INTERNATIONAL TAXATION

Case Law Update

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A. High Court

1 *CIT (International Tax) vs. M/s J. Ray Mc Dermott Eastern Hemisphere Ltd.- TS-493-HC-2022 (Bombay)*

Bombay HC dismissed Revenue's appeal holding that the question of constitution of PE was factual in nature and that no substantial question of law arose for HC's consideration

Facts

i) The Assessee, had an office in India at Andheri, Mumbai which according to it did not constitute a PE as the same was merely a liaison office for the supply of information which was only preparatory or auxiliary in nature for the enterprise (assessee).

ii) According to the Revenue, the assessee had a 'Permanent Establishment' as per Article 5(2)(c) of the India-Mauritius DTAA, in the form of the above-mentioned office in India. It contended that there was a survey conducted under section 133A of the Income-tax Act, 1961 on 10th August 2000 wherein it was found that (a) the Assessee kept the office of the Company at Dubai for its business, (b) the Assessee did not have any functional office in Mauritius and (c) the office at Andheri, Mumbai was used for the project implemented by the Assessee and constituted a PE as evident from the documents recovered during the survey.

iii) The CIT(A) and Tribunal held that the assessee did not have a PE.

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

Decision

i) The Hon'ble HC referred to Article 5 of the India-Mauritius DTAA, the relevant extracts of which are reproduced herewith:

> ***"ARTICLE 5 - Permanent establishment***
>
> *1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on.*

2. The term "permanent establishment" shall include—

(a) a place of management;

(b) a branch;

(c) an office;….

3. Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include:

(a) the use of facilities solely for the purpose of storage or display of merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or for collecting information for the enterprise;

(e) the maintenance of a fixed place of business solely-

(i) for the purpose of advertising,

(ii) for the supply of information,

(iii) for scientific research, or

(iv) for similar activities,

which have a preparatory or auxiliary character for the enterprise. ……..."

ii) The Hon'ble High Court held that the argument given by the Revenue was on the basis of Article 5(2)(c) of the India-Mauritius DTAA but did not consider clause 3 of the same Article wherein it is stated that notwithstanding Clause (2), the term "permanent establishment" will not include certain categories and that Article 5(3)(e) excludes certain categories.

iii) The Hon'ble High Court further noted that the Tribunal had examined the documents exchanged by the persons coordinating the activities carried out at the site as well as the list of messages, including fax and radio messages. It further noted that the Tribunal had examined the roles performed by each of the employees and found that the role of one of the employees (Mr. Tarkar) was only logistic and coordination, whereas the other employee (Mr. Rodrigues) looked after arranging meetings and two other employees were looking after communications. After considering all the material, the Tribunal recorded a finding that none of the documents showed that any business was done from the said office.

iv) Further, the HC held that the Revenue was not able to establish the allegation that any substantial business has been done from the office.

v) The Hon'ble High Court further noted that after considering the documents, the Tribunal found that the concerned place of business was only for the supply of information having preparatory or auxiliary character and that accordingly the same would fall under Article (5)(3)(e)(ii) of the DTAA. It further held that this finding of fact recorded by the Tribunal after due consideration of the material on record, could not be considered as perverse.

vi) The High Court concluded that the view of the Tribunal being a possible view and that being the position, the substantial question of law sought to be raised by Revenue was a question of fact and as the CIT(A) and the Tribunal had recorded concurrent findings on the aforesaid issue, the same did not require any further consideration.

B. Tribunal

2 *DY.CIT vs. Credit Suisse (Singapore) Ltd [2022] 139 taxmann.com 145 (Mum - Trib.)*

Offshore distribution commission received by FII/FPI who was a tax resident of Singapore from an Indian Mutual Fund for marketing its MF schemes abroad, was in nature of business income which could not be taxed in India in the absence of a PE. Further, the said commission could also not be taxed as other income under Article 23 of the India-Singapore DTAA

Facts

i) The assessee, a company incorporated in Singapore was registered as a Foreign Institutional Investor ('FII') with the Securities and Exchange Board of India ('SEBI') and had conducted portfolio investments in Indian securities in its capacity as SEBI registered FII/FPI.

ii) During the year under consideration, the assessee had carried out transactions in equity shares, GDRs, FCCBs, IDRs, Exchange Traded Derivatives, Debt Securities, Mutual Fund etc. The assessee and HDFC Asset Management Co Ltd had entered into an Offshore Distribution Agreement dated 06/09/2011 pursuant to which the assessee agreed to distribute Mutual Fund schemes launched by HDFC Asset Management Co Ltd, with a view to procuring subscriptions for such schemes from investors outside India.

