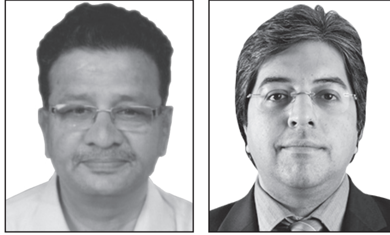

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INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Where the entire TP adjustment hinged only on one comparable and difference in functionality of assessee and said comparable was not discussed by Tribunal, entire issue of determining TP adjustment was to be considered afresh by TPO

Pyramid IT Consulting vs. Add. CIT [(2019) 105 taxmann.com 281 (Delhi HC)] - W.P. (C) 5198/2019

Facts

1. The assessee, engaged in the business of providing value added IT Solutions and IT staffing services to global companies, had selected two comparables having average margin of -18.07% while benchmarking the services rendered to its AE under the staffing segment.

2. The TPO rejected both the comparables and introduced another comparable i.e., HCCA Business Services Pvt. Ltd. (HCCA) having margin of 20.05% as against the assessee's margin of 2.46% and made an adjustment accordingly. The DRP as well as the Tribunal upheld the order of the TPO rejecting assessee's contention that HCCA was functionally different and thus not comparable.

3. The Tribunal also rejected the Miscellaneous Application (MA) filed by the assessee u/s. 254(2) against its own order, wherein the assessee had contended that (i) though the Tribunal had noted in its order that HCCA owned 'intangibles', yet it was not excluded as a comparable (ii) though the assessee had relied/placed before the Tribunal, the decision of the Tribunal in the case of *LG Chemicals India Pvt. Ltd. vs. ACIT* where the same comparable i.e., HCCA was excluded holding it to have a different functional profile from the assessee in that case, the said decision was not even discussed by the Tribunal in its order.

4. Aggrieved, the assessee filed a Writ Petition before the High Court against the Tribunal's order dismissing the MA.

Held

1. The Court noted that there was no discussion by Tribunal of its earlier order in LG Chemicals India Pvt. Ltd. where it was held that a company owning intangibles could not be compared with one which does not.

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2. Further, noting that the Tribunal had not discussed the difference in functionality of the assessee and HCCA, whereas the entire TP Adjustment has hinged only on one comparable, it held that Tribunal had overlooked assessee's objections against inclusion of HCCA (which according to the assessee was only providing payroll processing services as against staffing services provided by the assessee) and thus the same required a detailed consideration.

3. Accordingly, the Court allowed the assessee's writ petition and remanded the matter back to the TPO stating that the entire issue of determining the TP adjustment in respect of the transactions in the staffing segment should be considered afresh by the TPO uninfluenced by his earlier order.

2. Genesys International Corporation Ltd., engaged in providing diverse operations providing high-end and complex services, is not comparable to an entity providing only back office IT enabled services

CIT vs. EXL Services.com India Private Limited [TS-437-HC-2019 (Delhi)] - ITA 487 of 2019.

Facts

1. The assessee, a wholly owned subsidiary of EXL Service Holdings, was engaged in rendering business and knowledge process outsourcing, research and analysis and risk advisory (known as IT Enabled Services) for customers of the EXL group entities.

2. The assessee had selected 14 comparable while benchmarking the aforesaid services, out of which the TPO accepted 9 comparables and added 2 more comparables, thus arriving at a final set of 11 comparables whose average margin was 22.26% as against assessee's margin of 7.14%. Accordingly, he proposed an adjustment.

3. The assessee filed its objections before the DRP which *inter alia* accepted assessee's submission that Genesys International Corporation Ltd. (GICL) should be omitted from the list of comparables since the same was not functionally similar to the assessee. Accordingly, while passing the final assessment order pursuant to the DRP directions, the AO deleted the earlier proposed said adjustment.

4. The Revenue being aggrieved by the said order of the AO, filed an appeal before the Tribunal which upheld the DRP's direction and consequently the final assessment order passed by the AO.

