


INTERNATIONAL TAXATION
Case Law Update

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TRIBUNAL DECISIONS

1 ***Clearview Healthcare Pvt. Ltd vs. ITO***
[TS-3-ITAT-2020(DEL)]
Assessment Year 2014-15

Addition under section 56(2)(viib), deleted based on specific fact pattern and there being nothing to suggest the use of unaccounted money in the garb of share premium

Facts

i) The assessee company filed its return for the FY 2013-14 declaring a loss.

ii) During the same FY, the assessee had issued shares at a premium.

iii) The same amount of premium was charged and collected from both resident and non-resident applicants.

iv) The issue price for shares was determined based on a valuation re-port from a chartered accountant using the discounted cash flow (DCF) method.

v) The Assessing Officer determined the fair market value (FMV) of the shares under Rule 11UA of the Income-tax Rules, 1962 (Rules) and added the difference between such FMV and the share issue price to the total income of the assessee under section 56(2)(viib) of the Act.

vi) Assessee's contentions before the Tribunal:

(a) The money received as share premium was clean money and did not involve any unaccounted money. As per the legislative intent behind the insertion of section 56(2)(viib) of the Act, the said provision applies when unaccounted money is received in the garb of share premium.

(b) Share premium is fully justified from the fact that the same shares were sold in the next FY, after proper due diligence, to a non-resident at more than double the issue price, and capital gains were also offered to tax by the seller.

(c) The valuation report determining the fair value of shares was not countered by AO through a substitute - valuation from an alternate expert on the basis of the chosen DCF method.

vii) The Revenue contended that:

(a) Share premium received by the assessee in excess of the valuation determined under Rule 11UA of the Rules should be liable to tax under section 56(2)(viib) of the Act.

Decision

The Tribunal held in favour of the assessee as follows:

i) There is considerable cogency in the assessee's plea mentioning that the share premium received is justified due to the fact of shares being sold subsequently to a non-resident buyer for a much higher value.

ii) When shares are bought by the non-resident buyer on the basis of detailed due diligence and the same is substantiated by share purchase agreement and resolution, it cannot be said that the subsequent money received by the seller is not clean money.

iii) The assessee does not come within the mischief of section 56(2)(viib) of the Act as the legislative intent is to tax unaccounted money received in the garb of share premium, whereas the share premium received by the assessee is clean money.

iv) Hence, FMV of shares as substantiated by the assessee should be accepted and the addition of share premium made by the assessing officer is deleted.

2 ***M/s. Acciona Wind Energy Private Limited vs. DCIT***

[TS-797-ITAT-2019(Bang)]

Assessment Year : 2014-15

Capital Gains arising under section 46Aof the Act, on buyback of shares, not exempt under section 47(iv) of the Act

Facts

i) The assessee is a domestic company in which the foreign parent company holds 99.99% shares and the remaining 0. 01% shares are held by another group company.

ii) The assessee purchased its own shares from the parent company under a buyback scheme and claimed it to be exempt under section 47(iv) of the Act.

iii) During assessment proceedings, the Assessing Officer – held that exemption under section 47(iv) of the Act is not available as parent company is holding only 99.99% shares in the assessee.

iv) The First Appellate Authority affirmed the AO's order and also held that section 47(iv) of the Act is applicable in the context of prescribed modes of transfer specified in section 2(47) of the Act and the transaction involving buyback of shares being distinct from such prescribed modes, is not covered under section 47(iv) of the Act.

Decision

The Tribunal held as under:

i) Asseessee's submissions before the Tribunal

(a) As per the provisions of the Companies Act, 1956, a minimum of two shareholders are required for the incorporation of a private limited company. In the assessee's case, 99.99% of the shares were held by the parent company and the balance was held by a group company. Consequently, for all practical purposes, the parent company should be considered to hold the whole of the share capital.

(b) If, for applicability of section 47(iv) of the Act, the view that the entire share capital should be held by the parent company in its own name, is taken, practically, then there will be no situation in which section 47(iv) of the Act can be applied, and therefore this cannot be a correct view.

(c) Further, section 45 of the Act and not section 46A of the Act, is a charging section for capital gain and section 47 of the Act provides exemption from chargeability of capital gain. Therefore, the transaction of buyback of shares should not be taxable.

ii) The Revenue contended as follows:

(a) Section 47(iv) of the Act is not applicable, as the parent company is holding 99.99% of the share capital of its subsidiary company and the remaining shares are held by the group company.

(b) Section 47 of the Act is limited in its application only to section 45 of the Act, which is a general provision for the taxation of capital gain arising on transfer of capital asset. It does not apply to gain arising on buyback of shares to which provisions of section 46A of the Act applies.

iii) **Decision**

The Tribunal observed and held as under:

(a) Tribunal observed that to avail the exemption under section 47(iv) of the Act, one of the prescribed conditions is that shareholding in the Indian company should be entirely held by one company or its nominees.

