INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 *EY Global Services Ltd vs. ACIT - 133 taxmann.com 157 (Delhi)*

Payment received by UK Co from an entity in India for providing access to computer software was held to be not "royalty" and not taxable under Indo-UK DTAA in the absence of transfer of copyright in the software to do any of the acts mentioned in Section 14 of the Copyright Act, 1957

Facts

i) The Petitioner i.e. EY Global Services Ltd. (EYGSL) UK [hereinafter referred to as the 'EYGSL (UK)'], a limited liability company was engaged in providing technology and other support services and software licences to member firms of the EY network in various countries all over the world. All member firms, including EYGSL (UK), used the brand Ernst & Young (EY). The Petitioner – EYGSL (UK) had entered into contracts with various third-party vendors for the procurement of various software. It had also entered into a contract with EY member firms to provide support services and/or deliverables.

ii) The EYGBS (India) Private Limited [hereinafter referred to as the 'EYGBS (India)'] an Indian company engaged in providing back-office support and data processing services had entered into an agreement with the EYGSL (UK) whereby it received 'Right to benefit from the Deliverables and/or Services' from EYGSL (UK).The specific services mentioned in the Services Schedule annexed to the Memorandum of Understanding (hereinafter referred to as the 'MOU'), which were rendered by EYGSL (UK) under the Service Agreement and the MOU executed between itself and the EYGBS (India) were w.r.t. 1. Common standard and policies, 2. IT services, 3. Knowledge sharing.

iii) EYGSL (UK) and EYGBS (India) filed an application before the learned AAR seeking a ruling on the following questions:

Q.1 Whether amounts received/ receivable by EYGSL UK in accordance with the agreement entered into with EYGBS (India) *inter alia* on account of services and/or Deliverables as defined in the Agreement is chargeable to tax in India as "fee for technical services" under Article 13 of the Agreement for avoidance of Double Taxation between India and UK ("the India-UK Tax Treaty")?

Q.2 Whether the amounts received by EYGSL UK from EYGBS India, as reimbursement of costs for giving the "Right to benefit from the Deliverables and/or Services" under the terms of the agreement would constitute "income" in the hands of EYGSL UK within the meaning of the term in Section 2(24) of the Income-tax Act, 1961 ("the Act")?

Q.3 Whether the payments received by EYGSL UK for giving "Right to benefit from the Deliverables and/ or Services" under the terms of the agreement would be in the nature of "royalty" within the meaning of the term in:

i. Explanation 2 to clause (vi) of Section 9(1) of the Act?

ii. Article 13 of the India-UK Tax Treaty?

Q.4 Based on the answers to Questions (1) to (3) above, and in view of the facts as stated in Attachment III, and also in light of the declaration provided by EYGSL UK that it does not have a permanent establishment in India in terms of Article5 of India UK Treaty, whether the payments received by EYGSL UK would be chargeable to tax in India?

Q.5 Based on the answers to the Questions above, would the receipts by EYGSL UK from EYGBS India suffer withholding tax under section 195 of the Act, and at what rate?"

iv) The learned AAR answered questions as follows:

Q.1 Consideration received on account of provision of services/deliverables is not FTS.

Q.2 Consideration received amounts to service fees and it does not amount to reimbursement of expenses.

Q.3 Consideration received from giving a right to benefit from the computer software procured from several third-party vendors (deliverables) is in the nature of royalty under Article 13 of India -UK DTAA as well as section 9(1)(vi) of the Act whereas consideration received for giving a right to benefit from services is not in the nature of royalty under Article 13 of India-UK DTAA.

Q.4 In respect of Q.No.3, we have ruled that consideration for computer software is taxable as royalty. This is irrespective of the fact whether the applicant has a PE in India or not.

Q.5 Consideration received in respect of giving a right to benefit from computer software (deliverables) by the applicant would suffer withholding of tax under section 195 of the IT Act."

v) Aggrieved, the Petitioner filed a writ petition before the Hon'ble High Court challenging the ruling of the AAR.

