the remittance of cost-to-cost reimbursements to be made by the Petitioner without deduction of tax at source.

x) However, the said application filed by the Petitioner was rejected by the DCIT and it was asked to deduct tax at source at the applicable rate via order dated May 1st, 2020 on the ground that:

a) "There is no employer-employee relationship between Flipkart Internet Private Limited India and secondees seconded by the assessee.

b) The services rendered/provided by the seconded employees are in the nature of technical services, both under the Act and under DTAA as well.

c) Deduction under section 192 does not result in double deduction nor does it obviate the need to deduct under section 195.

d) Once the income is in the nature of FTS/FIS, it is to be taxed on a gross basis; there is no need to examine whether or not income element is embedded in the said payment"

xi) The Petitioner contended that the rejection of the application was wrong as there is no requirement to deduct tax under section 195 of the Act on payments which were in the nature of reimbursement, as 'withholding obligation' under Section 195 arose only when the 'sum-paid' to the non-resident was 'chargeable to tax' under the Act and also that the sums paid could not be regarded as Fees for Technical Services ('FTS').

xii) Aggrieved, the Petitioner filed a Writ Petition before the Hon'ble High Court.

Decision

i) The High Court considered the above-mentioned facts and analysed the situation in parts.

A. Whether the application of the petitioner filed under section 195(2) of the Income-tax Act was not maintainable?

i. The Hon'ble High Court noted that the Revenue had mentioned that the application under section 195(2) of the Act was maintainable only in the event of composite payment and that where a Nil Deduction was sought, recourse was to be made under section 197 of the Act. However, while rejecting the application filed by the Petitioner, the DCIT had not dealt with this aspect and had rejected the application on merits. As there was no finding given by the DCIT regarding the non-maintainability of the said application, the Court held that it was not open for the Revenue to canvass such a point in the proceedings instituted by the Petitioner.

ii. It also added that the scope of section 197 of the Act is different from that of section 195(2) of the Act, as section 197 would come into operation on an application by the recipient of an income, which was not a factual case here. The Hon'ble High Court, after considering the relevant rules and the forms concluded that the application under section 195 of the Act was at the instance of the person making the payment, while the application under section 197 is at the instance of the recipient.

iii. The Hon'ble High Court relying on various judicial precedents concluded that the determination under section 195(2) or section 197 of the Act by a grant of certificate was tentative in nature and that the assessee must be permitted to invoke such provision and seek for the certificate in order to avoid consequences of non-deduction as enumerated above. To place such a heavy burden of adjudication upon the assessee before invoking the tentative determination under section 195(2), may not be called for. Accordingly, the recourse to section 195(2) of the Act was perfectly in consonance with the object of section 195 and could not be faulted.

B. Whether the Petitioner was required to deduct TDS under section 195(2) of the Act read with Article 12(4) of the India-US DTAA?

i. The Hon'ble High Court relying on the decision of the Apex Court in the case of Engineering Analysis noted that the words chargeable under the Act if read in conjunction with the provision of Article 12(4) of DTAA and the obligation under section 195(2) of the

Act is looked at, it becomes clear that Fees for Included Services ('FIS') as defined in Article 12(4) was more beneficial to the assessee. Accordingly, Article 12(4) is required to be applied to determine liability to deduct tax.

ii. The Hon'ble High Court further noted that in terms of Article 12(4)(b) for the purpose of construing 'FIS', it was necessary that the rendering of technical or consultancy services did make available technical knowledge, experience, skill, know-how or process which may also consist of development and transfer of a technical plan or technical design. Accordingly, it was not a mere rendering of technical or consultancy services, but the requirement of "make available" in terms of Article 12(4)(b) that was to be fulfilled.

iii. The Hon'ble High Court thus concluded that the DCIT only mentioned that the payment made to Walmart Inc by the Petitioner would fall in the category of rendering technical, consultancy services but did not examine the make available aspect. Further, the M.S.A was also insufficient to treat such payment as FIS as it did not reveal the satisfaction of the requirement of make available which is a sine qua non for being a FIS.

C. Deduction under section 195(2) of the Act on the 'sum chargeable' under the Act -

i. The Hon'ble High Court noted that the finding that the services rendered fall within the description of FTS as defined in Explanation 2 in section 9(1)(vii) of the Act and that the element of profit was not an essential ingredient of receipt to make it taxable was erroneous.

ii. The Hon'ble High Court further added that as concluded above the beneficial provision from the Act and the DTAA is applicable to the assessee and hence the definition of FTS in section 9(1)(vii) of the Act is different from that in Article 12(4)(b) i.e. FIS, which requires "make available". Hence, the conclusion that the payment for the service was 'deemed income' u/s 9 of the Act was rejected.

