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INTERNATIONAL TAXATION
Case Law Update

A. SUPREME COURT

1 *Sap Labs India (P.) Ltd vs. ITO (with others) - [(2023) 149 taxmann.com 327 (SC)]*

Determination of Arm's Length Price by the Tribunal can be subject to scrutiny by the High Court in an appeal under Section 260A. Hence, the contrary view taken by the Karnataka High Court in the case of Soft brands India (P.) Ltd. was held to be not acceptable

Facts

i. The assessee along with many others had filed civil appeals against the judgements and orders passed by the various High Courts, more particularly the Hon'ble High Court of Karnataka.

ii. The Hon'ble High Court of Karnataka had dismissed the appeals preferred by the Revenue and some assessees' by relying upon its earlier judgement in the case of ***PCIT vs. Softbrands India (P.) Ltd. [406 ITR 513 (Kar) (2018)].***

iii. Before the Hon'ble Supreme Court it was submitted that the Hon'ble High Court of Karnataka in the case of Softbrands India (P.) Ltd had erroneously held that the Tribunal was the final fact finding authority on determining the arm's length price and therefore once the Tribunal had determined the arm's length price the same could not be subject to judicial scrutiny in an appeal under Section 260A of the IT Act.

iv. The Learned Additional Solicitor General of India ('LSG') further submitted that there could not be any absolute proposition of law that against the decision of the Tribunal determining the arm's length price, there should not be any interference by the High Court in an appeal under Section 260A of the IT Act.

v. It was further submitted that the primary issues raised in all the above-mentioned appeals filed by the Revenue/ assessee pertained to inclusion and exclusion of a few comparables and selection of filters.

vi. The LSG further relied on the respective sections and rules of Transfer Pricing and accordingly submitted that it was

always open for the High Court to consider and/or examine, whether the guidelines stipulated under the Act and the Rules, while determining the arm's length price have been followed by the Tribunal or not.

Decision

i. The Hon'ble Supreme Court after considering the facts and the arguments held that the short question which was posed for the consideration of this Court was, whether in every case where the Tribunal determined the arm's length price, the same should attain finality and whether the High Court was precluded from considering the determination of the arm's length price determined by the Tribunal, in exercise of powers under Section 260A of the Act.

ii. The Hon'ble Supreme Court while determining the said issue quoted Section 92C of the Act (extract reproduced below) -

"92C. (1) The arm's length price in relation to an international transaction [or specified domestic transaction] shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely : ……."

It further noted that Rule 10B of the Rules prescribes the determination of arm's length price under Section 92C and concluded that while determining the arm's length price, the Tribunal has to follow the guidelines stipulated under Chapter X of the Act, namely, Sections 92, 92A to 92CA, 92D, 92E and 92F of the Act and Rules 10A to 10E of the Rules.

iii. The Hon'ble Supreme Court further held that any determination of the arm's length price under Chapter X dehors (beyond) the relevant provisions of the aforesaid guidelines, could be considered as perverse and it might be considered as a substantial question of law as perversity itself could be said to be a substantial question of law.

iv. It further concluded that there could not be any absolute proposition of law that in all cases where the Tribunal had determined the arm's length price the same was final and could not be the subject matter of scrutiny by the High Court in an appeal under Section 260A of the Act.

v. The Hon'ble Supreme Court further added that when the determination of arm's length or question of comparability of two companies or selection of filters was challenged before the High Court, it was always open for the High Court to consider and examine whether the arm's length price has been determined while taking into consideration the relevant guidelines under the Act and the Rules and in case of comparables and filters whether the same was done judiciously and on the basis of the relevant material/evidence on record. It further added that the High Court could also examine whether the comparable transactions have been taken into consideration properly or not.

vi. The Hon'ble Supreme Court concluded that the view taken by the Hon'ble Karnataka High Court in the case of Softbrands India (P) Ltd. that in the transfer pricing matters, the determination of the arm's length price by the Tribunal was final and cannot be subject matter of scrutiny under Section 260A of the Act could not be accepted.

vii. The Hon'ble Supreme Court further added that in each case, the High Court should examine whether the guidelines laid down in the Act and the Rules were followed while determining the arm's length price

viii. Accordingly, all the appeals were allowed and the Hon'ble Supreme Court quashed and set aside the judgements and orders passed by the respective High Courts. The appeals were remanded back to the respective High Courts to decide the matters according to the guidelines provided in the Act and the Rules.

2 ***Van Oord ACZ India (P.) Ltd. vs. CIT [(2023) 149 taxmann.com 38 (SC)] (Also see Van Oord ACZ India (P.) Ltd. vs. CIT [(2010) 189 Taxman 232 (HC - Delhi)])***

Assessee could not be treated as assessee-in-default merely due to subsequent taxability of the foreign company wherein initially the assessee was held not to be liable to deduct tax at source for reimbursement made to the said foreign company [since the plea of non-taxability was accepted in the foreign company's return of income processed u/s 143(1)(a)]

Facts

i. Assessee-Company ('Assessee'), a wholly owned subsidiary of a non-resident company Van Oard ACZ Marine Contractors BV 'VOAMC', was engaged in the business of dredging, contracting, reclamation and marine activities.

ii. During the relevant previous year, it executed a dredging contract and in terms of the completed contract method, it debited to its profit and loss account mobilization and demobilization cost reimbursed to VOAMC. According to the assessee, the said cost related essentially to transportation of dredger, survey equipment and other plant and machinery from countries outside India to the site in India and re-transportation of the same on completion of the contract, including fuel cost incurred on transportation.

