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INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1 *CIT (IT) vs. Westin Hotel Management - [TS-875-HC-2022 (Delhi)]*

Payments received on account of Centralized Services (w.r.t sales, marketing etc.) do not constitute 'Fees for Technical Services' under the Act as well as the India-US Treaty

Facts

i) Assessee, a US-based company, engaged in the business of providing hotel-related services in several countries including India entered into three agreements with Indian hotels namely, (i) License Agreement for grant of right to use trade name, (ii) Operating Services Agreement and (iii) Centralized Service Agreement.

ii) Amounts received under the License Agreement and Operating Service Agreement being Royalties were offered to tax in India.

iii) Assessee claimed the amount received under the Centralized Service Agreement for providing hotel-related services as business income which was not taxable in India in the absence of a PE. However, the AO held that the services provided by the Assessee were taxable as FTS as per *Explanation* to Section 9(1)(vii).

iv) CIT(A) dismissed the assessee's appeal by holding that the centralized services agreement was merely a subsidiary and ancillary agreement to the main license agreement and would fall within Article 12(4)(a) of India-US DTAA.

v) Further, the Hon'ble Tribunal relied on the jurisdictional HC ruling in the case of Assessee's group entity *viz*. ***Sheraton International [Director of Income Tax vs. Sheraton International Inc (2009) 178 taxman 84 (Del)***] and held that the amount received from customers on account of centralized services viz. sales and marketing, loyalty programs, reservation service, technological service, operational services and training programs did not constitute 'Fee for Technical Service' as defined under Section 9(1)(vii) or Article 12(4)(a) of Indo-US DTAA.

vi) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court wherein the Revenue contended that the judgement of Sheraton was assailed in the Hon'ble Supreme Court and hence was pending adjudication.

Decision

i) The Hon'ble High Court noted that the Revenue had not brought anything on record to distinguish the facts of the present case with the facts of the quoted judgement i.e. Sheraton International which was decided in the favor of the assessee.

ii) It noted that though the said judgement was challenged by the Revenue before the Hon'ble Supreme Court, there was no stay on the said judgement till date.

iii) Further, it relied on SC ruling ***Kunhayammed and Others vs. State of Kerala and Another, (2000) 6 SCC 359*** wherein it was held that mere pendency of SLP does not put in jeopardy the finality of the order sought to be challenged. It was only if the application was allowed and leave to appeal was granted, that the finality of the order under challenge was jeopardised as the pendency of appeal reopens the issues decided and the correctness of the decision could be scrutinised in the exercise of appellate jurisdiction.

iv) It dismissed Revenue's appeal and held that the said income did not constitute FTS and that the judgement of Sheraton International would have a binding effect.

2 *PCIT vs. M/s Boeing India Private Limited- [TS-790- HC - 2022 (Delhi)]*

The Hon'ble Delhi High Court dismissed Revenue's appeal against Boeing India and upheld the ITAT order deleting the disallowance of ₹ 56.58 Cr for non-deduction of tax at source under section 195 of the Act in respect of reimbursement made by it to its AE in respect of payment of salary paid by its AE to the employees seconded to the assessee, and distinguished the co-ordinate bench ruling in Centrica India relied upon by the Revenue

Facts

i) Some expatriates were seconded by overseas entities to its Indian associated enterprise *viz* BICIPL (the assessee) via secondment agreements. The overseas entities paid salary to the seconded employees which were then reimbursed by the Indian Entity. Taxes were duly deducted and deposited under section 192 of the Income-tax Act, 1961 ('Act') on the salary paid to the seconded employees.

ii) The Assessing Officer disallowed the amount reimbursed by the assessee to overseas entities by invoking provisions of section 40(a)(ia) of the Act, on the ground that the Indian entity had failed to deduct tax at source on the amounts reimbursed to the foreign entities.

iii) The DRP upheld the order of the Assessing Officer.

iv) The Hon'ble Tribunal held that the Indian entity (assessee) was the economic employer of the expatriates deputed from overseas entities and noted that the secondees had expressed willingness to be deputed to the Indian entity. Further, it noted that the

Overseas entities agreed to release the employees to the Indian entity and that overseas entities would discharge the salaries to the secondees in the home country on behalf of the Indian entity and that the secondees would work for the Indian entity and would be under supervision, control and management of Indian entity.

