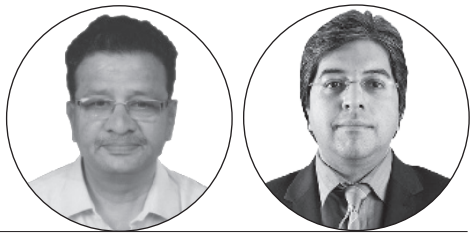

INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 ***PCIT v. Page Industries Ltd. [TS-19-HC-2021(KAR)-TP]***

Where assessee-company entered into a licence agreement with a foreign company (licensor company) for sale of readymade garments under a particular brand name, since licensor company did not participate in capital and management of the assessee-company as required u/s 92A(1), both the companies could not be regarded as AE of each other.

Facts

i) The assessee, a domestic company, was engaged in the business of manufacture and sale of ready-made garments. It was a licensee of the brand-name 'Jockey' for the exclusive marketing of Jockey readymade garments under a license agreement with Jockey International Inc., USA (hereinafter referred as 'JII'), a company incorporated in US and the owner of the brand 'Jockey'. In consideration for granting the right to use the aforesaid brand name, the assessee paid royalty at the rate of 5 per cent of the sales to JII. Out of abundant caution, the assessee disclosed the transaction of payment of royalty in its Form 3CEB and claimed the same to be at ALP.

ii) During the course of assessment proceedings, the TPO observed that the assessee had incurred certain expenditure on advertisement and marketing and product promotion. The TPO treated the said expenditure on advertisement and marketing and product promotion incurred by assessee as expenditure incurred on behalf of JII and held the same as an international transaction u/s 92B of the Act. The TPO computed the ALP by adopting the Bright Line Method and thus made an adjustment to assessee's income in respect of aforesaid expenditure. The action of the TPO was upheld by the DRP.

* assisted by CA Harsh Bafna.

iii) Before the Tribunal, the assessee contended that the conditions specified under section 92A(1) were not existing between the assessee and JII and therefore in the absence of any relationship between two companies, the said transaction did not constitute an 'international transaction' within the meaning of section 92B of the Act.

iv) The Tribunal allowed the appeal of the assessee, by observing that pursuant to amendments made in the opening words of 92A(2), by the Finance Act 2002, in order to constitute a relationship of an AE, the parameters laid down in both sub-sections (1) and (2) of section 92A should be fulfilled and therefore, since the parameters laid down in sub-section (1) were not fulfilled (as JII had no participation in the capital and management of the assessee), there was no relationship of AE between assessee-company and JII and therefore, the provisions of Chapter X of the Act had no application.

v) On appeal by the Revenue, the Karnataka HC held as under:

Decision

i) The High Court observed that it was evident from the Memorandum to Finance Bill, 2002 that section 92A(2) of the Act was amended to clarify that a mere fact of participation by one enterprise in the control and management of another enterprise would not make them AEs unless the criteria specified u/s 92A(2) were fulfilled and that sub-sections (1) and (2) were interlinked and were, therefore, to be read together.

ii) Thus, the HC held upheld the order of the Tribunal holding that the assessee company and the licensor company could not be treated as AEs.

B. Authority for Advance Rulings

2 *SeaBird Exploration FZ LLC [TS-29-AAR-2021]*

Vessel hiring payments made by an assessee, a tax resident of UAE, to a Cyprus tax resident, for global usage of seismic survey vessels under bareboat charter (BBC) agreements, in relation to providing offshore seismic data acquisition and processing services to ONGC and other oil companies in India, would be deemed to accrue/arise in India and would be taxable u/s 44BB of the Act.

