INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 *Obulapuram Mining Company Pvt Ltd [TS-1262-HC-2019(KAR)-TP]*

Reference to the TPO to determine the ALP u/s 92CA(1) in terms of the CBDT Instruction No. 3/2003 is mandatory in nature and thus an assessment order passed without making any reference to the TPO, for determining the ALP, is erroneous, and liable for revisionary proceedings u/s 263

Facts

i) The assessee, a domestic company engaged in the business of mining and export of iron ore, filed its return of income for AY 2008-09. During the year under consideration, the assessee had entered into international transactions with its AE i.e. M/s GLA Trading International PTE Ltd. The case of the assessee was selected for scrutiny assessment and the assessment was completed u/s 143(3) read with Section 153A of the Act, without making any reference to the TPO to determine the ALP of the said international transaction though the value of the said transactions exceeded INR 15 crores.

ii) Subsequently, the CIT passed order u/s 263 of the Act, by holding that the assessment order was erroneous and prejudicial to the interest of revenue, for the reason that as mandated by the CBDT Instruction No. 3/2003, the AO had not referred the matter to the file of the TPO for determination of ALP of the aforesaid international transaction.

iii) On appeal by the assessee before the Tribunal, the Tribunal by relying on co-ordinate bench decision in ***Tata Consultancy Services [TS-521-ITAT-2015(Mum)-TP],*** held that CBDT Instruction No. 3 dated 20.05.2003 was not binding on the AO and therefore concluded, the action of the AO of himself determining the TP adjustment without referring the matter to the TPO in the present case was one of the possible views and therefore the assessment order could not be said to be erroneous. The Tribunal thus quashed the order passed by the CIT u/s 263 and allowed assessee's appeal.

iv) On Revenue's appeal before the Hon'ble Madras HC, the HC held as under:

Decision

i) The Madras High Court placed reliance on the decision of Hon'ble Supreme Court in ***PCIT vs. SG Asia Holdings (India) Pvt Ltd (2019) 13 SCC 353***, wherein the Supreme Court had held that reference to the TPO to determine the ALP u/s 92CA(1) in terms of the CBDT Instruction No. 3 /2003 was mandatory in nature and thus the impugned order of the CIT u/s 263 of the Act was restored by the Madras High Court.

ii) The Madras High Court also observed that the order of the Tribunal in quashing the impugned order of the CIT u/s 263 was unsustainable in law as it ran counter to the decision of SC in SG Asia Holdings (supra).

iii) The Madras High Court also distinguished the decision of Supreme Court in ***Vodafone India Services Pvt. Ltd. vs. UOI (2007) 15 SCC 401*** by observing that the issue whether CBDT Instruction No. 3 /2003 was mandatory or not was not decided in the said decision. Further, the decision of Mumbai Tribunal in ***CIT vs. Tata Consultancy Service Ltd. (I.T.A.No.7513/M/2010)*** was held by the Madras HC as a decision rendered on the facts of that case and not an authority for consideration.

B. Tribunal

2 *Lubrizol Advanced Materials Inc. vs. DCIT [ITA No. 2455 /Ahd/2018]*

Employees deputed by the assessee (foreign entity) to I Co, working exclusively for I Co, did not constitute supervisory or agency permanent establishment of the assessee in India.

Facts

i) The assessee, a tax resident of USA, had entered into an inter-company services agreement with its Indian AE (hereinafter referred as I Co.) for the provision of engineering, technology, design and project supervisory services, in relation to setting up of a new manufacturing plant in India of the I Co. As per the said agreement, I Co. was to pay actual cost, plus a mark-up at 10%, to the assessee. Accordingly, the assessee sent its personnel to India to supervise the said project. The assessee treated the aforesaid arrangement as a supervisory permanent establishment (PE) in India under the provisions of Article 5(2)(k) of the India-USA DTAA and accordingly, filed its income- tax return declaring income therefrom.