Held

1. The Court noted that GICL was engaged in diversified operations providing high-end and complex services such as GIS Consulting, 3D Mapping, Navigation Maps, Remote Sensoring, etc., whereas the assessee was engaged only in providing back office IT enabled services.

2. Further, GICL operated as a full-fledged risk taking entrepreneur whereas the assessee was not. Therefore, apart from the functionality aspect, the comparison failed even on the basis of the scale of risk.

3. From the Annual Report of GICL, it was noticed that it had significant intangibles in the form of computer software and GIS data base whereas the assessee did not own any significant intangibles. It depended entirely on the intellectual property rights owned by the holding company.

4. Thus, the Court dismissed Revenue's appeal and held that no substantial question of law arose.

3. The Court directed the AO to issue certificate of no requirement of deducting tax at source under

section 197 with respect to capital gains earned by the Mauritian Entity on sale of shares of an Indian company on a *prima facie* view that the said gains was not taxable in India in view of Article 13 of the India-Mauritius DTAA. Also, directed the Revenue to release the TDS amount already deposited by the deductor with the Government subject to security amounting to 200% of disputed tax amount

Indostar Capital vs. Asst. Commissioner of Income Tax [TS-250-HC-2019 (Bombay)] - Writ Petition No. 3296 of 2018

Facts

1. The assessee-company, which was issued the Tax Residency Certificate (TRC) by Mauritius Revenue Authority, owning 7.13 crore (rounded off) shares of IFCL (Indian NBFC) which was 97.30% of its share capital, desired to offload some 1.85 crore (rounded off) of its shares of IFCL.

2. The assessee applied to the AO for grant of the certificate under section 197 of the Act making detailed averments as to why income (i.e., capital gains arising on sale of shares) receivable by it was not chargeable to tax as per the India-Mauritius DTAA. However, the AO rejected the application for certificate, holding that the transaction was not genuine and the entire tax structure was created to avoid legitimate tax liability arising in India.

3. Further, during course of proceedings, in absence of above certificate being issued in favour of the assessee, the payer deducted the relevant amount of TDS and deposited the same with the Government.

4. Aggrieved, the assessee filed a writ petition before the Court to challenge the order rejecting the application for certificate under section 197 as well as praying for refund of the amount deposited by the payer.

Held

1. The Court held that as per Article 13(4) of the India-Mauritius DTAA as it stood at the relevant time, the capital gains arising out of the sale of shares of Indian company acquired on or before 31-3-2017 could be taxed, if at all, in Mauritius i.e., it could not be taxed in India.

2. It relied on the decision in the case of *CIT(IT) vs. JSH (Mauritius) Ltd.* wherein it was held that when the assessee had placed reliance on DTAA between two countries, reference to section 9(1)(i) and *Explanation* 5 thereto would be of no relevance. The Court also took note of the CBDT Circular which had clarified that TRC will constitute sufficient evidence for accepting status of the residence as well as beneficial ownership for applying the DTAA.

3. Further, noting that the AO did not have any sufficient *prima facie* material to demonstrate that the entire transaction from the inception was sham, colourable device and a bogus transaction to simply avoid tax, it held that mere fact that the assessee-company had not transacted any other business by itself may not be conclusive proof to accept AO's contention. It held that the extent of administrative expenditure and the employment structure may be some of the factors which eventually would go to establish whether the transaction was sham and the very existence of the assessee was fraudulent, however by themselves they may not be sufficient. Further, it held that all these aspects could and need to be gone into in the assessment proceedings.

4. Accordingly, the Court (i) quashed the order rejecting the application filed by the assessee (ii) directed the AO to issue certificate under section 197 stating that there is no requirement to deduct TDS (iii) gave direction to release the TDS amount already deposited by the payer.

5. Further, taking note of Revenue's anxiety to protect recovery of taxes, it also directed the assessee to continue to hold minimum 50 lakh shares of ICFL (having valuation of 200% of the disputed tax amount) till the last day of passing the assessment order for the relevant year (unless the said order is passed before such date).