Facts

i) The assessee, a tax resident of UAE, was engaged in the business of rendering geophysical services to the oil and gas exploration industry, which interalia included activities in relation to 4C-3D seismic data acquisition and processing. In India, the assessee was providing offshore seismic data acquisition and processing services to ONGC and other oil companies. Further, for the purpose of executing the aforesaid work, the assessee required seismic survey vessels, which were special kind of vessels fitted with seismic recording systems and receiver units and which were used for undertaking seismic data acquisition and on-board data processing. In view of the same, the assessee had entered into two bareboat charter agreement (BBC Agreement) with different vessel

providing companies (VPCs), which were tax residents of Cyprus, for provision of requisite seismic survey vessels on a global usage basis.

ii) Before the Authority for Advance Rulings (AAR), the assessee sought a ruling on the taxability of the payments made to the VPCs in as much as whether the sums paid to the VPCs would be deemed to accrue or arise in India; whether the payments would be taxable u/s 44BB of the Act; whether the payment would be in nature of 'royalty' under the Act and whether the payment would be in nature of 'royalty' under the India-Cyprus DTAA.

iii) Before the AAR, the assessee contended as follows:

a. W.r.t accrued or deemed to accrue or arise in India, the assessee contended that the source of income would be where the originating cause was located i.e. the place where the vessel was given and the place where the vessel was delivered i.e. outside India (and not where the vessel was actually employed). The assessee relied on the decision of Reliance Industries Limited (82 TTJ 787), (Delhi ITAT), wherein it was held that a ship is located where it is registered. The assessee also contended that the source of income for the VPCs of the vessel lies in delivering and transferring the control of the vessel to the assessee and not its subsequent utilization in India. Further, the assessee also argued that under the BBC Agreements, the vessels were provided outside India to the charterer/assessee and the latter had brought the vessels to India for use in its operations and thus there was no business connection so far as the VPCs were concerned and further, the VPCs had not carried out any operation in India.

b. W.r.t applicability of section 44BB of the Act, the assessee relied on the decisions in the case of Wavefield Inseis 'ASA' (AAR No. 823 of 2009 and 844 of 2009) and Siem Offshore Inc. (AAR No. 875 of 2010), wherein it was held that provision of vessels on hire to be used in the prospecting or extraction of mineral oil would be covered under Section 44BB of the Act.

c. W.r.t the issue of being categorised as 'royalty', the assessee argued that the definition of royalty under the Act specifically excluded income from its purview 'use or right to use equipment's referred to in section 44BB' of the Act and hence, the captioned payment would not be characterised as 'royalty' under the Act. Further, the assessee also contended that even if the payment was considered taxable under Article 12 of India-Cyprus DTAA, as "Royalty", the provision of section 44BB of the Act being more beneficial would be applicable u/s 90 of the Act.

iv) Before the AAR, the Revenue contended as follows:

a. The Revenue argued that the provisions of the India-Cyprus DTAA were not applicable since

the transaction was between one non-resident with other non-residents and the payment made to the VPCs were not being made by an entity located in India and thus, the provisions of the Act had to be looked into for determining the taxability of the aforesaid payments.

b. The Revenue argued that under the BBC Agreement, all the expenses of Master and Crew remained with the assessee and thus the nature of receipts in the hands of VPCs took the nature of 'royalty', within the meaning of Section 9(1)(vi)(c) of the Act.

c. The Revenue also relied on the ruling of the Authority in the assessee's own case i.e. Ruling No.1295 of 2012 dated 28th March 2018, wherein it was held that the income of the non-resident lessor was liable for taxation as "business income" under section 44BB of the Act.

v) The AAR ruled as under:

Decision

i) The AAR observed that the VPCs had derived income from hiring of the seismic vessels, which was a ship that was solely used for the purpose of a seismic survey in the high seas and oceans for the purpose of pinpointing and locating the best possible area for oil drilling and such vessels were used only by the companies engaged in the oil drilling process. Therefore, in essence, the vessels hired were Research Ship which was used for marine acquisition of seismic data and was in the nature of scientific equipment. Any consideration received for use or right to use such scientific equipment would be in the nature of royalty u/s 9(1)(vi) of the Act unless it was found that such scientific equipment was covered under the provisions of Section 44BB of the Act.

ii) The AAR observed that there was no dispute that the vessels were used in prospecting of mineral oil in India and the vessels were hired by the assessee, pursuant to the contract with ONGC. Further, the AAR relied on the explanation to the section 44BB which clarified that 'plant' includes ship or any scientific apparatus or equipment used for the purpose of prospecting of mineral oil and thus, concluded that the research vessel employed by the assessee were covered within the scope of "plant" as defined u/s 44BB of the Act.

