INTERNATIONAL TAXATION
Case Law Update

Dr. CA Sunil Moti Lala
Advocate

A. SUPREME COURT

1 ***CIT (LTU) vs. Whirlpool of India Ltd. - [2024] 169 taxmann.com 95 (SC)***

Revenue's SLP was dismissed against order of High Court holding that where revenue had been unable to demonstrate by some tangible material that there was an international transaction involving AMP expenses between Indian subsidiary and foreign parent, revenue could not proceed to determine ALP of AMP expenses by inferring existence of an international transaction based on bright line test.

B. HIGH COURT

2 ***DIT International vs. Western Union Financial Services Inc. - [2024] 169 taxmann.com 461 (Delhi)***

Where assessee, a US based company, engaged in business of rendering money transfer services, established a liaison office (LO) in India, the Hon'ble HC upheld the order of the Hon'ble Tribunal holding that since activities undertaken by LO were merely preparatory or auxiliary in character and far removed from core business of assessee, LO would not constitute a PE. Permission granted by RBI proscribed LO from undertaking any commercial trading or industrial activity in India and since activities undertaken by LO were far removed from core business of assessee tests of 'preparatory' and 'auxiliary' as embodied in Article 5(3)(e) stood satisfied and, thus, LO would not constitute a PE. Further, since LO did not have any authority to conclude contracts, it could not be classified as a DAPE.

3 ***PCIT vs. CIENA Communications India (P.) Ltd. - [2024] 169 taxmann.com 660 (Delhi)***

The Hon'ble HC upheld the order of the Hon'ble Tribunal holding that where on-call advisory services provided to assessee by its US based AE through call did not make available technical knowledge and experience or skill to assessee, consideration paid by assessee to AE was neither taxable in India u/s 9(1)(vii) of the Act nor under Article 12 of the India-US DTAA.

4 ***PCIT. vs. Fluor Daniel India (P.) Ltd. - [2024] 169 taxmann.com 508 (Delhi)***

Where assessee was rendering engineering and related services (as a subcontract limited to specific functions as per requirement of its affiliate), the Hon'ble HC upheld the order of the Hon'ble Tribunal rejecting the following companies as comparables.

a. A company having highly technical capabilities of executing infrastructure development projects.

b. A company working in divisions like infrastructure, tourism, aviation, IT services, HRD and financial services, which were not similar to functions performed by assessee.

c. A company engaged in providing high end technical services with prestigious urban infrastructure facilities such as Airports, Railways and metropolis engineering consulting projects.

d. A company playing vital role in development of fertilizers industry in India.

5 ***PCIT. - 4 vs. Symphony Marketing Solutions India (P.) Ltd. - [2024] 169 taxmann.com 548 (Delhi)***

Where the assessee was providing call centre services to its AE, the Hon'ble HC upheld the order of the Hon'ble Tribunal rejecting the following companies as comparables

a. A company providing business process management services.

b. A company providing knowledge process outsourcing services.

C. Tribunal

6 ***TBEA Shenyang Transformer Group Company Ltd. vs. DCIT, International Taxation. - [2024] 169 taxmann.com 145 (Ahmedabad – Trib.) (SB)***

Transactions between foreign enterprise and its PE in India can be considered as international transaction for purpose of section 92B and, accordingly, be subject to 'arm's length price' adjustment. In the instant case, where Head Office (HO), situated in China had complete control over funds of assessee-PE and its revenue were determined by agreement signed by HO and furthermore assessee-PE was incurring loss, it was held that such an arrangement would be subject matter of transfer pricing.

Facts

i. The assessee, was a Project Office (PO) in India of TBEA, a company incorporated in China. Power Grid Corporation of India Ltd., (PGCIL) awarded a contract to TBEA to build sub-stations in India, comprising of off-shore supply, on-shore supply, and on-shore Services, governed by separate agreements. Under the on-shore services agreement, TBEA was to provide certain onshore services in the nature of inland transportation and civil work services to PGCIL within India. In order to provide these services, pursuant to the agreement with PGCIL, the TBEA set up a Project Office (i.e., assessee) in India to provide the onshore services. The onshore services were accordingly provided by the TBEA through its PO/ PE including sub-contracting a part of the work to independent third-party contractors. The HO in China had made/ received certain payments on behalf of

the PO as the PO did not have a bank account in India at the relevant time.

ii. The TPO took a view that since the original onshore service contract was executed between head office in China and PGCIL, the act of carrying out execution of the contract by the PO in India on behalf of head office in China and consequent incurring of expenses by it was required to be considered as the international transaction between the HO in China and PO. The TPO observed that the per unit civil work rate received from PGCIL was lower than the rate paid to sub-contractor. The TPO held that the PO was not adequately compensated for the onshore activity and had incurred losses. Therefore, the TPO held that the TP provisions were applicable to transactions between PO and its HO in China.

iii. On appeal to the Tribunal, the Division Bench referred the following question to the Special Bench, "Whether or not the transactions between a foreign enterprise outside India and its Indian permanent establishment can be considered as an international transaction for the purpose of section 92B of the Act, and accordingly can be subjected to the 'arm's length price' adjustment".

