INTERNATIONAL TAXATION
Case Law Update

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A. High Court & Supreme Court

1 *Augustus Capital PTE Ltd. vs. CIT(IT) [TS-718-HC-2023(DEL) (Delhi HC)]*

Section 9(1)(i)-*Explanation* 6 & 7, cure vagueness posed by prior retrospective amendments, hence, retrospective

Facts

i. Assessee, a Singapore based company, invested in equity and preference shares in another Singaporean company [Accelyst Pte. Ltd. (APL)] between January 2013 to March 2014. In Mar 2015, assessee sold its Singaporean investment to an Indian company for ₹ 41.24 Cr. For AY 2015-16, assessee declared Nil income and claimed a refund of ₹ 17.84 Cr.

ii. The assessee relied on the provisions of Explanation 6 & 7 to Section 9(1)(i) and submitted that since it acquired only 0.05% of the ordinary share capital and 2.93% of the preference share capital of the Singaporean Company and had no right of management and control on its affairs, hence the capital gains arising on account of transfer of shares was not taxable in India and that the aforesaid explanations though introduced in the year 2015, had retrospective application.

iii. Revenue made an addition of long term capital gain of ₹ 36.33 Cr (sale consideration of ₹ 41.24 Cr less COA of ₹ 4.91 Cr.) which was upheld by DRP and set aside by the Hon'ble Tribunal.

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

Decision

i. The Hon'ble High Court noted that Section 9(1)(i) of the Act inter alia seeks to impose tax albeit via a deeming fiction qua all income accruing or arising, whether directly or indirectly, through or from any property in India or through or from any asset or through transfer of asset situate in India, or the transfer of a capital asset situated in India.

ii. The judgment of the Supreme Court rendered in Vodafone, however, excluded from the scope and ambit of Section 9(1)(i) of the Act gain or income arising from the transfer of shares of a company located outside India, although the value of the shares was dependent on assets which were situated in India.

iii. It is to cure this gap in the legislation, Explanations 4 and 5 were introduced via FA 2012, which were given effect from 01.04.1962. Explanations 4, 5 inter-alia provide that the "share" or

"interest" derives, directly or indirectly, its value "substantially" from the assets located in India. Explanations 4 and 5 presented difficulties in that the expressions "share and interest" and "substantially" found in the explanations were vague, resulting in undue hardship for transferors/ assessee where the percentage of share or interest transferred was insignificant. The Finance Minister's Speech while introducing the amendments (Explanation 6 & 7) via FA 2015 (extracted below) is revelatory since a dim view was taken of the retrospective amendment brought about by Explanations 4 and 5, effective from 01.04.1962.

> *"114. The provision relating to indirect transfers in the Income-tax Act which is a legacy from the previous government contains several ambiguities. This provision is being suitably cleaned up….These changes would eliminate the scope for discretionary exercise of power and provide a hassle free structure to the taxpayers…"*

Therefore, the legislature took a curative step regarding the vague expressions used in Explanation 5, i.e., "share/ interest" and "substantially".

iv. The argument advanced on behalf of the Revenue, boiled down to the fact that the insertion of Explanations 6 and 7 via FA 2015 was to take effect from 01.04.2016 and could only be treated as a prospective amendment. The argument advanced in support of this plea was that Explanations 6 and 7 brought about a substantive amendment in Section 9(1)(i) of the Act. This submission was misconceived because Explanations 6 and 7 alone would have no meaning if they were not read along with Explanation 5. Therefore, if Explanations 6 and 7 have to be read along with Explanation 5, which concededly operates from 01.04.1962, they would have to be construed as clarificatory and curative. If Explanations 6 and 7 are not read along with Explanation 5, no legislative guidance would be available to the AO regarding what meaning to give to the expression "share/interest" or "substantially" found in Explanation 5.

v. The Hon'ble High Court relied on Commissioner of Income Tax vs Alom Extrusions Ltd., (2010) 1 SCC 489 and Commissioner of Income Tax I, Ahmedabad vs Gold Coin Health Food Private Ltd., (2008) 9 SCC 622 and concluded that although Explanations 6 and 7 were indicated in FA 2015 to take effect from 01.04.2016, they could be treated as retrospective, having regard to the legislative history which led to the insertion of Explanations 6 and 7.

vi. Accordingly, the Hon'ble High Court held that no substantial question of law arose and dismissed the Departments appeal.