iii) Accordingly, the AAR held that the aforesaid payment to VPCs would be for supply of plant and machinery on hire used in the prospecting for mineral oil in India and was squarely covered under the provision of section 44BB(2)(a) of the Act and further, since the receipt was found to be covered under the provision of section 44BB of the Act, it could not partake the character of royalty in view of specific exclusion under clause (iva) of Explanation 2, to section 9(1)(vi) of the Act. The AAR relied on the decision in case of ***Seabird Exploration FZ, LLC, UAE 192 Taxman 471 (AAR - New Delhi***) and ***Wavefield Inseis Asa (187 Taxman 62) (AAR),*** wherein it was held that the sum

paid by the assessee to the VPCs under global usage BBC agreement was taxable in India u/s 44BB of the Act.

iv) The AAR also held that, as the business activity in the nature as described in section 44BB of the Act was carried out by the VPCs through the seismic vessels, the place where the vessels were deployed for the operation would be deemed to be the source of such business income. The AAR also held that the source of the business income of the VPCs was embedded in the contract awarded by ONGC to the assessee and the deployment of the seismic vessels in India by the assessee was pursuant to this contract. Therefore, the payment made by the assessee to VPCs was in connection with the utilization of the vessels in India and thus, the income of the VPCs accrued in India through a business connection in India. The AAR, by relying on the decision of Hon'ble Supreme Court in case of GVK Industries Ltd. (371 ITR 453)(SC), held that the business activity of the VPCs had a clear nexus with the Indian territory in as much as that there was an existence of close, real, intimate relationship and commonness of interest between the VPCs and the assessee and thus it satisfied the essence of "business connection" and "territorial nexus".

v) The AAR further relied on the decision of the Authority in assessee own case [AAR No. 1295 of 2012 dated 28th March 2018 reported as ***SeaBird Exploration FZ LLC. [2018] 92 taxmann.com 328 (AAR - New Delhi)]*** wherein it was held that the vessel engaged in a seismic survey at high sea constituted a fixed place PE of the VPCs and the period of operation of the said vessel in India was immaterial in determining whether a fixed place PE of the VPCs was constituted in India or not, as held by the Supreme Court in case of ***Formula One World Championship Ltd. vs. CIT (International Taxation) [2017] 80 taxmann.com 347/248 Taxman 192/394 ITR 80***. Accordingly, the AAR held that the income earned by the VPCs would intrinsically be linked with the said PE and the income arising from the said PE located in India would be liable to tax in India as business income of the VPCs u/s 44BB of the Act.

C. Tribunal

3 *ITTIAM Systems Pvt. Ltd vs. ITO- [TS-22-ITAT-2021(Bang)]*

Credit of the entire foreign taxes paid in USA, Japan and Germany would be available as a foreign tax credit in India, as per the provisions of the respective DTAA's. However, in the case of Korea, foreign tax credit would be limited to taxes paid/payable in Korea or India, whichever is less. Further, in case of Taiwan, where India does not have a DTAA, FTC would be computed based on the rate of tax applicable in India or Taiwan, whichever is less, on such doubly taxable income.

Facts

i) The assessee, a tax resident of India, was engaged in the business of signal processing application and media processing and communication. During the year under consideration, i.e. AY 2013-14 and AY 2014- 15, the assessee earned income from Japan, Korea, Germany and USA, with which India

have a DTAA. Further, the assessee had also earned income from Taiwan with which India does not have a DTAA during the year under consideration. The assessee claimed the entire amount of INR 1.80 crores as a foreign tax credit (hereinafter referred to as 'FTC') in respect of revenue which was subjected to tax outside India. The assessee claimed the entire FTC in relation to the taxes paid outside India since the effective tax rate in respect of income taxed outside India was 14.32 % (computed on the basis of the tax withheld and total gross receipts) and the effective tax rate in India was 32.45 %.