Decision

i) A reading of the judgement of the Hon'ble Supreme Court in Engineering Analysis Centre would clearly show that for the payment received by EYGSL (UK) from EYGBS (India) to be taxed as 'royalty', it is essential to show a transfer of copyright in the software to do any of the acts mentioned in Section 14 of the Copyright Act, 1957. A licence conferring no proprietary interest on the licensee, does not entail parting with the copyright. Where the core of a transaction is to authorise the end-user to have access to and make use of the licenced software over which the licensee has no exclusive rights, no copyright is parted with and therefore, the payment received cannot be termed as, 'royalty'

ii) The EYGBS (India), in terms of the Service Agreement and the MOU, merely received the right to use the software procured by the EYGSL (UK) from third-party vendors. The consideration paid for the use of the same, therefore, could not be termed as 'royalty' as held by the Supreme Court in Engineering Analysis Centre (supra). In determining the same, the rights acquired by the EYGSL (UK) from the third-party software vendors were not relevant. What was relevant was the Agreement between the EYGSL (UK) and the EYGBS (India). As the same did not create any right to transfer the copyright in the software, the same would not fall within the ambit of the term 'royalty' as held by the Supreme Court in Engineering Analysis Centre (supra).

iii) In view of the above, the impugned Rulings passed by the learned AAR were set aside and it was held that the payment received by EYGSL (UK) for providing access to computer software to its member firms of EY Network located in India, i.e. EYGBS (India), did not amount to 'royalty' liable to be taxed in India under the provisions of the Income Tax Act, 1961 and the India-UK DTAA.

2 *Coursera INC vs. ITO-TS-1142-HC-2021 (Del)*

HC: Holds 10% TDS on Coursera's receipts unreasonable, since subjected to 2% EL; Directs for reasoned order as per Sec. 10(50)

Facts

i) Assessee-company, a US tax-resident and an e-platform operator, was acting as an aggregator of educational institutions and providing easier access to various courses;

ii) The assessee filed a writ petition challenging Revenue's order against rejection of its application for NIL TDS certificate u/s 197(1) of the Act in respect of its receipts for FY 2021-22, whereby Revenue had directed the customers of the Assessee to withhold tax @ 10% without giving reasons for arriving at such rate.

Decision

i) Delhi HC, without delving into merits of the case, set aside order u/s 197 directing TDS @ 10% on assessee's receipts in India, & directed the Revenue to pass a de novo order excluding the receipts already subjected to Equalisation Levy in the light of the provisions of Section 10(50);

ii) HC observed that there was no reasoning as to how the rate finally determined had been arrived at. It held that the impugned order noted that the receipts from Indian customers were not chargeable to tax as royalty/FTS under the provisions of the Act read with India US tax treaty and since the assessee had been suo moto paying equalization levy @ 2% on receipts from Indian customer, such receipts may be subjected to TDS under section 195 of the Act @ 4% keeping in the interest of Revenue.

However, the HC further noted that the assessee had been directed to deduct TDS @ 10%.

iii) The HC further opined that the impugned order did not take into account the impact of the amendment carried out in Section 10(50) by Finance Act, 2021 w.e.f. Apr 1, 2021, whereby the amounts taxable as royalty/fees for technical services under the Act read with Section 90/90A and the relevant DTAA would not be considered for the charge of Equalisation Levy;

iv) Further, the HC noted that the assessee in its application u/s 197, described itself as an e-commerce operator. In the later part of the same application, it claimed itself to be a university for the purposes of Article 12(5)(c) of the India-US DTAA. However, though the AO in the Impugned Order held that the assessee was not eligible for the benefit of article 12(5)(c) of the DTAA, the said order did not contain any reasoning or discussion on the applicability or otherwise of various sub-articles of the DTAA to the facts of the case.