(b) In the facts of the case, the Tribunal observed that group company was not holding the shares in the capacity of a nominee of the parent company. Therefore, the exemption under section 47(iv) of the Act is not available.

(c) The Tribunal observed that section 45 of the Act deals with the taxability of capital gain on transfer of capital asset, and section 47 of the Act provides exemption to certain category of transfers.

(d) Section 46A of the Act, applicable in case of buyback of shares does not require transfer of any capital asset.

(e) Therefore, buyback of shares taxable under section 46A of the Act is not entitled to exemption under section 47(iv) of the Act.

Thus, the Tribunal stressed that to be covered within the purview of section 47(iv) of the Act, strict compliance of the conditions prescribed in that section is required.

3 ***Audi AG vs ADIT***
[TS-548-ITAT-2019(Mum)]
Assessment Years: 2009-10 and 2010-11

India-Germany DTAA – Permanent Establishment – Article 5 - German company does not have a PE or business connection in India for sale of cars on a principal to principal basis to its associated enterprise in India

Facts

i) The assessee, a German company, is one of the world's leading car manufacturers. The assessee is a part of Volkswagen Group Sales India Private Limited (VGS) and is engaged in the business activities i.e. export of cars, export of parts and accessories, export of tools and machinery and export of sales promotion material. It also provides service to its Indian Group Companies for grant of right to use information technology system, provision of training outside India, consultancy/ management and other support services.

ii) The assessee had appointed VGS as a sole distributor of Audi brand cars in India. The assessee also sold part and accessories to Skoda Auto India Private Ltd (SAIPL/ Skoda India), pursuant to which Skoda India manufac-tures/assembled Audi brand cars in India in its manufacturing unit at Au-rangabad, India. VGS is engaged in wholesale trading of Audi and Volkswagen brand car. VGS purchases fully built-up cars from the as-sessee, Volkswagen Group (AG) and Skoda India and sales the same to the dealers/distributor.

iii) During the Assessment Years 2009-10 and 2010-11, the assessee sold fully built-up cars and accessories to its AEs in India.

iv) The Assessing Officer (AO) observed that VGS is the exclusive distributor whose only source of income was from Audi business. The business activi-ties of VGS were devoted wholly on behalf of the assessee. Further, the activities of the assessee and VGS completed each other and VGS was functioning as an extended arm and replacement of the assessee in India. The AO held that the assessee had business connection in India and had a PE in India in the form of VGS as per Article 5(1) and 5(5) of the tax trea-ty. Accordingly, it was held that income attributable to the PE was taxable in India. Consequently, the AO attributed 35 per cent of the total income of the assessee in India. The Dispute Resolution Panel (DRP) upheld the order of the AO.anel (DRP) upheld the order of the AO.

Decision

On Appeal, the Tribunal held in favour of the assessee as under:

i) There was no dispute that the activities of manufacturing of car was completed by the assessee outside India and constitute a separate and independent activity. The assessing officer did not bring any material to counter the stand of the assessee that Cars are not sold to VGS on principal to principal basis and thereafter, VGS sold it on a principal to principal basis to the dealers.

ii) The Tribunal relied on the decision of ***ACIT vs. Daimler AG [2012] 52 SOT 93 (Mum).*** In the said case also, the assessee was in the business of manufacturing and selling premium vehicles worldwide and it was tax resident of Germany. In the case of Daimler AG, despite the fact that the AE was performing more activities than the VGS, it was held that the AE was not created either fixed place PE nor dependent agency PE.

iii) The income arising on the sales of car by VGS to dealers in India was income accruing or arising in India and was taxed separately in the hands of VGS. The Tribunal observed that merely acting for non-resident principal would not itself render an agent to be considered PE for the purpose of allocating profit. The assessee was not undertaking any definite activity to which profit can be attributed.

iv) Accordingly, it was held that the VGS was an independent and sepa-rate entity, which was engaged in selling of fully built-up cars import-ed from the assessee, Volkswagen AG and Skoda India to dealers and distributors. Thus, it cannot be regarded as a PE of assessee in India.

v) The decision in the case of ***Aramex Logistic Private Limited [2012] 22 taxmann.com 74 (AAR)*** relied on by the tax department was distinguishable on facts of the present case. In the said case, Aramex (F Co.) entered into a contract with the customer outside India for delivery of parcel, where the delivery of the parcel located in India. Further, Aramex (F Co.) had an agreement with Aramex India for the delivery of the parcel to the location in India. The privity of contract was between Aramex and customer outside India. The completion of the contract for the delivery of the parcel will only be complete once the parcel is delivered to the location in India. Accordingly, the activity performed in India by Aramex India, viz; delivery of the parcel to the location in India is part of one transaction which cannot be independently performed.

vi) However, in the present case, the car was manufactured by the assessee outside India and constitutes a separate and independent activity. The car was sold to Volkswagen Group for further sale in India and VGS was not acting on behalf of the assessee nor was the assessee selling cars through VGS. Moreover, the cars were sold on principal to principal basis. Hence, the assessee did not have business connection under the Act and PE under Article 5 of the tax treaty.

