 

INTERNATIONAL TAXATION
Case Law Update

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A. HIGH COURT

1 ***Epcos Electronic Components S.A vs. Union of India***

[2019] 107 taxmann.com 227 (Delhi) – W.P. (C) No. 10417 of 2018

Revision petition under section 264 before CIT seeking rectification of return in respect of which intimation is sent under section 143(1) for taking benefit of Most Favourable Nation clause is maintainable

Facts

1. The assessee a company incorporated in Spain earned service fees for providing management related services to EIPL, an Indian Company. The assessee filed return offering the same for tax @ of 20% plus surcharge and education cess under Article 13 of the DTAA between India and Spain. The AO by an intimation dated 10th March, 2016 under Section 143(1) of the Act processed the return of income.

2. The assessee, later realised while referring to Article 13 of the DTAA that it had failed to refer to Clause 7 of the Protocol appended to the DTAA which is an integral part and parcel of the DTAA. According to the terms of the protocol, further concessional rate of tax was to be charged in terms of the agreement between India and another member of the OECD, by India after 1st January 1990, wherein India limits its taxation on FTS to a rate lower than that provided in Article 13 of the DTAA, then the said rate shall apply under the DTAA to the assessee as well.

3. This led the assessee to file the revision petition under Section 264 of the Act seeking to revise the order under Section 143 (1) of the Act claiming it to be prejudicial to the Petitioner's interest as the rate of tax should be 10% and not 20% for the FTS earnings, as the DTAA between India and Sweden was entered into on 25th December, 1997 i.e., more than two years after the DTAA between India and Spain which provided for the tax on FTS at 10%. The assessee also prayed for relief in respect of surcharge and education cess paid by mistake.

4. However, the CIT rejected the above contentions and observed that no amount was payable by the assessee in terms of the intimation under Section 143(1) of the Act and therefore no prejudice was caused to the assessee in terms thereof. He also observed that if the assessee was of the view that its income was chargeable to tax at 10% it should have mentioned the same in its return of income or should have subsequently filed revised return. It was held that Section 264 of the Act could not be invoked to rectify the assessee's mistake, if any.

5. **The assessee filed a writ petition against the order of the CIT rejecting the petition filed u/s. 264.**

Held

1. The Court observed that in *Vijay Gupta vs. CIT* (2016) 68 taxman.com 131 (Del) it was held that "intimation under section 143(1) is regarded as an order of the purposes of section 264 of the Act".

2. The assessee had voluntarily paid tax at the rate of 20% in terms of the Indo-Spain DTAA as tax on FTS and therefore there was no further tax to be paid at the time of filing of the return. However, it was not even denied by the Department that the assessee committed a mistake and should have paid tax at 10%. Even though, this extra 10% was paid by the assessee was of its own volition, it was indeed prejudicial to the assessee. Consequently, all the ingredients of Section 264 of the Act got attracted.

3. Thus, the Court quashed the order passed by the CIT and directed the Respondents to permit the assessee to rectify its return by paying tax on FTS at 10%.

2 ***PCIT vs. Sterling Oil Resources Ltd.***
[TS-639-HC-2019(BOM)] - ITA 341 of 2017

Share application money paid to an AE which remained with it for a considerable period of time could not be recharacterised as loan in absence of any material on record to suggest that the transaction was a sham. Consequently, no notional interest could be taxed in respect of the said share application money

Facts

1. The assessee-company had applied for allotment of shares of its AE. Such shares were, eventually allotted but after a gap of more than two years. The Department held a belief that for the period during which the share application money remained parked with AE, the same should be brought to tax on notional interest basis.

2. The Tribunal deleted the addition on the ground that the Assessing Officer cannot recharacterise the transaction. Thus, it was held that in the present case there was no interest free loan by the assessee to its AE

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

Held

1. The Court had under similar circumstances dismissed Revenue's Income Tax Appeal No. 1248/2016 holding that TPO could not disregard the apparent transaction and substitute the same without any material of exceptional circumstances pointing out that the assessee had tried to conceal the real transaction. It observed that TPO could not question the commercial expediency of the assessee entering into such transaction.