B. Tribunal

3 ***ITO vs. Rajeev Suresh Ghai [[2021] 132 taxmann.com 234](Mumbai - Trib.)***

Unaccounted monies paid to a builder in India for making investments in India, by an assessee who was a non-resident Indian settled in and a tax resident of UAE - not chargeable to tax in India as an unexplained investment under section 69 as well as Article 22 of India-UAE DTAA being article for taxation of residuary income [AY 2010-11]

Facts

i) The assessee, a non-resident Indian, fiscally domiciled in and a tax resident of the UAE for the last three decades was alleged to have invested his unexplained income in specific residential properties in India. The assessee was thus called upon to file the Return of Income in India and the said return was further subjected to the scrutiny proceedings.

ii) The assessee, during the course of the assessment proceedings, explained that he had invested a sum of ₹ 850 Lakhs in residential flats in Mumbai but all the related payments were made by official channels and produced the evidence for the same. However, the Assessing officer ('AO'), as per the information received by the investigation wing, noted that, during the relevant financial year for AY 2010-11, the assessee had paid cash aggregating to ₹ 2,50,40,000 to M/s Ahuja Builders and had also received ₹ 4,47,150 in cash as interest, in respect of the amounts so paid. The AO accordingly taxed the sum of ₹ 2,50,40,000 as an unexplained investment under section 69 of the Act followed by ₹ 4,47,150 being interest on loan under section 68 of the Act. Aggrieved, the assessee carried the matter in appeal before the learned CIT(A).

iii) The learned CIT(A) deleted the impugned addition on the ground that the assessee was a tax resident of the UAE and as income under section 68 and 69 of the Act, can only be covered under the treaty head 'other income' [i.e. residuary income Article 22 of the India - UAE Double Taxation Avoidance Agreement ('DTAA')] such an income could only be taxed in UAE and not in India.

iv) Aggrieved, the AO filed an appeal before the Tribunal.

Decision

i) The Tribunal noted that the assessee being fiscally domiciled in and a tax resident of the UAE was entitled to all the benefits of the India-UAE DTAA. Hence the taxability of the transaction had to be as per the various income treatments mentioned in the India-UAE DTAA. However, as the income being taxed was not covered under a specific income head of the DTAA, it had to be treated as 'other income' and dealt with as per the provisions of Article 22 (residuary income head dealing with other income) of the India-UAE DTAA.

ii) Further, the Tribunal observed that, as per Article 22(1) of the India-UAE DTAA, subject to the provisions of paragraph 22(2), any item of income of a resident of the UAE irrespective of wherever it arises and not being dealt with in other Articles of the India-UAE DTAA, shall be taxed in the UAE only. In the instant case, the assessee had only invested the money in India and had not earned the money from India. The assessee did not conduct any economic activities in India. The unexplained investments, which were inherently in the nature of the application of income rather than earning of income, could not thus be taxed in India under Article 22(1) of the India-UAE DTAA.

iii) Further, the Tribunal mentioned that paragraph 22(2) of the Article only restricts the scope of Article 22(1) by mentioning that paragraph (1) will not apply if the assessee had a Permanent Establishment ('PE') in India or the assessee was providing any independent personnel services in India. This was not the case with the assessee. Hence, Article 22(2) was not applicable in the case of the assessee.

iv) The Tribunal further mentioned that the situation would have been materially different if the unexplained investments in question would have been made out of the incomes generated in India. However, that was not the case with the assessee. Further, the Tribunal also clarified the fact that Article 23(1) of the India-UAE DTAA would not apply in the case of the assessee as the question under consideration was not the taxation on capital represented by an immovable property but taxation on account of a part of investment in an immovable property being unexplained.

v) Further, the Tribunal also cleared that in such a case where the assessee is a tax resident of the other country, the residuary rights belong to the residence jurisdiction, apart from that, the taxability can be triggered only for source jurisdiction which in turn refers to the jurisdiction in which the income is earned rather than the jurisdiction in which it is invested and also that the scheme of tax treaties restricts its rights of taxation either to residence or to source jurisdiction. The Revenue thus derived no support from the India-UAE DTAA, which, under the scheme of section 90(2) of the Act, must make way to the domestic law provisions except to the extent the applicable treaty provisions are 'more' favourable to the assessee.

vi) Thus, the Tribunal upheld the order of the CIT(A) in the favour of the assessee, it being well-reasoned with proper conclusions, and declined to interfere in the matter and concluded that the treaty did not cover the taxation of income of the nature of such unexplained investment and that was the end of the road so far as taxation of an income, in any head other than the residuary head of 'other income', is concerned. Since the said income was not even taxable under the residuary article 22, there could not be any taxation in the hands of the assessee under the India-UAE DTAA. As far as the alleged interest income was concerned the Tribunal observed that there was no evidence or even a serious allegation that there was an interest income.