D. Whether a deduction is on gross receipts?

i. The Hon'ble High Court distinguishing the mechanism of sections 194J/194C of the Act and that of section 195(2) of the Act and relying on the judgement of the Apex

Court in the case of GE India Technology rejected the contention of the Revenue of deduction was to be made on the gross amount.

E. Secondment and reimbursement of costs

i. On the grounds that a) Walmart Inc. Issues invoices of secondment b) the equity eligibility of seconded employee continue to be tied with Walmart Inc. and c) Walmart Inc. had the power to decide the continuance of the services with Walmart Inc. in the USA after the termination of their secondment in India - DCIT had concluded that there was no employer-employee relationship between the Petitioner and the seconded employees. However, the DCIT failed to make note of the relationship between the Petitioner and the seconded employees during the period of secondment.

ii. The Court concluded that as the Petitioner issued appointment letters, as the employees reported to the Petitioner, the Petitioner had the power to terminate the services of the employees, the Petitioner was the employer of the seconded employees; an employer-employee relationship did exist between them. Further, it also added that the fact of who the employer was would have no conclusive bearing on whether the payment made was FIS or not in the light of the further requirement of make available.

iii. The Hon'ble High Court distinguished the decision of the Apex Court in the case of Northern Operating Systems, relied upon by the Revenue and held that the said judgement was in the context of service tax and the only question for determination was as to whether the supply of manpower was covered under the taxable service and was to be treated as a service provided by the foreign company to an Indian company, whereas in the instant case, the legal requirement is whether to treat service as FIS, which is 'made available' to the Indian Company.

F. Distinguishing the Judgement in Centrica India Offshore (P.) Ltd vs. Commissioner of Income-tax-I, New Delhi

a. The Hon'ble High Court noted that the facts of the aforesaid case were different from that of the instant case.

b. It noted that it is to be established that a) the domestic entity was the real employer and there was no service PE in the

local country b) there was indeed reimbursement in the true sense and that the cost payment among related entities was to be ignored and c) the FIS satisfied the make available test.

c. Accordingly, there was a difference in the facts and the material on record in both scenarios.

ii) The Hon'ble High Court noted that the DCIT had filed a note dated 10th March 2020 to the CIT, requesting for deduction of TDS @ 0% on cost-to-cost reimbursement. However, his opinion was directed to be reconsidered as per the endorsement found by the Hon'ble High Court in the file submitted and eventually an order was passed by the DCIT contrary to his earlier view, rejecting the application filed by the Petitioner.

iii) The Hon'ble High Court set aside the findings in the impugned order and the conclusion therein regarding the employer-employee relationship being based on the wrong premise and held that the Revenue missed the Hon'ble Karnataka HC Division Bench's judgement in the case of Abbey Business services wherein it was held that the secondment agreement constitutes an independent contract of service in respect of employment and proceeded to decide that secondment falls under FIS.

iv) The Hon'ble High Court directed the DCIT to issue a Certificate under section 195(2) of the Act to the effect of 'Nil Tax Deduction at Source' as regards the Petitioner's application dated 15th January 2020.

B. Tribunal

2 *BMC Software Asia Pacific Pte Ltd vs. ACIT (IT)- [(2022) 140 taxmann.com 328 (Pune Tribunal)]*

IT Support Services in relation to software sale was not taxable as Fees for Technical Service neither under Article 12 of the India-Singapore DTAA as a) the sale of software was not taxable as royalty and consequently I.T Support services could not be taxed as FTS under Article 12(4)(a) on the ground that the same was ancillary and subsidiary to a payment taxable as royalty under Article 12(3)(a) b) the condition of making available of the technical knowledge etc. under Article 12(4)(b) was not satisfied

Facts

i) The Assessee, a tax resident in Singapore, was engaged in selling Software products to end-users and customers. The assessee filed a Nil Return during the relevant year.