ii) During the course of assessment proceedings, the AO observed that the assessee had wrongly compared the rate of tax outside India with the rate of tax in India in as much as that the effective tax rate outside India was calculated by the assessee on the gross receipts whereas the effective tax rate payable in India was calculated on income. The AO observed that in view of the provisions of the respective DTAA's, FTC had to be calculated based on the income and not the gross receipts and thus, the AO re-computed the FTC claim and allowed INR 40 lakhs as FTC available to the assessee for the year under consideration. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the action of the AO in relation to the methodology of computing the FTC claim. However, the CIT(A) also granted FTC in relation to the revenue earned from Korea (which was not allowed by the AO, without providing any reasons in relation thereof). The CIT(A) also dismissed the additional ground of the assessee that the FTC which had been denied, should be allowed as a business expenditure u/s 37(1) of the Act, without providing any reasons thereof.

iii) On appeal, the ITAT held as under:

Decision

Claim of FTC vis-à-vis countries where India has entered into a DTAA

i) On perusal of Article 25 of the India-US DTAA, the Tribunal observed that, if a resident Indian derives income, which may be taxed in USA, India should allow as a deduction from the tax on the income of the resident, an amount equal to the tax paid in USA, whether directly or by deduction. Further, the Tribunal also observed that the conditions mandated in the DTAA were that if any 'income derived' and 'tax paid in US' on such income, then tax relief/credit should be granted in India on tax paid in US and the same conditions were provided for under the India-Japan and India-Germany DTAA. Accordingly, the Tribunal observed that in all the above clauses, for eliminating double taxation of doubly taxable income in the hands of the assessee, it was necessary to establish that the taxes were paid by the assessee in USA, Japan, and Germany. In view of the above, the Tribunal held that the assessee was eligible for the entire amount of taxes paid in USA, Japan and Germany, by relying on the decision of the Karnataka High Court in case of ***Wipro v. DCIT (2016) 382 ITR 179 (Kar),*** wherein the Karnataka HC had held that assessee would be entitled to take credit u/s 90(1)(a)(ii) of income tax paid in a foreign country even in

relation to income which was exempt under section 10.

ii) W.r.t the revenue earned from Korea, the Tribunal observed that as per Article 23 of the India-Korea DTAA, FTC was available only in respect of taxes paid in Korea, which did not exceed the taxes payable in India on such doubly taxed income. Thus, there was a difference in FTC available to the taxpayer on taxes paid in USA, Japan and Germany vis-s-vis Korea in as much as that under the said DTAAs, FTC in India would be allowed to the extent of the tax paid in those countries, whereas, under India-Korea, FTC was available only in respect of taxes paid in Korea, which did not exceed the taxes payable in India on such doubly taxed income. Accordingly, w.r.t the claim of FTC on the revenue earned from Korea, the Tribunal held that FTC would be restricted to tax actually paid in Korea or payable in India on such doubly taxable income, whichever is lower.

Claim of FTC vis-à-vis Taiwan (with whom India does not have a DTAA)

iii) The Tribunal observed that India did not have a DTAA with Taiwan and therefore, FTC was available to the assessee against taxes paid in Taiwan in terms of the provisions of Section 91. Section 91 provides for deduction of tax paid in any country from the Indian Income tax payable by the taxpayer of a sum calculated on such doubly taxed income, even though there is no tax treaty.

iv) Therefore, the Tribunal observed that even in the absence of a DTAA, by virtue of the statutory provision, the benefit conferred under Section 91 is extended to the income tax paid in foreign jurisdictions. Section 91 further lays down that a resident assessee would be entitled to a deduction from his tax liability, of a sum calculated on the doubly taxed income at the Indian rate of tax or the rate of tax of the other country concerned, whichever is lower. In view of the above, the Tribunal held that as per Section 91, in case of Taiwan, FTC would be available and was to be computed based on the rate of tax applicable in India or Taiwan, whichever was less, on such doubly taxable income.

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It was an exciting time and I enjoyed every minute of it even though I was working harder than ever before in my life.

A.P.J. Abdul Kalam