v) Further, the Hon'ble Tribunal perused the TDS certificates, Form 15CA and 15CB, tax deducted by the Indian entity and concluded that the Indian entity had deducted tax under section 192. Basis the above, it held that once the tax is withheld under the provisions of section 192, then the provisions of section 195 would not apply. Considering the same, the Hon'ble Tribunal deleted the disallowance made by the AO.

vi) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Decision

i) The Hon'ble High Court noted that the assessee had deducted tax at source under section 192 of the Act and expressed its agreement with the opinion of the Hon'ble Tribunal that section 195 of the Act had no application once the nature of payment was determined as salary and deduction was made under section 192 of the Act.

ii) Further, it distinguished the judgment in Centrica India Offshore Pvt. Ltd (relied on by the Revenue), holding that the said judgement had no application in the present case as the Hon'ble Tribunal had given a finding that the real employer of the seconded employees continued to be the Indian Entity and not the overseas entity.

iii) It further relied on the judgement of the ***Apex Court in DIT(IT) vs. A.P Moller Maersk*** dated 17th February 2017 wherein it was held that "once the character of the payment is found to be in the nature of reimbursement of the expenses, it cannot be income chargeable to tax."

iv) It also relied on the judgement of the Hon'ble Delhi High Court in ***Commissioner of Income Tax Delhi II vs. Karl Storz Endoscopy India (P) Ltd., ITA No. 13/2008 dated 13th September 2010*** wherein it was held that:

'Article 15 states that the salaries, wages and other similar remuneration derived by a resident of a Contracting State (Germany) in respect of an employment shall be taxable in the other Contracting State (India) only if the employment is exercised there i.e. salaries paid to such personnel are taxable in India and not taxable as FTS. Also it added that as per explanation 2 to Section 9(1)(vii) which gives the meaning of the expression FTS as per which inter alia any amount paid as salary cannot be taxed as FTS'

v) Accordingly, it dismissed the Revenue's appeal.

Note:

With respect to the Transfer Pricing Adjustment of ₹ 22.16 lakhs on account of outstanding receivables from Associated Enterprises the Hon'ble Tribunal concluded that no interest was paid to the creditor/ supplier nor any interest had been earned from an unrelated party. Moreover, being a 100% captive service provider, the revenue of the assessee was 100% from its AEs and hence the question of receiving any interest on receivables did not arise. It further relied on

various judgements. The Hon'ble High Court upheld the view of the Tribunal.

B. TRIBUNAL

3 *Trimble Solutions India (P.) Limited vs. ITO [(2022) 141 taxmann.com 331 (Mum- Tribunal]*

Once the margin of profit in the distribution segment had been accepted after consideration of management fees paid, there was no question of making any separate adjustment insofar as payment of management fees was concerned. Accrual of benefit to assessee or commercial expediency of any expenditure could not be a basis for disallowing same

Facts

i) The assessee, an Indian Company was carrying on the business of distribution of software products. It entered into a Distribution Agreement with Tekla Corporation, Finland (associate enterprise) to distribute and sub-license shrink-wrap software products developed by the associated enterprise.

ii) Assessee also entered into a Service Agreement with aforesaid associated enterprise whereby support and guidance were provided to the assessee in the area of marketing, communications, quality management as well as information management services.

iii) In the year under consideration, the assessee had entered into the following transactions with its associated enterprise: a) Purchase of Software Products - ₹ 13,90,61,888 and b) Payment of Management Fees - ₹ 57,97,830. The assessee adopted a combined transaction approach to benchmark the aforesaid international transactions with its associated enterprises using Transactional Net Margin Method ('TNMM') considering the transactions were inextricably linked.

iv) The TPO noted that the assessee had failed to establish rendition, receipt and benefit availed from the services, in respect of which management fees were paid by the assessee to its associated enterprise and treated the arm's length price of international transaction pertaining to 'Payment of Management Fees' as NIL and proposed an upward adjustment of ₹ 57,97,930.

v) The DRP rejected the objections filed by the assessee mentioning that the assessee had failed to satisfy the 'benefits test' and 'willingness to pay test'.