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2 *PCIT vs. Qualcomm India (P.) Ltd. [(2023) 156 taxmann.com 288 (HC - Delhi)]*

Once working capital adjustment is granted, there is no requirement of any further adjustment w.r.t outstanding receivables

Facts

i. The assessee permitted a ninety (90) days credit period to its AEs. Once the credit period exceeded 90 days interest was charged.

ii. The TPO interalia made adjustment on account of outstanding receivables. Further, working capital adjustment was denied by the TPO but allowed by the DRP.

iii. Before the Hon'ble Tribunal it was argued on behalf of the assessee that once working capital adjustment was allowed, then no adjustment on account of interest on receivables was required to be made.

iv. The Tribunal, has relied upon its decision dated 1-11-2021 for AY 2015-16 and concluded that the said issue needed to be restored to the Assessing Officer (AO) for verifying the assessee's claim, albeit, after providing reasonable opportunity of hearing to the assessee.

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

Decision

i. The Hon'ble High Court accepted the submission of the assessee that once working capital adjustment was made, no further adjustment was required to be made on account of interest received on receivables, in view of the judgment of the coordinate bench in ITA 765/2016, titled ***Pr. Commissioner of Income Tax-V vs. Kusum Health Care Pvt. Ltd.***

ii. Further, the Hon'ble High Court rejected the Revenue's argument that since a specific amendment was brought about in Section 92B of the Income-tax Act, 1961 with the insertion of the Explanation, therefore, adjustment ought to have been made - by holding that the aforesaid plea of the Revenue had already been considered in the case of ***Kusum Health Care Pvt. Ltd. (supra).***

iii. Accordingly, the Revenue's appeal was dismissed.

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3 ***PCIT vs. Fujitsu India (P.) Ltd. [(2023) 156 taxmann.com 310 (HC - Delhi)]***

RPM was held to be the most appropriate method in case of distribution and marketing activities when goods were purchased from associated entities and there were sales to unrelated parties without any processing and value addition.

B. Tribunal

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4 ***DCIT vs. Ramco Systems Ltd. [[(2023) 156 taxmann.com 640 (ITAT - Chennai)]***

Where assessee claimed relief of foreign tax credit at rate of 10 per cent of royalty received by it from Australian company and said claim was accepted by AO, but thereafter, due to revision in rate of withholding tax to 15 percent, additional withholding tax was deducted, AO was not justified in denying the claim of additional tax deduction.

Facts

i. Assessee -company, engaged in business of software developing, claimed relief under section 90 which included a sum being withholding tax deducted by an Australian company on royalty paid to assessee at rate of 10 per cent of royalty. The said claim was accepted by the AO.

ii. Thereafter, as Australian tax authorities revised rate of withholding tax to 15 percent, additional withholding tax was deducted and paid to Australian Government, after filing the return.

Consequently, the assessee claimed additional relief of FTC during the assessment proceedings which was denied by the AO.

iii. The CIT(A) directed the AO to allow the relief on account of additional FTC claim.

iv. Aggrieved, the Revenue filed appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal held that the question of foreign tax credit for withholding tax on royalty income was not in dispute.

ii. The claim did not impact the income of the assessee but only related to giving credit for additional taxes paid on the income already declared.

iii. Once credit for foreign withholding tax had been allowed@ 10%, the subsequent revisional rate of tax was also required to be allowed.