4 *Harish Salve vs. ACIT [[2021] TS-1116-ITAT](Delhi - Trib.)*

Delhi ITAT allowed a credit of taxes paid in the UK in proportion to the taxes on overseas income offered in India

Facts

i) The assessee being an individual and an Advocate by profession, derived income from Business, Capital Gain and Other Sources. The assessee filed his return of income for AY 2015-16 on 30.09.2015 declaring a total income of ₹ 93,05,67,910. The assessee further revised his return on 31.03.2017 declaring the revised total income of ₹ 93,40,35,870 which was further selected for scrutiny proceedings under section 143(3) of the Act wherein the total income of the assessee was assessed at ₹ 94,40,20,730. The Assessing Officer ('AO') had disallowed the expenses incurred for granting scholarships to Indian Law students admitted to the Exeter College of Law in Oxford, in order to further the professional interest of the assessee, amounting to ₹ 99,84,863.

ii) The AO had noted that an identical issue arose in the assessee's own case in AY 2012-13 and AY 2014-15, and while deciding the issue in AY 2012-13 the then AO had noted that there was no specific provision on the allowability of scholarship paid to students under any section of the Act and hence the expense on such account would amount to gift by the assessee and as a gift could not be considered wholly and exclusively for business purpose the same was not allowable as an expense. Hence, following the predecessor AO's decision, the AO disallowed the scholarship amount of ₹ 99,84,863.

iii) Further, the AO had not allowed the credit of the entire TDS amount of ₹ 6,66,17,666 claimed by the assessee and also did not allow the relief of ₹ 8,57,07,736 claimed under section 90 of the Act for the taxes paid in the UK. Aggrieved by the order of the AO, the assessee filed an appeal before the CIT(A).

iv) The learned CIT(A) confirmed that the facts of the year under consideration were identical to the assessee's own case for AY 2011-12 to AY 2014-15. However, as the predecessors of those years had confirmed the addition made by the then AO's, the CIT(A) upheld the order of the AO disallowing the scholarship amount.

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

Decision

i) The Tribunal noted that identical issue's had arisen in the assessee's own case in AY 2011-12, 2013-14 and 2014-15 before the Hon'ble Tribunal.

ii) The Co-ordinate Bench for AY 2011-12 had observed that the allowability of an expenditure incurred by the assessee under section 37(1) of the Act is required to be tested in accordance with the nature and scale of the business/ profession of the assessee. It may be a case that for one person that particular expense was wholly and exclusively for business and for another one it was not.

iii) The Co-ordinate Bench for AY 2011-12 had further mentioned that to judge the allowability of the expenditure, the AO should put himself in the shoes of the assessee and then decide whether the expense was necessary or not for the business of the assessee, concluding that the allowability of the expense shall always be judged from the mindset of the assessee. The Bench further added that the requirement of incurring the expenditure by a professional/ businessman changes by the change in the dynamics of the business, its complexities and its uniqueness.

iv) The Co-ordinate Bench concluded that as the assessee had provided proper nexus between the expenditure incurred and how the same had helped him in professional growth, such an expense was allowable under section 37(1) of the Act citing it to be wholly and exclusively for the business/profession. Further, it added that as there was no capital asset created it could not be said to be of a capital nature and just because in the agreement it was mentioned as an annual gift in the form of a Scholarship, it was not actually a gift.

v) As no material was placed on record demonstrating that the order of the Tribunal in the assessee's own case for earlier years had been either overruled/ set aside or stayed by the higher judicial forum, the Tribunal for AY 2015-16 relied on the decision of the Co-ordinate bench and allowed the said expense under section 37(1) of the Act, considering it to be incurred wholly and exclusively for the business.

vi) In respect of the TDS credit not being allowed by the AO and not being disposed of by the CIT(A), as the assessee had filed a rectification application for the same, the Tribunal remanded the matter back to the AO mentioning credit to be given to the assessee after necessary verifications.

vii) Further, in respect of the relief of ₹ 8,57,07,736 claimed by the assessee under section 90 of the Act in respect of the tax amounting to ₹ 11,71,22,901 paid by the assessee in the UK, the Tribunal observed that since the required tax had been paid by the assessee both in India as well as the UK (confirmed by the Revenue), the assessee was eligible for the proportionate credit of the tax paid. The Tribunal thus restored the matter back to the AO, ordering the AO to give to the assessee the claimed credit after giving an opportunity of being heard to the assessee if required.