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

Decision

i) The Hon'ble Tribunal observed that the assessee derived various benefits like Quality Management, Corporate Marketing, Information Management, Customer Relationship Management and Corporate Communication, via the agreements entered with the associated enterprise.

ii) It noted the assessee's submission that the managerial service availed from the associated enterprise would not have been able to be performed with the same level of efficiency and effectiveness by a 3rd party vendor given the fact that these services were unique for the group and required expertise and experience in the relevant field and it would have involved very

high cost and also huge amounts in hiring third-party vendors.

iii) It remarked that the TPO neither undertook any benchmarking analysis by adopting any of the prescribed methods under the Act nor searched any comparable transaction for considering the arm's length price at NIL and noted the observations from the judgement of Hon'ble Delhi High Court in ***CIT vs. Cushman and Wakefield (India) (P.) Ltd. [(2014) 46 taxmann.com 317]*** wherein it was held that :

'The TPO's report was binding on the AO subsequent to the Finance Act, 2007. Hence though TPO is empowered to state that the ALP is Nil (after consideration of the facts) given that an independent entity in a comparable transaction would not pay any amount. However, it should not just state that the assessee did not benefit from the said services and hence the expenditure shall be disallowed.'

iv) It further noted that no doubts about payments made by the assessee were raised by the Assessing Officer under section 37 of the Act. Relying on the judgement of the Hon'ble Delhi High Court in the case of ***CIT vs. EKL Appliances Ltd. [(2012) 24 taxmann.com 199***], it held that accrual of benefit to the assessee or the commercial expediency of any expenditure incurred by the assessee could not be the basis for disallowing the same. The Tribunal also relied on the judgements of the Hon'ble Jurisdictional High Court in the case of ***CIT vs. Lever India Exports Ltd. [(2017) 78 taxmann.com 88]*** and that of the co-ordinate bench in the case of ***Hamon Cooling System (P.) Ltd vs. Dy. CIT [(2020) 116 taxmann.com 879]***.

v) It noted that the assessee by considering both the international transactions as inextricably linked had benchmarked them together by adopting the TNMM and that the TPO had accepted the said benchmarking analysis in respect of the international transaction pertaining to 'Purchase of Software Products'. Assessee's margin after considering the expense of management fee was higher as compared to margins of the comparable companies.

vi) It further relied on the judgement of the Hon'ble Delhi High Court in the case of ***Sony Ericsson Mobile Telecommunications India (P). Ltd vs. CIT [(2015) 55 taxmann.com 240]*** and held that once the margin of profit in the distribution segment was accepted after consideration of management fees, then there was no question of making any separate adjustment in so far as payment of management fees was concerned. It thus allowed the assessee's appeal.

4 *Cadila Healthcare Ltd. vs. DCIT(IT) [(2022) 142 taxmann.com 211 (Ahmdebad-Tribunal)]*

Payments made by pharma company in India to non-residents in USA/Canada for clinical trials were held to be not taxable as FTS or royalty and thus were not liable for TDS u/s 195. However, similar payment to a non-resident in Mexico was taxable as FTS in the absence of "make available" clause in the treaty

Facts

i) The assessee, a global pharmaceutical company, had its principal place of business in Ahmedabad, India. With a core competence in the field of

healthcare, the assessee provided healthcare solutions ranging from formulations, active pharmaceutical ingredients and animal healthcare products etc.

ii) During the year under consideration, the assessee made remittances to some non-residents under different heads i.e. to three parties of the USA, one party of Canada and one party of Mexico for clinical trials. Further, one payment was made to one party belonging to the USA towards consultancy fees. No tax was deducted at the source from the said payments.

iii) According to the AO, these remittances made by the assessee to the overseas parties were FTS in nature and thus liable for tax withholding in terms of section 195 of the Income-tax Act, 1961 ('Act').

iv) The CIT(A) allowed relief in respect of payments made for clinical trials to parties in the USA and Canada on the ground that in those cases there was no transfer of any skill or knowledge to the assessee on the issuance of study reports by these overseas entities and hence the "make available" clause in both DTAA's of the USA as well as Canada was not satisfied. The CIT(A) also relied on the Tribunal order in the Assessee's own case for AY 2010-11 wherein the same issue was decided in the favour of the assessee.

v) Regarding the alternate contention raised by the AO, that the said payments would qualify as Royalty, the CIT(A) held that looking into the nature of payments, if the very nature of clinical trials and testing services were considered, it became evident that the services could only come within the meaning of "fee for technical services" and could not be treated as "Royalty". Thus, in respect of payments made towards clinical trials by the assessee to entities situated in the USA and Canada, CIT(A) held that no taxes were required to be withheld.