2. Accordingly, it dismissed Revenue's appeal as no substantial question of law arose.

3 ***PCIT vs. Li and Fung (India) Pvt. Ltd.***
[TS-658-HC-2019(Del)] – ITA NO. 176 of 2019

An entity that is a captive service provider cannot be compared to an entity providing service to large number of outside entities

Facts

1. The assessee, a captive unit and subsidiary of Li & Fung (South Asia Limited), a Company incorporated in Mauritius was engaged in the business of providing sourcing support services for which it was paid service charges at cost plus mark-up of 8%.

2. The PLI of the assessee company was computed by the assessee at 7.92% whereas the average PLI of the comparables was computed at 3.76% as per the analysis in the transfer pricing document. On reference being made to TPO a new search process was conducted with the final list having seven comparables and the PLI was

computed at 14.35%. The TPO had also included Axis Integrated System Ltd. as comparable noting that as per the annual report the said company had received income under the Head of "liaisoning charges" which as per the TPO showed that the said company was also providing business support services, similar to assessee's function.

3. The DRP upheld the TPO's order.

4. In appeal by assessee, the Tribunal excluded the said comparable.

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

Held

1. The Court noted that the Tribunal had rightly pointed out that no comparison could be drawn between an entity that is a captive service provider to its group entities and an entity like Axis, which was providing liaisoning services to a large number of entities. More importantly, Axis was also engaged in the business of issuing digital certification.

2. The Court also relied on its earlier decision in the case of *Rampgreen Solutions Pvt. Ltd. vs. CIT* 377 ITR 533 (Del) wherein it was held that *"comparability analysis by the transactional net margin method may be less sensitive to certain dissimilarities between the tested party and the comparables. However, that cannot be the consideration for diluting the standards of selecting comparable transactions/entities. A higher product and functional similarity would strengthen the efficacy of the method in ascertaining a reliable arm's length price. Therefore, as far as possible, the comparables must be selected keeping in view the comparability factors as specified. Wide deviations in profit level indicator must trigger further investigations/ analysis."*

3. Accordingly, the appeal filed by the Revenue was dismissed.

4 ***Pr. CIT vs. BirlaSoft (India) Pvt. Ltd.***
[TS-672-HC-2019 (Delhi)] - ITA No. 587 and 596 of 2019

Where assessee was a service provider to its associated enterprise (AE) as well as non-AEs internal benchmarking analysis could be done for determining arm's length price

Facts

1. The assessee-company had adopted Internal TNMM method for benchmarking of International transactions for provision of software development services for AY 2012-13 and 2013-14

2. The TPO/AO rejected the adoption of the said method.

3. The Tribunal allowed assessee's appeal following its order in assessee's own case for the assessment year 2008-09 wherein it was held that

i. The assessee was justified in undertaking internal benchmarking analysis on standalone basis by placing on record working of operating profit margin from international transactions with AEs and transactions with unrelated parties undertaken in similar functional and economic scenario, and the same should be the basis for determination of arms's length price in respect of international transactions undertaken with the associated enterprise

ii. The TPO had no mandate to have recourse to external comparables when in the present case, internal comparables were available, which could be applied for determining the arm's length price of international transactions with AEs.

4. Further, the Tribunal also noted that the aforesaid decision of the Tribunal for AY 2008-09 was also followed by the Tribunal in AY 2009-10 which was upheld by Hon'ble Delhi High Court in ITA No. 44/2015.

5. Aggrieved, Revenue filed an appeal before the High court.

Held

1. The Court noted that Hon'ble Delhi High Court in ITA No. 44/2015 in assessee's own case in AY 2009-10 had held that since the assessee was a service provider to its associated enterprise (AE) as well as other foreign customers or non-AEs, the suggestion that the non-AE transactions which reported lower margins are to be used for benchmarking the AE transactions was acceptable. Thus, no adjustment was called for. Furthermore, the Tribunal's reasoning was in accord with Rule 10B(1)(e)(ii) of the Income-tax Rules.