ii) The assessee had earned income from India aggregating to ₹ 109,01,25,420/- from the sale of Software licenses (₹ 67.94 crores) and support services in relation thereto (₹ 41.06 crores), which was not offered for taxation on two grounds:

a. the first component i.e. sale of software licenses did not result in the transfer of copyright ('first component'), and was thus not taxable as royalty

b. the second component was for Support services which did not make available any technical know-how to the customers ('second component'), and was thus not taxable as FTS

iii) The AO noted that the Dispute Resolution Panel ('DRP') in earlier assessment years had confirmed the action of the AO in treating the sale of Software licenses as Royalty. Hence, the AO held that the first component was chargeable as Royalty under the Act as well as Article 12(3)(a) of the India-Singapore DTAA and the second component was taxable as `fees for technical services under the Act and also Article 12(4)(a) of the India-Singapore DTAA.

iv) The assessee raised objections before the DRP by contending that the Tribunal has deleted similar taxability in its own case for the A.Ys. 2010-11, 2016-17 and 2017-18. The DRP held that the income from the sale of software licenses (i.e. the first component) was not chargeable to tax in the light of the judgment of the Hon'ble Supreme Court in the case of ***Engineering Analysis Centre of Excellence Pvt. Ltd. vs. CIT (2021) 432 ITR 72 (SC).*** However, w.r.t the second component i.e. IT support services the DRP called for a Remand Report from the AO wherein the AO held that the IT Support Service charges were covered by clauses (a) and (b) of para 4 of Article 12 of the India-Singapore DTAA as against his earlier stand of taxability only under Article 12(4)(a) of the India-Singapore DTAA taken by him in his draft order. Accordingly, the DRP upheld the taxability of IT Support charges as FTS under the India-Singapore DTAA.

v) Aggrieved, the assessee filed appeal before the Hon'ble Tribunal.

Decision

i) W.r.t the taxability of the IT Support service charge under Article 12(4)(a)of the India-Singapore DTAA, the Hon'ble Tribunal held that :

a. the AO had taxed the income from software as Royalty under Article 12(3)(a) of the India-Singapore DTAA which the DRP had held to be wrong and had deleted the said addition.

b. para 4(a) provides that the FTS means any consideration for services which are ancillary and subsidiary to the application or enjoyment of the right, etc. for which payment described in para 3 was received. Thus, it was evident, that for an income to fall under para 4(a), it is necessary that there should be some amount falling in para 3(a) and the income as per para 4(a) should be for services ancillary to the enjoyment of the right property etc., `for which a payment described in paragraph 3 is received.

c. therefore the existence of any consideration under Article 12(3)(a) was a sine qua non for bringing any amount to tax under para 4(a) of Article 12.

d. since there was no amount taxable as royalties under Article 12(3)(a), the IT Support service charges,

as a natural corollary, could not be brought within the purview of Article 12(4)(a) of the India-Singapore DTAA.

ii) W.r.t the taxability of the IT support service charge under Article 12(4)(b) of the India-Singapore DTAA, the Hon'ble Tribunal held that:

a. Para 4(b) of Article 12 stipulates that consideration for services of technical nature etc. becomes FTS if such services "make available" technical knowledge, experience, skill, know-how or process etc. that enables the person acquiring the services to apply the technology contained therein.

b. as per para 4.3 of the Remand Report (submitted by the AO) which gives a description of the services rendered by the assessee, it was graphically apparent that the assessee had been called upon to perform a sizing review for new integrations and new lines of businesses; assisting Customer Operations team to perform Remedy operations; reviewing application performance and health check and quarterly review of activities undertaken. Further, the assessee was asked to deploy two persons for rendering on-site services. Accordingly, services rendered by the assessee to (***Bharti Airtel, Wipro Ltd.*** etc.) were described in detail.

c. thus, the services provided by the assessee did not require technical knowledge.

d. relying on the definition of 'make available' judicially settled by the judgements of the Hon'ble Karnataka High Court in ***CIT vs. De Beers India Minerals Pvt. Ltd. (2012) 346 ITR 467 (Kar.)*** and the Authority for Advance Ruling in Production resources group, in ***Re (2018) 401 ITR 56 AAR***, it becomes palpable that in order to `make available' technical services, it is essential that the recipient of the services must acquire such technical know-how etc. which he could himself use in future without any assistance of the provider. It could not be any act or service which is availed that simultaneously gets consumed without leaving any know-how in the hands of the service-receiver.

e. the services provided by the assessee were consumed with their provision and hence the assessee did not "make available" any technical knowledge, experience or skill etc. to its customers to apply in future.

iii) The Hon'ble Tribunal thus concluded that the income from the IT Support Service charge was not taxable as 'fees for technical services.

Note: Though not explicitly mentioned in the facts of the case it can be presumed that the assessee had No PE in India.