vi) W.r.t payment made by the assessee to Cambridge and Soft Corporation, USA for consultancy services, the CIT(A) again allowed relief to the assessee on the ground that the "make available" clause was not satisfied in the instant set of facts.

vii) W.r.t to the clinical trial payments to a party situated in Mexico i.e. Ciliantha Research Mexico, amounting to ₹ 90,49,625, the counsel for the assessee submitted before the CIT(A) that it had entered into a supply and distribution agreement with Zydus Pharmaceuticals Mexico, with the objective of promoting its businesses in Mexico. The Assessee argued before the CIT(A) that the case of the assessee was covered under the exception provided in section 9(1)(vii)(b) of the Act read with the clarificatory amendment under Explanation 2, which was to the effect that since the services were both rendered as well as utilised outside India (for the purpose of earning any income from any source outside India), the same was not chargeable to tax in India and hence there was no liability to withhold taxes on these payments. It relied on the judgement of the Hon'ble Delhi High Court in the case of ***DIT vs. Lufthansa Cargo India [60 Taxman.com 187]***.

viii) However, the CIT(A), rejected the plea of the assessee by saying that there is a difference in 'source of income' outside India and 'source of receipt of income' outside India. The

CIT(A) relied on the judgement of ***CIT vs. Havells India Ltd [21 Taxman.com 476 (Delhi)***] wherein it was held that in order to fall within the second exception provided in section 9(1)(vii)(b), the source of income, and not the source of receipt, should be situated outside India i.e. the assessee should have had utilised the services in the business carried on outside India for making or earning income from any source outside India. He added that in this case, the assessee was a mere exporter of products in India and his entire business was situated and carried out in India itself. Hence, he concluded that there was no business outside India and hence exception to section 9(1)(vii)(b) would not be applicable. The CIT(A) also added that since there was no make available clause in the India- Mexico DTAA, such remittance made would be treated as FTS/FIS and thus liable for tax deduction at source.

ix) Aggrieved, both the assessee and the Revenue filed appeals before the Hon'ble Tribunal.

Decision

i) W.r.t to the remittances made to the USA and Canada for clinical trials as well as consultancy, the Hon'ble Tribunal relied on its decision in the assessee's own case i.e. ***ITO vs. Cadila Healthcare Ltd. [(2017) 77 taxmann.com 309 (Ahmedabad - Trib.)]*** and ***ITO v. B.A. Research India (P.) Ltd. [(2016) 70 taxmann.com 325 (Ahmedabad - Trib.)]*** and ***ITO vs. Veedan Clinical Research [144 ITD 297 (Ahmedabad Tribunal)]*** and concluded that the condition of "make available" under the India-USA/India-Canada tax treaty was not being met, and accordingly, the services did not qualify as "fee for technical services/fee for included services".

ii) Further, as to whether these remittances for clinical trials to the USA/Canada could be treated as Royalty, it concluded that the view of the CIT(A) that the remittances made for clinical trials could not be treated as Royalty was correct. It further added that in the instant facts, the payment was towards clinical trials/ testing conducted by an overseas company and they could not be termed as falling under any of the specific clauses of royalty under the India USA/India Canada Tax Treaty. It placed reliance on the judgements of ***Anapharm Inc., In re [2008] 174 Taxman 124 (AAR***) and ***Diamond Services International (P.) Ltd. vs. UOI [2008] 169 Taxman 201 (Bombay)*** and ***Dr. Reddy's Laboratories Ltd. vs. ADIT [2017] 78 taxmann.com 63 (Hyderabad - Trib.)*** to conclude the same.

iii) Accordingly, the Hon'ble Tribunal dismissed the Revenue's appeal.

iv) W.r.t to the clinical trial payments made to the Mexico party, the Hon'ble Tribunal concluded that the said services would qualify as technical services in the absence of the make available clause in the India-Mexico treaty and that thus there was a requirement to deduct tax at source at the time of payment with respect to these services.

v) The Hon'ble Tribunal also rejected the claim of the assessee that the said payment was covered under the exception to section 9(1)(vii)(b) and accordingly dismissed the appeal of the assessee.

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