5 ***DCIT v. Reliance Jio Infocomm Ltd***
[TS-305-ITAT-2019(Mum)]
Assessment Year: 2016-17

India-Singapore DTAA –Payments for availing bandwidth services are not taxable as royalty under the India-Singapore tax treaty

Facts

i) i) The assessee is engaged in the business of providing telecom services in India. During the Assessment Year (AY) 2016-17, the assessee entered into a 'bandwidth service agreement' (agreement) with a Singapore based entity. The Singapore entity was holding a facility-based operator licence in Singapore which enabled it to establish, install, maintain, operate and provide telecommunication services in Singapore and also provide bandwidth services to the service recipients across the globe.

ii) As per the terms of the agreement, the assessee remained under an obligation to withhold tax, if any, on the payments made to the Singapore entity for provision of bandwidth services.

iii) In pursuance of the aforesaid terms, the assessee remitted the payment to the Singapore entity for provision of bandwidth services and deposited taxes at the rate of 11.11 per cent [i.e. rate of 10% under Article 12 of the DTAA duly grossed upon in terms of Section 195A] in terms of Section 195 of the Act.

iv) However, the assessee thereafter took a stand that it was not obligated to deduct tax at source under Section 195 of the Act from the aforesaid payment made to Singapore entity. The assessee carried the matter to the Commissioner of Income-tax (Appeals) [CIT(A)] under Section 248 of the Act claiming that no tax was required to be deducted on the amount paid to the Singapore entity.

v) The assessee contended that the amount remitted for providing bandwidth services was the Singapore entity's business income. However, the Singapore entity did not have any business connection or Permanent Establishment (PE) in India and therefore, as per Article 7 of the tax treaty the amount remitted by the assessee to the Singapore entity could not be taxed in India.

vi) The Commissioner of Income-tax (Appeals) [CIT(A)] observed that the assessee had only received access to service and not to any equipment that was deployed by the Singapore entity for providing the bandwidth services. Therefore, CIT(A) concluded that the payments made for the provision of bandwidth services were in the nature of business profits and could not be classified as royalty or fees for technical services.

Decision

On appeal, the Tribunal held in favour of the assessee as under:

i) The assessee pursuant to the terms of the 'agreement' had only received standard facilities, i.e., bandwidth services from the Singapore entity. The Tribunal observed that the assessee had access to services and did not have any access to any equipment deployed by the Singapore entity for providing the bandwidth services. Further, the assessee did not have any access to any process which helped in providing of such bandwidth services by the Singapore entity. As a matter of fact, all infrastructure and process required for the provision of bandwidth services were always used and under the control of the Singapore entity, and the same was never given either to the assessee or to any other person availing the said services.

ii) The Tribunal agreed with CIT(A) that as the process involved to provide the bandwidth services was not a 'secret,' but was a standard commercial process that was followed by the industry. Therefore, the same could not be classified as a 'secret process' to treat the payment as 'royalty' under the tax treaty.

iii) The amount paid by the assessee to the Singapore entity was neither towards use of (or for obtaining right to use) industrial, commercial or scientific equipment, nor towards use of (or for obtaining right to use) any secret formula or process, therefore, the same could not be classified as payment of 'royalty' by the assessee.

iv) The amendment in Section 9(1)(vi) of the Act will not have any bearing on the definition of 'royalty' as contemplated in the tax treaty. The Tribunal relied on the decision of Bombay High Court in the case of ***CIT vs. Reliance Infocomm Ltd. (ITA No. 1395 of 2016, dated 5 February 2019)*** wherein it was observed that mere amendment in the Act would not override the provisions of tax treaties.

v) The Tribunal observed that though the term 'royalty' as used in Article 12 of India-Hungary tax treaty takes within its sweep transmission by satellite, cable, optic fibre or similar technology, the definition of 'royalty' in the India-Singapore tax treaty has a narrow meaning. It has been observed that despite the fact that the India-Singapore tax treaty was amended, however, the definition of 'royalty' therein has not been tinkered with and remained as such.

vi) Accordingly, the Tribunal held that the amount received by the Singapore entity from the assessee for providing standard bandwidth services could not be characterised as 'royalty' as per the tax treaty, and was taxable as 'business profits'. The Singapore entity did not have any business connection or a PE in India. Therefore, business profits were not taxable in India.