2. Accordingly, the appeal filed by the Revenue was dismissed.

5 ***Cognizant (Mauritius) Ltd. and Anr. vs. Deputy Commissioner of Income-tax, (International Taxation)***

[2019] 106 taxmann.com 389 (Madras) -W.P. Nos. 1244 & 1245 OF 2018

When an order is passed by AO which is not in conformity with report submitted by TPO, the assessee can file objections before DRP against the said order and writ petition for the same is not maintainable

Facts

1. The Petitioners were the shareholders in Cognizant Technology Solutions India Private Limited [In short "CTSIPL"]. As on 31-3-2013, one of the Petitioners i.e., Cognizant (Mauritius) Limited owned 1,39,93,649 shares and the other Petitioner Cognizant Technology Solutions Corporation, USA owned 39,60,000 shares in CTSIPL.

2. The Board of Directors of CTSIPL resolved that the shares could be bought by CTSIPL at the value of ₹ 23,915/- per share under Section 77 A of the Companies Act. CTSIPL had ascertained valuation of its shares through SEBI registered Category-I Merchant Banker and the price per share of the Company, based on the valuation undertaken using the Discounted Free Cash Flow ["DCF"] method, was ₹ 23,915.10.

3. The AO referred the determination of ALP for buy-back of shares to the TPO. TPO passed an order on 31-10-2017 accepting the transaction to be at ALP. Thereafter, a show cause notice was served by the AO on the Petitioners and a draft Assessment Order was passed on 31-12-2017 contending that FMV of the aforesaid shares was ₹ 8,512/- and consequently the excess consideration over the said FMV was assessed under Section 56(1).

4. The Petitioners filed a Writ Petition contending that the draft order was passed in violation of the principles of natural justice and in contravention of Section 92CA(4) of the Act, and since AO had failed to pass draft assessment order in conformity with TPO's order, the Dispute Resolution Panel had no jurisdiction to consider the objection of the Petitioners.

5. The Respondents filed a Counter Affidavit contending that the Writ Petition was liable to be dismissed *in limini* as the Petitioners had an effective and efficacious alternative remedy under the IT Act. They were entitled to file objections before the DRP under Section 144-C of the IT Act or to file an appeal against the final assessment order before the Commissioner of Income Tax (Appeals) under Section 246A of the IT Act.

Held

1. The Court framed the following questions for consideration :-

(i) whether principles of natural justice had been violated as alleged by the petitioners and

(ii) whether these Writ Petitions were maintainable at this stage.

2. The Court noted the fact that the Authorized Representative of the Petitioner-Company had appeared before the Respondent and submitted the documents and a reply to the show cause notice. Thus, there was no breach of principles of natural justice.

3. The Court further held that a plain reading of the sub-section (6) of Section 144 C of the IT Act made it clear that the Dispute Resolution Panel had very wide powers to consider all the materials and pass appropriate orders under 144C(7) of the Act. Thus, the Writ Petition was dismissed and Petitioners were given the liberty to raise all the issues before the Dispute Resolution Panel within two weeks from the date on which the judgment/order was made ready.

B. Tribunal Decisions

6 ***Kingfisher Airlines Ltd vs. DDIT***
[TS-430-ITAT-2019(Bang.)]