Decision

i. The SB noted the assessee's contention that the provisions of India-China tax treaty override the provisions of the IT Act and as per Article 9 of the treaty and that TP provisions were not applicable in the instant case. The SB held that having relied on Article 9 of the tax treaty, the assessee had lost sight of Article 7(2) of India-China Tax Treaty. In the context of a PE in India of a foreign enterprise, Article 7(2) provides that profits, which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities shall be attributed to India. So, PE has to be treated as a distinct and separate enterprise. So even if profit attribution has to be done as per treaty, PE has to be treated as a distinct and separate enterprise from the HO. Therefore, even under the tax treaty, the PE is a separate enterprise.

ii. Since, PE is a separate enterprise from the HO for the purpose of transfer pricing provisions, the decisions relied by the assessee to contend that one cannot generate income by dealing with self are not applicable in given context. The transfer pricing provisions are applicable to transactions between two enterprises and not between two persons.

iii. The assessee contended that there is no income arising out of international transactions in the current case as there is only fund movement between HO and PE and actual transactions are between PE and third parties. The SB held that the fundamental question that arose in this context was whether in an independent party scenario whether an enterprise would permit its receipts and payments to be routed through third party. The HO had complete control over the funds of PE. The revenue of assessee-PE were determined by agreement signed by HO. These all aspects have influence on the taxable income that is to be determined in the hands of assessee-PE. The understanding of income in the context of transfer pricing has to be in commercial and business sense.

iv. Further, the word 'transaction' in the context of transfer pricing has to be understood as per the clause (v) of section 92F, which is wider than the normal understanding of word 'transaction'. Thus, transaction includes arrangement, understanding or action in concert. The arrangement or understanding between two enterprises may also give rise to income or loss and it may be subject matter of transfer pricing. In the instant case, the arrangement between the HO and the assessee-PE is giving rise to loss in the hands of PE and thus such an arrangement is subject matter of transfer pricing. The assessee-PE has undertaken obligation of rendering onshore services to which the HO had agreed. The funds of assessee-PE were controlled and managed by HO. If the income or loss in the hands of PE was not due to arrangement with HO, then such a case would not be covered which was not so in the instant case.

v. Section 92 brings income arising from international transaction within the ambit of transfer pricing provisions. The international transaction is between the associated enterprises. As held above it is viewed that PO and HO are separate enterprises. Further, as per Article 7(2) of the India-China DTAA and paras 15, 16 & 17 of the commentary on Article 7 on Model tax convention published by OECD in 2010 also states that permanent establishment is to be treated as a functionally separate entity. PO and HO have transaction between them which has an impact on 'income'. Both are non-residents and thus, satisfy the basic test of section 92B.

vi. The question which is before Special Bench covers both sub-sections (1) and (2) of section 92B. In the instant case, the PO has undertaken the obligation of rendering onshore services on behalf of HO and at same terms and conditions which the HO agreed with the PGCIL. The PE incurred substantial losses in executing such services. The crux of the matter is whether unrelated party would have taken up the obligation of rendering onshore services, which at the threshold itself results in loss. Whether PO was made to accept the term of onerous contract by the HO. If this be the fact pattern, provisions of section 92B(2) may be applicable in such kind of cases. The SB directed that the Division Bench may analyse the applicability of section 92B(2) in accordance with law.

vii. The SB noted that the assessee had submitted that as per the provisions of section 90, the provisions of the DTAA (to the extent it is beneficial to the assessee) override the provisions of the Act. It was further submitted that as per Article 9 of India-China DTAA, the profits derived by the one enterprise would be subject to transfer pricing and determination of ALP, only where one of the two Enterprises was a resident of the other contracting state (India). It was submitted that neither the HO nor the PE can be termed as resident and thus transactions between them shall not be subject to transfer pricing considering provisions of Article 9 of DTAA.

viii. The Hon'ble SB held that the purpose of Article 9 is limited to only confirm that broadly similar rules exist in domestic law. Article 9(1) does not, in itself fulfil any necessary function, as it only formulates rules that may already exist in domestic laws. Article 9(1) does not bar an adjustment of profits under the domestic law even under conditions that differ from those of