6. Accordingly, the writ petition was disposed of.

4. TPO erred in recharacterising the assessee from a business support service provider to a trader and further erred in including the FOB value of goods sourced from India for its AEs in the operating cost of the assessee to compute the assessee's margin while adopting TNMM

Pr.CIT vs. M/s. Itochu India Private Limited [TS-428-HC-2019 (Delhi)] - ITA Nos. 1111, 1129 & 1130 of 2018

Facts

1. The assessee was in the business of rendering support services in relation to facilitation and market support to its AEs in order to facilitate sourcing transactions of its AEs with prospective sellers. As per the TP study, the assessee's margin (*viz.*, 110.91%, 123.52% & 129.34% for AY 2007-08, AY 2008-09 & AY 2009-10 respectively) was higher than the mean of comparables margin (*viz.*, 15.29%, 15.28% & 14.05% for AY 2007-08, AY 2008-09 & AY 2009-10 respectively).

2. The TPO recharacterised the business profile of the assessee from a business support service provider to a trader and included the Free on Board (FOB) value of goods sourced from India in the operating cost of the assessee to compute the assessee's margin for benchmarking using TNMM. He conducted a fresh search identifying trading companies as comparable to assessee and made an adjustment with respect to business support services rendered by the assessee to its AEs, considering average margins of such trading companies.

3. The assessee filed appeal before CIT(A) which held that the assessee was engaged in the business of rendering business support services and was not a trader. Further, it held that the FOB value of goods sourced by AEs could not be included in the cost of the assessee for computing the assessee's margin. The CIT(A) also accepted the comparables selected by the assessee in its TP study and held that the assessee's international transactions were at arm's length.

4. The Tribunal also upheld the CIT(A)'s order.

5. Aggrieved Revenue had filed appeal against Tribunal's order.

Held

1. The Court relied on the decision in the case of *Li & Fung India Pvt. Ltd. vs. CIT (2014) 361 ITR 85 (Del)* wherein it was held that to apply TNMM, assessee's net profit margin realized from the international transactions had to be calculated only with reference to the cost incurred by itself and not by any other entity i.e., third party vendors or AEs. Thus, it held that including the FOB value of AE's contract in the operating cost of the assessee in order to determine its margin was not sustainable in law.

2. It held that the Tribunal had rightly held that the TPO had artificially enhanced the cost base of the taxpayer and proposed a mark-up of the FOB value of goods sourced by AEs and as such this approach was not available in TNMM as per Rule 10B(1)(e) of the Income-tax Rules.

3. Further, it held that the Tribunal's observation that the TPO "had wrongly

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recharacterised the business function of the taxpayer from a business support service provider to a trader" also did not suffer from any legal infirmity.

4. Accordingly, the Revenue's appeal was dismissed.

B) Tribunal Decisions

I) Tribunal upholds assessee's claim of split-residency based on Article 4 of the India-USA tax treaty

DCIT vs. Shri Kumar Sanjeev Ranjan [TS-191-ITAT-2019 (Bang)]

Assessment year : 2013-14

Facts

i) The assessee, a US citizen, was on a temporary cross-border assignment to India, from June 2006 until 10th August, 2012, and thereafter, repatriated to the USA with his family.

ii) For the financial year (FY) 2012-13 (assessment year 2013-14), the assessee was a Resident and Ordinarily Resident (ROR) of India and resident of the USA under the domestic tax law of the respective countries.

iii) For FY 2012-13, the assessee filed his tax return and declared his total income after claiming the exemption under Article 16(1) of the tax treaty for the salary income earned for the period 11th August, 2012 to 31st March, 2013.

iv) During the assessment proceedings, the Tax Officer (TO) asked the assessee to submit his residential status, legal position on split residency and exemption under Article 16(1) of the tax treaty for the salary income earned for the period 11th August, 2012 to 31st March, 2013.

v) The assessee contended that in case an individual is a resident of both contracting states of the tax treaty, the residential status of the individual needs to be determined in accordance with Article 4(2) of the tax treaty (tie-breaker rules).