ii) Independent of the above, two more employees of the assessee namely, Mr. Tim and Mr. Matt, were seconded to I Co as full- time working employees and the said employees were acting as the managing directors (MD) and were getting salary from I Co. However, for administrative convenience, part of the salary was paid by the assessee in the USA (and the same was reimbursed to

assessee on cost-to-cost basis by I Co). I Co deducted taxes on the salary paid to Mr. Tim and Mr. Matt, including the amount reimbursed to the assessee. Further, both the employees, T and M, offered their income to tax in India.

iii) Further, the assessee during the year under consideration i.e. AY 2011-12, had also sold certain goods to the I Co in pursuance of a Purchase Agreement signed by the Mr. Tim and Mr. Matt being I Co's MDs.

iv) During the course of assessment proceedings, the AO held that the assessee had the following PEs in India:

v) Supervisory PE, for the following reasons:

a. In the event of opening ceremony of the Indian manufacturing unit, a news release was published on the website of the assessee wherein, Mr. Tim was referred to as MD of South Asia of the assessee. This suggested that Mr. Tim was working with the assessee.

b. The personal profile of Mr. Tim and Mr. Matt indicated that they were highly skilled, professional and specialised in supervising the growth and expansion of the plant. Likewise, these employees had been working on different projects at different locations throughout the globe as employees of the assessee. These employees were working in supervising capacities on behalf of the assessee, constituting the part of the activities carried on with respect to supervisory PE in India.

c. The contention of the assessee that the global income of these employees had suffered tax in India was not accepted as the passport and bank statement copies were not furnished.

d. In the earlier AY, the assessee had admitted that Mr. Tim and Mr. Matt were visiting India for supervisory purposes in connection with the Indian manufacturing plant.

e. In view of the above, the AO attributed the salaries of Mr. Tim and Mr. Matt (including the amount reimbursed by I Co to the assessee) to the income of the supervisory PE of the assessee in India.

vi) Agency PE, for the following reasons:

a. The aforesaid two employees were working on behalf of the assessee with I Co, which established the agency PE of the assessee in India under Article 5 of the DTAA

b. The assessee failed to substantiate its claim based on documentary evidence that the sale of goods under the Purchase agreement was not a part of the project operation in India in connection with the Supervisory Agreement.

c. Therefore, the sale of goods under the Purchase agreement should be brought to tax in India. Accordingly, the AO worked the amount of profit attributable to India as per the provisions of Rule 10 of the Income-tax Rules, 1962 (Rules) and added the same to the total income of the assessee.

vii) The DRP provided partial relief to the assessee, as follows:

viii) W.r.t Supervisory PE, the DRP held:

a. That the AO had treated entire salary reimbursement as income of the assessee. However, only the profit related to the receipt was to be taxed. As per the Supervisory Agreement, the assessee was to be paid its expenses with a mark-up of 10%. Accordingly, the AO was directed to restrict the addition to the mark-up of 10%.

ix) W.r.t Agency PE, the DRP:

a. Directed the AO to calculate the profit attribution on the basis of the global profitability of the assessee or 10%, whichever was higher, as against the calculation of 50% of the turnover made by the AO in the draft assessment order.

x) The assessee filed an appeal before the Tribunal:

Decision

i) W.r.t the constitution of supervisory PE of the assessee in India, the Tribunal observed that the issue in the case under consideration was whether Mr. Tim and Mr. Matt were the employees of the assessee viz-a-viz rendering services in connection with the supervisory PE, or whether these were employees of I Co. The Tribunal held in favour of the assessee (i.e. that they were employees of I Co) , taking into consideration the following factors:

a. Salaries of Mr. Tim and Mr. Matt were paid by I Co on which I Co deducted taxes u/s 192 of the Act and issued withholding tax (TDS) certificates in Form-16. The said employees also filed their returns of income in India and copies of the same were furnished before the AO.

b. As per the agreement for reimbursement of employee cost (between the assessee and I Co), the assessee was the ultimate parent company of I Co which was engaged in the business of manufacturing and selling of natural product. The I Co required personnel having high skill and expertise in connection with its business in India. Accordingly, personnel were deputed to India. It was agreed that the deputed personnel would be I Co's employees in India and would work under the supervision and guidance of I Co and exclusively for I Co in India. I Co would pay salaries to these personnel and bear the cost of benefits provided to them. It was agreed that a part of the salary would be paid in foreign currency to these employees for the purpose of convenience, but the quantum of the same would be decided by I Co, as per the rules and regulations applicable in India.