Payment made to Non-Resident for using foreign training facilities (in Dubai, Germany and Singapore) for training its pilots and cockpit crews out-side India cannot be regarded royalty/FTS

Assessment years : 2007-08 & 2008-09

Facts

i) The assessee (Kingfisher Airlines Ltd.) made payments to non-residents for training pilots and cockpit crew to Dubai, Germany and Singapore respectively. The training facilities were all located outside India, the training was given in the said countries and payments for the same were also made outside India. Thus, all ingredients of the transaction were outside India. It was claimed that the training given by the above companies was part of their routine business, involved use of technology by the training companies however did not involve transfer of any technology to employees of assessee.

ii) The assessee thus did not treat these services as fees for technical services (FTS). AO, on the other hand treated assessee as defaulter as per provisions of section 201(1) and 201(1A) for having not deducted tax at source u/s. 195 in respect of the payments made as aforesaid to non-residents. AO opined that these payments had the character of FTS u/s. 9(1) (vii) as well as relevant DTAA between India and the respective countries of which the recipients of payment from the Assessee were tax residents.

iii) CIT(A) held that payment made to Lufthansa Germany was not Royalty and payments made to UAE concern was not liable for tax in India and accordingly provisions of Section 195 were not applicable. With respect to payments made to Singapore, CIT(A) directed to reduce simulator usage fees from total payments and treat the balance amount as FTS liable for tax deduction u/s. 195 and directed the AO to recompute tax payable u/s. 201(1) and interest u/s. 201(1A).

iv) Aggrieved, both assessee and Revenue filed an appeal with Bangalore ITAT.

Decision

The Tribunal held in favour of the assessee as under:

i) Re: Payment made to M/s. Lufthansa, Germany

ITAT noted that a flight simulator was an essential part of training imparted to the pilots and crew of aircraft and the hourly quantification of such charges for use of the simulator did not mean that the assessee was hiring the same or making payment for a right to use the same. ITAT held that without the imparting of training by the instructors, the hiring of simulator on its own did not have any purpose and hence it could not be said that the assessee paid royalty for use of simulator;

ii) Payment to M/s. CAE Aviation, Dubai

ITAT held that this payment was not in the nature of Royalty. ITAT observed that the question whether it was FTS did not arise because of the absence of a clause relating to FTS in the DTAA regarding FTS and the settled position of law that in the absence of a clause in a treaty not dealing with a particular item of income, the same should not be regarded as residuary income but income from business and in the absence of Permanent Establishment in India (PE) of the non-resident in India, the same cannot be taxed. ITAT found that CIT(A)'s decision was in line with Co-ordinate Bench ruling in case of ABB FZ-LLC [TS-8702-ITAT-2017 (Bangalore)-O], which was a case rendered in the context of DTAA between India and UAE. ITAT held that CIT(A)'s decision was a correct interpretation of the treaty and found no grounds to interfere with the decision of the CIT(A) on this issue.

iii) Payments made to M/s. Alteon Singapore

(a) ITAT found that CIT(A) had upheld AO's order only on the ground of insertion of an explanation for retrospective amendment to the Sec. 9 by (by the Finance Act, 2010) from 1-6-1976. ITAT stated that, *"tax deduction at source obligation cannot be fastened on a person on the basis of a retrospective amendment to the law, which was not in force when the payments were made."* ITAT observed that Revenue sought to rely upon the *Explanation 2* to section 195 inserted by Finance Act of 2002 w.r.e.f 1-4-1961 which laid down that even if the payment by a resident in India to a non-resident constitutes business income in the hands of the non-resident then irrespective of the existence or non-existence of a permanent establishment of the non-resident in India, tax is liable to the deducted at source by the resident in India making payment to non-resident. ITAT noticed that such provision did not exist at the time when the assessee made such payments to the non-resident and it was not possible for the assessee to foresee an obligation to deduct tax at source by a retrospective amendment to the law. ITAT opined that amendment brought in by the Finance Act with retrospective effect, which was passed in the year subsequent to the year under consideration, should not be considered for penalizing the assessee by treating him as an assessee in default.

(b) Relying on *Kerala Vision Ltd.* [TS-342-ITAT-2014(COCH)-O], TTK Prestige Ltd [TS-6739-ITAT-2014 (Bangalore)-O] and *Asia Satellite Telecommunications Co. Ltd.* [TS-823-HC-2011(DEL)-O] ITAT held that a liability to deduct tax at source cannot be fastened on an assessee on the basis of a retrospective amendment to the law.