vi) For the period 1st April, 2012 to 10th August, 2012, since the house property of the assessee in the USA was let-out, for the purpose of the tie-breaker, the house will be considered as "unavailable for use" to the assessee during this period. Hence, he satisfied the first test for "availability of permanent home" in India and tie-broke his residency to India for this period.

vii) For the period 11th August, 2012 to 31st March, 2013, since there was a tie in the first test of tie-breaker rules under the tax treaty (availability of permanent home in both contracting states), the second tie-breaker test "centre of vital interest" needs to be looked into.

viii) Based on the following facts, the assessee contended that for the period 11th August, 2012 to 31st March, 2013, he tie-broke his residency to the USA, as his centre of vital interests was in the USA:

- He and his dependent members (his wife and two children) are citizens of the USA and repatriated to the USA with him after 10th August, 2012;
- He has two house properties, car and all other personal belongings in the USA;
- He has voting rights in the USA;
- He holds a driving license in the USA;
- His designated country of residence is the USA, and he has filed Virginia state tax returns, as Virginia was his home;
- He has all his investments (in shares, mutual funds, 401k and insurance policies) in the USA and contributes to the social security plans of the USA; and

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- His habitual abode is in the USA for the following reasons:
  - He has been working for USA-based companies in the USA;
  - He is contributing towards the USA social security since 1988;
  - He is a citizen of the USA since 1992;
  - He is paying taxes in the USA since 1988;
  - His spouse and children are continuously residing with him in the USA;
  - His children are born in the USA;
  - He spends summer vacations in the USA;
  - He has spent an aggregate of 30 years in the USA; and
  - He has plans to stay in the USA for the rest of his lifespan with his spouse and children.
- The TO contended that the personal and economic relations refer to a long and continuous relation that an individual nurtures with a place. Therefore, the assessee cannot claim that after the end of his assignment (i.e., from 11th August, 2012) his economic and personal relations were suddenly closer to the USA than India.
- There is no concept of split residency under the provisions of the Indian Income-tax Act, 1961 or the tax treaty.
- The assessee did not satisfy the conditions for claiming exemption under the tax treaty, as he did not furnish the Tax Residency Certificate (TRC) or the Form 10F.
- In view of the above, the TO added the assessee's global income earned during the period 11th August, 2012 to 31st March, 2013 to his total income.
- The assessee submitted the TRC before Commissioner of Income-tax (Appeal) [CIT(A)] for the years 2012 and 2013 obtained from the USA tax authorities.
- CIT(A) held that as the assessee had a permanent home available to him in both India and the USA for the period 11th August, 2012 to 31st March 2013, there was a tie in the first test of the tie-breaker rules under Article 4(2)(a) of the tax treaty.
- Based on the facts presented before the CIT(A) (mentioned supra), it was concluded that by applying the second tie-breaker test, the assessee has established that his centre of vital interests (personal and economic relations) was closer to the USA, and therefore, he was a resident of the USA for the period 11th August, 2012 to 31st March, 2013.
- Since the assessee's residency tie-breaks to the USA under the tax treaty, the exemption is available to him.

Tribunal's decision

- The Tribunal held that the CIT(A)'s conclusion on determining the residential status of the assessee under the tax treaty was not based on the TRC, but on the test of his personal and economic relations (centre of vital interests) under Article 4(2) of the tax treaty.
- The Tribunal agreed with the conclusion of the CIT(A) on the basis of the facts presented by the assessee before the CIT(A).

II) Companies for which data is not available in the public domain can be selected by the Transfer Pricing Officer as comparables

by using their power to call for information under Section 133(6) of the Income-tax Act.

Philips Medical Systems (P.) Ltd. vs. ITO [2019] 102 taxmann.com 441 (Kol.)