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

5 *Insta Pharmaceuticals Ltd. vs. ACIT [(2023) 156 taxmann.com 391 (ITAT-Ahmedabad)]*

Where assessee had adopted internal CUP for benchmarking its transaction of loans advanced to its AEs and charged interest at rate of 3.32 percent being rate of interest quoted by internal CUP on seeking loan from Bank of Nova Scotia, Singapore (BNS), the Tribunal accepted the internal CUP and held that since BNS was a renowned bank having global operations, authenticity of quotation could not be doubted.

Facts

i. The assessee had advanced loan to its AEs and charged interest at the rate of 3.22 per cent being higher than the LIBOR based on a quotation given to the assessee by Bank of Nova, Scotia (BNS), Singapore, on seeking loan from it.

ii. The TPO, however, rejected the internal CUP taken by the assessee by holding that it was merely a quotation and proposed application of rate arrived at LIBOR/EURIPOR plus different mark ups and further addition of 100 basis points towards forex risk adjustment. Accordingly, he made an upward adjustment towards interest on advances.

iii. On appeal, the Commissioner (Appeals) upheld the order of the TPO. He distinguished the judgement of Hon'ble Gujarat High Court [***CIT vs. Adani Wilmar Ltd., (2014) 363 ITR 338 (Guj.)***] relied upon by the assessee.

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

Decision

i. The Hon'ble Tribunal held that the internal comparable taken by the assessee, being the rate of interest quoted by the Bank of Nova Scotia, Singapore, on a proposal of USD loan to the assessee, was rejected for the reason that it was a mere quotation.

ii. The CIT(A) held that the quotation was not a reliable document and referred to the decision of the Gujarat High Court in the case of ***CIT vs. Adani Wilmar Ltd., (2014) 363 ITR 338 (Guj.)*** in this regard. The reasoning borrowed by the Commissioner (Appeals) from the aforesaid judgement was that in

the said case the Gujarat High Court had held "publication" of rates by Oil Board as authentic and reliable; and, in the instant case the quotation of the Bank of Nova Scotia, Singapore was not a publication, and therefore, could not be said to be reliable. This comparison drawn by the CIT(A) was of no relevance. How a publication was reliable, while a quotation was not had not been explained by the CIT(A).

iii. What can be derived from the order of the Gujarat High Court is that what is relevant for accepting an internal CUP is authenticity of the document from which it is derived. In the said case, it was a quotation which was published by the Oil Board and was held by the High Court to be an authentic document which could be relied upon. In the instant case, no reason was given by the authorities below, nor was there any finding by the Revenue Authorities below to the effect that quotation of the Bank of Nova Scotia, Singapore was, in any way, not authentic.

iv. There was no investigation or inquiry conducted by the Revenue Authorities with regard to the authenticity of the quotation, and the Bank of Nova Scotia, Singapore is a renowned bank having global operations. Therefore, there was no basis for doubting the authenticity of the quotation.

v. The decision of the Gujarat High Court in the case of ***CIT vs. Adani Wilmar Ltd., (2014) 363 ITR 338 (Guj.)*** supported the case of the assessee that the internal CUP being derived from an authentic document, cannot be rejected. Thus, the basis of the CIT(A) for rejecting the internal CUP of the assessee was not correct.

vi. There is no doubt that the internal CUP is the best comparable which can be taken for comparability analysis as compared to external comparable and as no deficiency had been found in the internal CUP, the external CUPs taken by the Assessing Office/TPO were to be rejected as not applicable for comparability analysis in the instant case.

vii. In view of the above, the Hon'ble Tribunal concluded that the transactions of loans advanced to AEs by the assessee was adequately demonstrated by the assessee to be at arm's length price based on the comparability analysis done with its internal comparable. Therefore, no TP adjustment to the same was warranted and the adjustment made by the authorities below was directed to be deleted.

Note – The Hon'ble Tribunal also held that where international transactions of sales had been demonstrated to be at arm's length by adopting TNMM method; after making working capital adjustment to Profit Level Indicator (PLI), there remained no scope for making any further adjustment on account of overdue outstanding receivables on account of very same sale transactions made to AEs, since working capital adjustment made to PLI took care of overdue outstanding receivables.

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