(c) ITAT concluded that CIT(A) erred in holding that FTS was taxable in India only because of the retrospective amendment to the law and he erred in not holding that the liability to deduct tax at source arises at the time of making payment and therefore there would be no obligation to deduct tax at source. Accordingly, the order of the CIT(A) holding assessee to be an assessee in default u/s 201(1) of the Act to the extent of the payment relating to FTS and consequent liability towards interest u/s. 201(1A) of the Act was cancelled by ITAT allowing assessee's appeal.

7 ***DCIT vs. Sri K. E. Faizal***
[TS-389-ITAT-2019(COCH)]

India-UAE DTAA – Short Term Capital Gains arising to a Non-Resident on sale of units of equity oriented mutual funds are not taxable under India-UAE treaty

Assessment Year: 2012-13

Facts

i) The assessee, a Non-Resident in India for the Assessment Year (AY) 2012-13, was a resident of the UAE and had obtained a Tax Residency Certificate from the revenue authorities of the UAE for the relevant period.

ii) During the AY 2012-13, the assessee had sold equity oriented mutual funds in India and had STCG from such sale amounting to INR 13,499,407.

iii) While filing the India tax return for the said AY, the assessee had claimed such STCG as exempt by virtue of Article 13(5) of the Treaty.

iv) During the scrutiny assessment, the Assessing officer (AO) had held that the underlying instrument of an equity oriented mutual fund is a share and consequently, as per Article 13(4) of the Treaty, STCG should be taxable in India. Accordingly, the AO denied such exemption claimed by the assessee and added a sum of INR 13,499,407.

v) Aggrieved by the order passed by the AO, the assessee had filed an appeal with the Commissioner of Income-tax (Appeals) CIT(A). The CIT(A) relying on *ITO (IT) vs. Satish Beharilal Raheja* [(2013) 37 taxmann.com 296 (Mumbai-Trib.] held that STCG would not be taxable in India as the equity oriented mutual funds are not shares and therefore Article 13(5) of the Treaty (and not Article 13(4)) would be applicable.

vi) Aggrieved by the order of the CIT(A), the tax department had filed an appeal with the Tribunal.

Decision

The Tribunal held in favour of the assessee as follows:

i) Before the Tribunal, the tax department contended that the underlying instrument of any equity oriented mutual fund is nothing but a share and hence the gains arising from the sale of equity oriented mutual fund would result in sale of shares. Accordingly, such gains from sale of shares (units of mutual funds in the instant case) is taxable under Article 13(4) of the Treaty which provides that income arising to a resident of UAE from transfer of shares (and not any other property) in India, may be taxed in India.

ii) Tribunal observed that the assessee had qualified to be a NR and accordingly, the sale of equity oriented mutual fund in India would be taxable in India u/s. 5(2) of the Income-tax Act, 1961.

iii) However, considering the provisions of the treaty, the Tribunal observed the following:

(a) Term, 'share' is not defined under the treaty; hence share would carry the meaning as per the Act.

(b) As per the provisions of Securities and Exchange Board of India (Mutual Funds) Regulations, 1995, mutual funds in India can be established only in the form of 'trusts' and 'not companies'.

(c) The definition of Security under the Securities Contract (Regulation) Act, 1956, it can be inferred that shares and units of mutual funds are two different types of securities.

(d) As per Article 13(5) of the Treaty, income arising to a resident of UAE from transfer of property other than shares in an Indian company, are liable to tax only in the UAE. The Tribunal also placed reliance of *ITO (IT) vs. Satish Beharilal Raheja* [(2013) 37 taxmann.com 296 (Mumbai-Trib)] and *Apollo Tyres Ltd vs. CIT* [2002J 122 Taxman 562 (SC) wherein it was held that units of mutual funds cannot be regarded as shares.

iv) Given the above, the Tribunal held that for an assessee who is a resident of UAE, STCG arising from sale of units of mutual funds (and not shares) are not liable to tax in India and consequently dismissed the appeal of the tax department.