c. No adverse inference could be drawn against the assessee merely on the basis of the information displayed on its website. Further, the information displayed on the website could not precede the documents such as employment agreements (between I Co and the employees), and agreement

for reimbursement of employee cost (between the assessee and I Co), which were available on record for deciding the issue under consideration.

ii) W.r.t the constitution of agency PE of the assessee in India, the Tribunal directed the AO to delete the said addition, by observing as follows:

a. Mr. Tim and Mr. M were not the employees of the assessee but of the I Co. Therefore, the Purchase Agreement signed by them was entered on behalf of I Co in the capacity of authorised signatory being the directors.

b. Consequently, there was no connection between the employees and the assessee which could establish agency PE in India. Thus, the whole basis for treating the transaction of impugned sale and purchase as attributable to the agency PE was held to be not sustainable.

3 *Sumitomo Corporation vs. DCIT [2021] 127 taxmann.com 638 (Delhi - Trib.)*

Where assessee, a Japanese Co, supplied equipments and spare parts to an I Co from outside India and had not undertaken any activity of installation and commissioning of equipment supplied, no portion of assessee's income from said offshore supply would be taxable in India under Article 5 of the India and Japan DTAA

Facts

i) The assessee, a tax resident of Japan, was engaged in the business of supply of equipments for various projects and also executed erection and commissioning of equipment at the various project sites in India. The assessee did not undertake any activity of installation and commissioning of equipment supplied and was separately providing 'supervision services' of the installation and commissioning of such equipment, which was offered to tax under Article 12(2) of India-Japan DTAA.

ii) During the course of assessment for the year under consideration i.e. AY 2013-14, the AO held that the profit from supplies of equipment, supplied by it from Japan to Maruti Suzuki India Limited (MSIL) in India was taxable in India, since:

a. A composite contract was entered where the scope of the contract included supply, transportation, supervision of installation, commissioning and testing of equipment at the site of MSIL

b. Responsibility and risk associated in such supply did not cease outside India

c. Technical personnel from HO frequently visited site of MSIL to gather specifications and based on the same, supplied the equipment.

d. Negotiation and signing of the contract took place in India

e. The assessee continued to undertake the risk of rejection of the supply, therefore, the transfer of ownership would not change the legal position that off-shore supply was taxable in India.

iii) Accordingly, the AO attributed 50% of the global profits of the assessee to the Indian operations of the assessee. The action of the AO was upheld by the DRP, however the DRP reduced the attribution of 50% as done by the AO to 35%. The assessee filed an appeal before the Tribunal:

Decision

i) The Tribunal held in favour of the assessee, by observing that no profit had accrued to the assessee in India, in relation to supplies made by it, as it had not undertaken any activity of installation and commissioning of equipment supplied and was independently and separately providing supervision services of the installation and commissioning of such equipment, which was offered to tax by the assessee.

ii) The Tribunal placed reliance on its co-ordinate bench decision in assessee's own case wherein it was held as follows:

   a. The goods were sold from outside India and thus, the risk and title were also transferred outside India and no transaction took place in India. The assessee at no stage was involved in custom clearance, inland transportation. No PE was involved in the sale of the said goods.

   b. The supervision was done after the supply of equipments and the Revenue could not establish that the assessee was having a fixed place PE or supervisory PE in India.

   c. The ratio laid by the Hon'ble Apex Court in case of ***M/s Ishikawaiima Harima Heavy Industries Ltd. [2007] 288 ITR 408 (SC)*** was applicable to the facts of the case.

iii) Further, the Tribunal overruled the finding of the Ld. DRP that the transactions of offshore supply and installation and supervision by the assessee, were closely interlinked and were continuous by holding that the said activities were totally separate from each other and that there was no interlink or continuation between the offshore supply, installation and supervision.

iv) The Tribunal also noted that the AO himself had not brought to tax any such amount from supplies made to MSIL from AY 2014-15 onwards and thus deleted the addition.

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Honesty is the best policy, and a virtuous man must gain in the end.

— *Swami Vivekananda*