Facts

- The assessee is a distributor and commission agent for medical equipment in India. During the year it has imported equipment and spares for distribution from its associated enterprise (AE). It has also received commission income from its AE. The assessee justified the arm's length nature of transactions by application of Transactional Net Margin Method at entity level. The assessee used 10 comparable companies and operating profit to sales as the profit level indicator.
- The Transfer Pricing Officer (TPO) however rejected all the comparable companies selected by the assessee (providing reasons such as substantial related party transactions, functional comparability, low turnover, etc.). The TPO selected two comparable companies for which data was not available in the public domain.
- Upon appeal, the CIT(A), while reducing the adjustment by accepting 5 out of 10 comparable companies of the assessee, also held that restriction to use publicly available data does not apply to the AO. Hence the two comparable companies selected by the TPO were also accepted resulting in selection of seven comparable companies including two selected by the TPO.
- Cross appeals were filed both by the assessee as well as the department.

Tribunal's decision

i) The Tribunal upheld the decision of the CIT(A) that the restriction stipulated in Rule 10D is applicable only to the auditor and not to the TPO, who has an inherent power to make enquiry and collect and use the information and material which is found to be relevant for the purpose of transfer pricing analysis in order to determine the arm's length price of the relevant international transactions between the AE.

ii) The Tribunal rejected a comparable engaged in manufacturing as well as trading activity in the absence of segmental details as it is not functionally comparable to the assessee which is mainly engaged in trading activity.

III) Multiple counting and period of leave is to be excluded from the period of stay of an employee to determine Service PE threshold

Linklaters vs. DDIT [TS-210-ITAT-2019 (Mum)]

Assessment Year : 2002–03

Facts

i) The assessee, a partnership firm, is a tax resident of United Kingdom (U.K.) and is engaged in the practice of law. Apart from its head office in the U.K., the assessee has offices in various other countries around the world. The assessee does not have any branch office in India. The assessee was appointed as a legal advisor for some of the projects in India and provided legal consultancy services to them. In connection with rendering such legal consultancy services, the assessee received fees from the clients in India.

ii) The assessee filed its return of income for the Assessment Year (AY) 2002-03 on 31st October, 2002, declaring nil income. The statement accompanying the return of income stated that since the assessee had no branch office in India, the fee received is not chargeable to tax in India in the absence of a PE in India.

iii) The Assessing Office (AO) observed that the employees/other personnel of the assessee have rendered services in India for more than

90 days during the relevant financial year, hence, the assessee had a PE in India in terms of Article 5(2)(k)(i) of the tax treaty. Therefore, income earned from rendering legal consultancy services in India is taxable in India.

Decision

i) The only issue that is required to be examined is, whether the employees/other personnel of the assessee have stayed and rendered services in India during the relevant financial year exceeding the period of 90 days to constitute a PE in India.

ii) In this context, the assessee had contended that (a) if the vacation period of one of the employees Shri Narayan Iyar (said employee) is excluded, the period of stay of the employees of the assessee in India would be 87 days and (b) multiple counting of employees in a single day is not permitted.

iii) The said employee had not rendered any services in India from 17th April, 2001 to 4th May, 2001, as he was availing a study leave and therefore, the same period has to be excluded for computing the period of 90 days as no other employee of the assessee was rendering services in India.

iv) The next issue which requires consideration is, whether multiple counting of employees on a single day is permissible. A careful reading of Article 5(2)(k)(i) of the tax treaty makes it clear that as per the expression used therein if the employees or other personnel have stayed in India for a period exceeding 90 days in any 12 month period, it will constitute a PE. In the facts of the present case, the AO had reckoned any 12 month period to be the financial year beginning from 1st April, 2001 to 31st March, 2002.

v) Therefore, the stay of employees in India on a particular day has to be taken cumulatively and not independently. That being the case, multiple counting of employee in a single day, as was done by the tax authorities, is not impermissible under Article 5(2)(k)(i) of the tax treaty. The Tribunal referred to the decision of the Mumbai Tribunal in the case of *Clifford Chance vs. DCIT [2002] 82 ITD 106 (Mum)*, relied upon by the assessee.

vi) Thus, if the period during which the said employee was on leave is excluded and the multiple counting of employees in a single day is avoided, the aggregate period of stay of assessee's employees' in India during the relevant financial year is 87 days.

vii) Therefore, there was no PE of the assessee in India during relevant assessment year. That being the case, the fees received by the assessee from legal consultancy services rendered in India is not taxable in India.

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