3 *Huhtamaki India Limited vs. DCIT [2022] 140 taxmann.com 4 (Mum - Trib.)*

Non-availability of date-wise analysis of transactions with AEs and non-AEs was no reason to reject TNMM. The same would be relevant only when CUP was adopted as MAM & not TNMM. Hence, internal TNMM adopted by the assessee could not be rejected on the grounds of non-availability of date-wise analysis for comparison of AE and Non-AE transactions

Facts

i) The assessee was primarily engaged in the business of manufacturing and sale of flexible packaging materials, rotogravure printing cylinders, CPP films, labels and metalized films. During the year under consideration, the assessee had manufactured and sold finished goods to its AEs and had exported raw materials and consumables to its AEs.

ii) The assessee benchmarked the above two transactions by applying internal TNMM as the most appropriate method. The profit level indicator (PLI) adopted by the assessee was Operating profit/ operating cost (OP/OC). The margin from the sale of manufactured finished goods to unrelated parties was -0.78% vis a vis 3.31% from its AEs. Since the margin of goods sold to AEs was higher than the margin earned from the sale of manufactured goods to non-AEs, the said transaction was considered to be at ALP using internal TNMM. Further, as a matter of abundant caution, the assessee also benchmarked the transactions by using External TNMM as the MAM. The assessee's margin was 3.31% from the export of manufactured finished goods and raw materials/consumables to AEs. The assessee compared its margin with 12 comparable companies whose margins were in the range of 2.84% to 7.06% with a median of 5.55%. Assessee's margin was falling within the arm's length range and thus claimed to be at arm's length.

iii) The TPO rejected the segmental results furnished by the assessee and stated that the same were not on an actual basis. Further, the TPO rejected 9 comparables companies from the chosen list of 12 comparable companies by the assessee and took 3 comparable companies of the assessee i.e. Packaging India Pvt. Ltd., Umax Packaging Ltd., and TCPL Packaging Ltd., and arrived at the average margin thereon at 8.5% and made an upward adjustment of INR 8,63,57,985.

iv) The Learned DRP held that AE and Non-AE segments had to be FAR compliant and hence, they could not be compared using Internal TNMM as the data w.r.t both the above segments pertained to different dates and thus there would not be a proper Internal TNMM comparison. Accordingly, Internal TNMM was rejected as MAM. The Hon'ble DRP further held that the audited segmental accounts given by the assessee should be accepted after proper modifications/adjustments made by the assessee which had also been submitted before the ld. DRP. Further, the DRP accepted four more comparables chosen by the assessee but rejected the remaining 5 comparables

as they were engaged only in the packaging industry and not the flexible packaging industry (like the assessee).

v) Aggrieved, the assessee filed appeal before the Hon'ble Tribunal.

Decision

i) The Tribunal held that date-wise comparison of data in respect of AE vis-a-vis non-AE transactions would be relevant only under the Comparable Uncontrolled Price (CUP) method. In the instant case, the ld. DRP had duly accepted TNMM as the Most Appropriate Method. The date-wise analysis for comparison of AE and non-AE transactions would be relevant only when CUP was adopted as MAM. They were certainly not relevant when TNMM is adopted as MAM.

ii) The Tribunal held that there was absolutely no difference with functions performed or Assets employed vis-à-vis AE and non-AE transactions. The Tribunal observed that the assessee had made higher margins with AE as compared to non-AE transactions. Hence, certainly, the assessee's international transaction with AE using Internal TNMM as the MAM was at arm's length, which had to be accepted.

iii) The Tribunal held that with respect to external TNMM, only broad functional comparability was required to be seen. Hence, even the regular packaging industry would become broadly functional comparable with flexible packaging industry in which assessee engaged in. The Tribunal further placed reliance on ***Watson Pharma Pvt. Ltd., vs. DCIT 168 TTJ 281 (Mum)*** and ***GE India Technology Centre Pvt. Ltd., vs. DCIT 141 TTD 245 (Bang)*** wherein it was held that TNMM requires only broadly functional end product/services comparability. The Watson Pharma case was upheld by the jurisdictional High Court in ***PCIT vs. Watson Pharma Pvt. Ltd., 257 Taxman 65 (Bom).*** The Tribunal, thus directed that the five comparable companies which were rejected by the ld. DRP ought to be included in the final list of comparables. By this process, effectively all the 12 comparables chosen by the assessee, on without prejudice basis, for applying External TNMM was approved.

iv) Accordingly, the entire TP adjustment was deleted.

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"The cheerful mind perseveres and the strong mind hews its way through a thousand difficulties."

— Swami Vivekananda