Article 9(1) but the intention is to have economic double taxation covered by the convention. Assuming that argument of the assessee that DTAA provisions in Article 9 override the Act is correct, then one needs to attribute profits to the PE as per provisions of Article 7 of the Treaty. Thus, one would also have to apply Article 7(2) of India-China Tax Treaty.

ix. In the context of a PE of a foreign enterprise in India, the Article 7(2) provides that profits that will be attributed to PE shall be profits which the PE might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a PE. Article 7(2) of the India-China DTAA leads to the conclusion that determination of profits under the hypothesis of the PE being a distinct and separate enterprise, dealing wholly independently with the enterprise of which it is a PE, is nothing but adherence with the arm's length principles. The underlying philosophy of TP provisions and Article 7(2) is same wherein both try to analyse as to how third parties would have dealt with each other under uncontrolled conditions. Thus, contention of the assessee that there is conflict between Article 9 of the DTAA and domestic TP provisions was rejected.

x. In light of aforesaid reasoning, it concluded that the transaction between foreign enterprise and its PE in India could be considered as an international transaction and be subject to ALP adjustment. The Hon'ble SB directed that the matter be placed before the Division Bench to give effect to the direction of this order.

7 *Manab Chandra Ghosh vs. ACIT - [2024] 169 taxmann.com 449 (Kolkata – Trib.)*

Where assessee, non-resident employee of an Indian company, was sent to Indonesia for rendering services and he received foreign assignment allowances for services rendered in Indonesia, the Hon'ble Tribunal held that since assessee was a non-resident and services were rendered outside India, said allowances were not taxable in India.

Facts

i. The assessee, an employee of IBM India Pvt. Ltd. had undergone a short-term assignment to Indonesia and consequently, the assessee claimed to be a non-resident for the assessment year 2016-17 as per the provisions of the Income Tax Act.

ii. The assessee filed his return of income (declaring total taxable income of Rs.49,590) claiming that the income received and accrued in Indonesia for rendering service outside India, was not taxable under section 5(2). The assessee also claimed a refund of the TDS.

iii. The AO rejected the claim of the assessee as he had failed to produce the valid tax residency certificate (TRC) from Indonesia.

iv. The CIT(A) dismissed the appeal of the assessee.

v. Aggrieved, the assessee filed appeal to the Tribunal.

Decision

i. Based on the passport details, the Hon'ble Tribunal noted that the assessee was present in India for only 61 days during the financial year 2015-16 which qualified him as a non-resident under section 5(2) and only income received or deemed to have accrued or arisen in India, is taxable for a non-resident.

ii. It is undisputed that the assessee was a non-resident employee in IBM India Pvt. Ltd. (an Indian Company) and was sent abroad to Indonesia for rendering services there.

iii. There was no dispute that the services were rendered in Indonesia and the foreign assignment allowances received by the assessee was for services rendered in Indonesia and no evidence suggested that income accrued or arose in India.

iv. The assessee failed to produce the TRC before the AO, which was a procedural lapse and did not negate the substantive compliance.

v. After considering the facts and circumstances of the case and following the decision in the case of ***DCIT vs. Sudipta Maity [2018] 96 taxman.com 336 (Kolkata-Trib.),*** the Hon'ble Tribunal deleted the addition made by the AO based on the fact that the income related to services rendered & received outside India was not taxable in India. The AO was accordingly directed to allow the refund as claimed by the assessee.

8 *Avtec Ltd. vs. ACIT, LTU - [2024] 168 taxmann.com 692 (Delhi-Trib.)*

The Hon'ble Tribunal held that where assessee made payment to a non-resident independent warehouse service provider based in USA for space utilization of warehouse outside India, and non-resident had no business activity in India, the Hon'ble Tribunal held that payment made by assessee was not an income within ambit of section 9 and was not exigible to tax in India. Also, since no technology had been transferred, 'make available' conditions were not complied with and, therefore, payment made to non-resident did not fall under description of FTS under Article 12 of the India-US DTAA.

9 *Anand NVH Products (P.) Ltd. vs. DCIT - [2024] 169 taxmann.com 684 (Delhi- Trib.)*

The Hon'ble Tribunal held that Corporate guarantee is an international transaction and commission charged by a commercial bank under bank guarantee cannot be a benchmarking parameter and suitable comparable for determination of arm's length price of alleged international transaction. Since in financial year 2016-17, assessee had paid 1 per cent as cost of extending SBLC (Standby Letter of Credit) to AE, it directed the AO/TPO to consider rate of 1 per cent to be ALP for this international transaction.

■●■