5 *Dell International Services India Private Limited vs. JCIT [TS-704-ITAT-2021 (Bang)-TP]*

Royalty payment under aggregated benchmarking using TNMM was held to be at ALP-- No separate adjustments to be made on interest on outstanding receivables from AE if the working capital adjusted margins from were the outstanding receivables had emanated were found to be at ALP -- Buyback of shares held to be at ALP on the basis of Valuation Reports. [AY 2009-10]

a) With respect to the Royalty payment

Facts

i) The assessee, a private limited company, was engaged in the business of development and export of computer software and Information Technology

Enabled Services (ITes) and was entitled to tax holiday benefits as per the provisions of section 10A of the Income-tax Act, 1961 ('The Act').

ii) The assessee had entered into an inter-company sublicense agreement with PSC Management Partnership ('PSC') for payment of Royalty to use (a) “Perot Systems” as a trade name and as part of a corporate name, (b) “Perot” as part of the internet domain name and (c) “Marks” in connection with the business and in the provision of sale of certain goods and services. As per the agreement the assessee had to pay PSC @ 3% in respect of the third party gross revenues. Accordingly, the assessee paid a royalty of ₹ 3.83 crores on sales to third party customers amounting to ₹ 129,88,01,587.

iii) The assessee, considering the payment of Royalty as inextricably linked and wholly necessary for the assessee's provision of software development and related services, aggregated the payment of royalty with software development services and carried out common TP analysis by using TNMM as MAM and claimed the royalty payment to be at ALP.

iv) The TPO, with respect to the payment of Royalty, held that no independent party would pay royalty under similar circumstances and hence determined the 'ALP' as Nil. The TPO stated that out of total revenues of ₹ 433 crores, sales to AE stood at ₹ 303 crores. Hence, the brand name of Perot used by the assessee did not deserve a separate payment in the form of Royalty. The TPO had also stated that the assessee had not justified how other companies under similar circumstances had paid royalty and no benchmarking analysis had been provided in this regard to justify arms-length nature of the transaction.

v) The DRP upheld the action of the TPO with respect to the Payment of Royalty having ALP as Nil under the CUP method. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision

i) The Tribunal observed that neither the TPO nor the DRP had brought any CUP on record for the royalty payment and that as per Rule 10B, to apply the CUP method, identification of the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction or a number of such transactions is a pre-requisite. It held that in order to determine ALP of royalty payment at NIL using CUP, the TPO/DRP ought to have brought on record the CUP. In the absence of a CUP, ALP could not be determined at NIL using the same CUP method. The Tribunal further noted that the royalty payment of ₹ 3.83 crores was considered as an operating expenditure in computing the net profit margin of the software segment and the said margin was accepted by the TPO to be at arm's length. It was thus impermissible to isolate the royalty payment and separately evaluate the ALP of the same.

b) With respect to outstanding receivables from AEs.

Facts

i) The assessee had an amount of ₹ 12,47,94,000 as receivables from the debtors being over dues for a period exceeding six months, out of which ₹ 10,81,19,000 were of AE debtors and ₹ 1,61,73,000 were of Non-AE debtors. The assessee did not charge any interest from the AE as well as the third parties i.e. Non-AE's.

ii) The TPO treated the debts outstanding for a period of more than six months in respect of transaction with assessee's AEs as a deemed loan and applied the CUP method to benchmark the transaction on an ad-hoc basis. The TPO further held that the receivables due from AEs were deemed BBB rated loans that had a yield of 20% more than BBB rated corporate bonds for five years. On this basis, the TPO arrived at a rate of 17.22 % as the arm's length interest rate chargeable for the relevant assessment year. Accordingly, the TPO made an adjustment of ₹ 1,87,04,192 as interest computation at 17.22% per annum on the outstanding receivables from the AEs.

iii) The DRP directed the AO/TPO to verify the working capital adjusted margins of the assessee from which the outstanding receivables emanated and if the same were found to be at ALP, then there had to be no separate adjustments for the interest on outstanding receivables. However, in the final assessment order issued by the AO, he upheld the order of the TPO mentioning that the DRP had no power to set aside/remand the matter.