iii) During the year under consideration, the assessee, inter-alia, earned Offshore Distribution Commission Income of ₹ 16,38,81,445 from HDFC Asset Management Co Ltd, which was claimed as exempt under Article 12 of the India-Singapore DTAA as no technology etc was made available. Further, it was claimed that the said income being in nature of business income could not be taxed in India, in the absence of a PE in India.

iv) The AO came to conclusion that the commission paid to the assessee could not be treated as fees for technical services as the assessee was getting a fixed ratio of commission on a quarterly basis for rendering the services. The AO further held that as the assessee was operating as a distributor/lead manager of HDFC Mutual Fund, an Indian fund, which was controlled and regulated by SEBI and RBI in India, therefore,

location control and management of the fund was situated in India, which constituted a business connection in India and created a sufficient nexus of the offshore distribution income with India. Accordingly, the AO taxed the commission income received by the assessee under 9(1)(i) of the Income Tax Act, 1961 and as other income under Article 23 of DTAA.

v) Aggrieved, the assessee filed appeal before the CIT(A). The learned CIT(A) held that the offshore distribution income was not fees for technical services. The learned CIT(A) further held that offshore distribution income earned by the assessee was in the nature of business income and that in the absence of a Permanent Establishment in India, the same was not taxable in accordance with Article 7 of DTAA.

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

Decision

i) The Tribunal noted that the Revenue sought to tax the commission income by invoking provisions of Section 9(1)(i) and it was not the contention that income was taxable under any other provisions of Section 9.

ii) The Tribunal held that for taxing the income as deemed to accrue or arise in India, the income should be 'reasonably attributable' to operations carried out in India whereas in the instant case, all the operations were carried out outside India; Thus, it held that the offshore distribution commission could not be treated as 'reasonably attributable' to any operation carried out in India.

iii) The Tribunal further placed reliance on the SC ruling in ***Toshoku Ltd- 125 ITR 525 (SC)*** wherein in the context of commission earned on sale proceeds of tobacco, it was held "The commission amounts which were earned by the non-resident assessees for services rendered outside India cannot, therefore, be deemed to be incomes which have either accrued or arisen in India";

iv) In view of the fact that Assessee conducted portfolio investments in Indian securities in its capacity as SEBI registered FII, the Tribunal dismissed Revenue's appeal & upheld the learned CIT(A)'s conclusion that offshore distribution commission was in the nature of business income, which could not be taxed in India in the absence of PE.

3 *TV 18 Broadcast Limited vs. ACIT TS-372-ITAT (Mum)-TP*

Subscription to interest-free Optionally convertible debenture issued by foreign AE was held to be at ALP. The said transaction was of quasi capital nature & could not be characterized as debt to justify a TP adjustment

Facts

i) The assessee, a domestic company engaged in the business of television, broadcasting, production of related media software, distribution services and allied activities, had subscribed to optionally convertible debentures (OCD) issued by IBN 18 Mauritius (AE), to the tune of US $ 2,30,000.

ii) The assessee claimed that the transaction was in the nature of quasi-capital and that issuance of interest-free optionally convertible debenture was routinely done by public companies for their independent investors and, as such, the same was an arm's length transaction.

iii) The TPO held that debenture is debt and should be benchmarked on that basis. Further, the TPO computed the weighted average cost of capital of the assessee as an arm's length consideration for the optionally convertible debenture subscribed by the assessee company and worked out the rate to 3.20% p.a. after granting a reduction of .01% notional coupon rate of the assessee & made the consequent adjustment.

iv) Aggrieved, the assessee filed appeal before the learned CIT(A) who by relying on the assessee's sister concern decision directed TPO to adopt LIBOR plus 150 bps as arm's length rate & computed the consequent adjustment.

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

Decision

i) The Tribunal held that though TPO discussed at length the nature of 'debenture' being a debt instrument, it however missed out on the fact that debenture simpliciter was materially different vis-a'-vis an OCD wherein the opportunity to subscribe to equity was a predominant motive for the subscription of OCD.

ii) The Tribunal noted the undisputed point that the OCDs in question had subsequently been converted into equity capital at par value.

iii) The Tribunal further relied on ***Cadila Healthcare Ltd- TS- 241-ITAT-2017(Ahd)-TP***, wherein similar notional interest adjustment on optionally convertible loan to overseas AE was deleted by holding that assessee's transaction was in the nature of quasi-capital and that the same could not be characterized as a debt.

iv) The Tribunal allowed the assessee's appeal and deleted the impugned arm's length adjustment, and the grounds raised by AO on quantification of the ALP were held to be infructuous.

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"This is a great fact: strength is life; weakness is death. Strength is felicity, life eternal, immortal; weakness is constant strain and misery, weakness is death."

— *Swami Vivekananda*

"Prayer is not an old woman's idle amusement. Properly understood and applied, it is the most potent instrument of action."

— *Mahatma Gandhi*