8 ***Linklaters LLP vs. DCIT***
[2019-TII-172-ITAT- Mum-INTL]

India-UK DTAA – Determination of Service PE - To determine a threshold for Service PE under the India-UK tax treaty 'any 12 month period' is to be construed as previous/ financial year

Assessment Year : 2002-03

Facts

i) The assessee, a Limited Liability Partnership, is a tax resident of U.K. and it offers legal consultancy services to its clients all over the world including India. During the Assessment Year (AY) 2013-14, the assessee provided professional services to its Indian clients.

ii) The assessee contended that it did not have PE in India in terms of Article 5(2)(k)(i) of the tax treaty as its employees did not stay in India more than 90 days during the relevant year. The expression 'any twelve month period' as used in Article-5(2)(k)(i) of the tax treaty has to be construed as previous year relevant to AY under consideration. The aforesaid ratio has been laid down by the Tribunal in *Linklaters LLP vs. DCIT* [2018-TII-348-ITAT-MUM-INTL] while deciding its own case. The assessee contended that the total number of days spent by the employees in India was 42 days. Therefore, in terms of Article-5(2)(k)(i) of the tax treaty, the assessee did not have PE in India during the year.

iii) The tax department contended that the expression 'any twelve month period' as used in Article-5(2)(k)(i) of the tax treaty would not mean the previous year as defined in Section 3 of the Act. The tax department contended that, had it been the case, then, like Article-5(2)(k)(i) of the tax treaty, fiscal year which has been defined to be the previous year would have been used in Article 5(2)(k)(i) of the tax treaty. Thus, the meaning ascribed to fiscal year cannot be ascribed to the term 'any twelve months period'.

Decision

The Tribunal held in favour of the assessee as follows:

i) The Tribunal relied on assessee's own case for the AY 2012-13. The Tribunal in earlier case observed that the AO referring to Article 5(2)(k)(i) of the tax treaty had concluded that the assessee had a PE in India, since, its employees or personnel have rendered services in India for a period of 90 days or more within any 12 month period. However, the Tribunal observed that the expression 'any 12 month period' as used in Article 5(2)(k)(i) of the tax treaty had not been defined anywhere in the tax treaty.

ii) Therefore, the meaning of the said expression could be taken with the aid of the provisions of the Act, since, the income is sought to be taxed in India. Section 5 of the Act which defines scope of total income refers to the total income of any previous year of a person who is a resident. Similarly, Section 6 of the Act postulates that an individual or a HUF or a company or any other person can be considered to be a resident in India in any previous year if it satisfies the condition mentioned therein.

iii) Thus, for the purpose of being considered as a resident in India a reference had been made to the previous year. Section 4 of the Act, which is the charging section, mandates that a person shall be charged to income tax in respect of the total income of the previous year. The expression 'previous year' has been defined under Section 3 of the Act to mean the financial year immediately preceding the AY. Thus, as per the provisions of the Act, the 12 month period would mean the previous year or the financial year which is the unit for which the income of a person is taxable.

iv) If the provisions of Article 5(2)(k)(i) of the tax treaty is read harmoniously with the provisions of the Act, it would be fair and reasonable to conclude that the expression 'any 12 month period' mentioned in Article 5(2)(k)(i) of the tax treaty had to be construed to mean the previous year or financial year as per Section 3 of the Act, since, the income is sought to be taxed in India.

v) Therefore, the Mumbai Tribunal in the instant case directed the AO to verify as to whether the employees/personnel of the assessee were situated in India for rendering services for a period not exceeding ninety days during the previous year and if it is found to be so, then, it has to be held that the assessee did not have a PE in India during the year under consideration.

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