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

Decision

i) The Tribunal observed that sales to AE were more than sales to non-AEs, hence, the debtors were more in AE as compared to non-AE but the percentage of debtors to sales was less in AE as compared to that of non-AE.

ii) Further, the Tribunal observed that there was no interest charged on both AE and Non-AE sales and also mentioned that the Hon'ble Rajasthan High Court in the case of ***PCIT vs. Sharda Spuntex P. Ltd. (2018), 93 taxmann.com 489*** had held that when interest was not charged to non-AE debtors there could not be any occasion to make ALP adjustment for notional interest on delay in realization of trade debts from the AEs.

iii) The Tribunal also observed that the NPM of the assessee was within arm's length range even after working out the comparability adjustment on account of the working capital and that the net profit margin of the assessee in the software segment was 33.18% which was higher than the net profit margin of the 11 comparables selected by the TPO at 24.32%. Accordingly, the Tribunal mentioned that the margin of the assessee included the compensation for the credit period in connection with the delayed receivables.

iv) Thus, the Tribunal directed the AO/TPO to examine the working capital adjusted margins of the assessee corresponding to the international transaction and further directed that if the same were found to be better than that of the comparables no separate adjustment was required to be made in this regard.

c) With respect to the Buyback of shares

Facts

i) The assessee had brought back 94,30,794 equity shares of ₹ 2 each from Perot Systems TSI Private Limited (Mauritius) at the price of ₹ 90 per share. The buyback price was backed up by two valuation reports of independent valuers - one by PWC (Statutory Auditors) and another was by an independent Accountant Mr Chajjed Kedia. The assessee had claimed the transaction to be at the ALP basis of the two valuation reports. It was submitted by the assessee that the valuation was done as per various methods and the price range of shares determined was between Rs. 90 to ₹ 100.

ii) The TPO rejected the assessee's claim and computed the value of the shares to be ₹ 31.17 per share which led to a TP adjustment of ₹ 55,48,13,611. Further, the TPO also made a secondary adjustment of ₹ 3,98,07,877 for not charging interest in respect of the excess amount paid to the AE for buyback of shares stating that had it not been for this excess payment, the money would have remained with the taxpayer and it would have earned at least 17.22% interest.

iii) The DRP deleted the adjustments made by the TPO observing that the TPO got confused with the net asset value of shares as per the PwC report and the final valuation as per the Chajjed Kedia Report. Further, as the TP adjustment on buyback of shares was deleted, the DRP also deleted the addition of ₹ 3,98,07,877 for not charging interest in respect of the alleged excess amount paid to AE for buyback of shares.

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

v) Further, the assessee also raised an additional ground with respect to the non-applicability of transfer pricing provision for the buyback of shares and the consequent secondary adjustment of the notional interest.

vi) The assessee further relied on the Bombay High Court decision (given in favour of the assessee) of ***Vodafone India Services P Ltd vs. Union of India [2014 (368 ITR 1)]*** and other AAR rulings to support the above-given contention of the assessee that the transaction of buyback of shares by the assessee is outside the purview of Indian TP regulations in the absence of any income chargeable to tax for the assessee arising out of such transactions.

Decision

i) The Tribunal observed that the TPO's reasoning for the rejection of two independent valuation reports had been rejected by the DRP on merits. It further observed that the DRP had clearly given the various inconsistencies in the TPO's valuation.

ii) The Tribunal, on analysing the TPO's valuation, held that the TPO had cherry-picked the numbers and figures from different methods of valuation in both the valuation reports in the manner beneficial to the Revenue.

iii) The Tribunal further observed that the assessee had followed the valuation prescribed by the RBI in AP(DIR Series) Circular No. 16 dated October 4, 2004, for the purpose of determining the value of share buyback. Whereas the TPO had disturbed the independent valuation reports without bringing on record another independent valuation report to justify the addition. Also, the TPOs valuation was not as per the prescribed methods of determining the ALP.

iv) The Tribunal thus upheld the findings of the DRP and the consequent deletions made by the DRP.