iii. The assessee had reimbursed the cost relating to mobilization and demobilization incurred by VOAMC on the basis of invoices received by VOAMC from the non-resident service providers.

iv. Accordingly, the assessee filed an application with the Dy. Commissioner, International Taxation, for issuing nil tax withholding certificate in respect of such reimbursement on the ground that the amount represented pure reimbursement of expenses and, thus, there was no income liable to tax in India in the hands of VOAMC. However, the Dy. Commissioner held that the reimbursement of costs to VOAMC was liable to tax in India and determined 11 percent of the reimbursement amount as the profit arising to VOAMC in India

and directed the assessee to deduct tax at source on the above basis.

v. The assessee in accordance with the aforesaid order had deducted the tax at source as per the instructions of the Dy Commissioner. However, during the assessment proceedings, the AO disallowed the amount reimbursed to VOAMC by invoking provisions of section 40(a)(i) on the ground that the assessee had short deducted tax at source under section 195 while making payments to VOAMC.

vi. On further appeal, the CIT(A) as well as the Hon'ble Tribunal upheld the order of the AO. The appeal was then filed before the Hon'ble High Court.

vii. The Hon'ble High Court concluded that the assessee was not liable to deduct tax at source under section 195(1) in respect of the mobilization and demobilization costs reimbursed by it to VOAMC as the plea of VOAMC that it was not liable to pay to tax in India was accepted in its return processed u/s 143(1)(a) and the TDS had also been refunded. However, it also mentioned that the assessment proceedings in case of VOAMC were reopened and if the final view taken was that the VOAMC was assessable to tax, the assessee would also be treated as the assessee in default, which would attract the consequences provided under section 40(a)(i).

viii. Aggrieved, both the assessee and the Revenue filed cross appeals before the Hon'ble Supreme Court.

Decision

i. As regards the Revenue's appeal, the Hon'ble Supreme Court held that as it had been specifically found (by the Hon'ble High Court) that the assessee in the present case (company in India) was held to be not liable to deduct the tax at source, no interference of this Court was called for against the impugned judgment of the High Court. However, the question of law, if any, on interpretation of section 195 was kept open.

ii. As regards the assessee's appeal, the Hon'ble Supreme Court noted that the assessee was aggrieved by that part of the observation made by the High Court in the impugned judgment by which the High Court had observed that as the assessment proceedings in the case of VOAMC were reopened and therefore if the final view taken was that the VOAMC was assessable to tax, the assessee herein would also be treated as assessee in default, which would attract the consequences provided under Section 40(a)(i) of the Act. The Hon'ble Supreme Court held that once the assessee herein was held to be not liable to deduct the tax at source at all, merely because subsequently VOAMC was held liable to be taxed in India, the assessee herein could not be treated as assessee in default.

iii. Further, the Hon'ble Supreme Court held that the impugned decision was based on surmises and conjectures and therefore the aforesaid part of the order of the Hon'ble High Court was not right and hence was liable to be set aside and quashed.

B. HIGH COURT

3 *CIT vs. Ad2pro Media Solutions (P.) Ltd. [(2023) 148 taxmann.com 226 (Karnataka)]*

Where assessee-company made payments to US Company for marketing services and scope of work was to generate customer leads using/subscribing customer data base, market research, analysis, and online research data, payments so made could not be considered as royalty or FTS and hence, no TDS was required to be deducted since admittedly the services were utilised in USA and also the service provider had not made available any technical knowledge, experience, know-how, process to develop and transfer technical plan or technical design

Facts

i. The assessee, a private company, was engaged in the business of providing graphic design solutions for advertising and marketing communications. On verification of 15 CA data, it was observed that the company had remitted huge amounts to US based company for marketing services without deduction of TDS.

ii. The Assessing Officer had passed an order under section 201(1) and 201(1A), holding that the payments made by the assessee for marketing services to the US Company was taxable in India as FTS. He was of the opinion that the assessee utilized the services of the US Company even in the negotiations with customers and in finalizing contracts, and the same could not be done without sharing technical knowledge, know-how, processes or experience, thus making available technical knowledge.

iii. The CIT(A) held that the payments received by the US Company were both Royalty and Consultancy Services and were taxable under the Act as well as the DTAA.

iv. The Hon'ble Tribunal held that the payments made could not be considered either as Royalty nor as FTS and hence no TDS was deductible.

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

Decision

i. The Hon'ble High Court noted that the assessee had made payments to the US Company which had no permanent establishment in India.

ii. The Hon'ble High Court further noted that according to the Revenue the payments made to the US Company for marketing services take the character of FTS and was chargeable to tax in India as per Article 12 of the DTAA, as according to the Revenue the royalties and fees for included services might also be taxed in the Contracting State.

iii. It noted that as per the order of the AO, the following services were provided/ rendered by the US Company:

   a) Assistance in arranging and facilitating rendering of advertisement design services of Ad2pro India in USA

   b) Assistance in developing market for services rendered by Ad2pro India in USA

c) Assistance in providing customer leads and procurement of orders for Ad2pro India

d) Assistance in negotiations with customers and in finalizing contracts between customers andAd2pro India

e) Assistance in collection of payment on behalf of Ad2pro India and repatriating at a collection fee of 1.5% of the collections made.

iv. The Hon'ble High Court noted that as per the AO's order, the assessee utilized the services of the US Company even in the negotiations with customers and in finalizing contracts, and the same could not be done without sharing technical knowledge, know-how, processes or experience.

v. However, the Hon'ble High Court observed that the language employed in the FTS clause of DTAA was unambiguous and held that the services rendered by the US Company did not make available its technical knowledge, skill, know-how, process or transfer of technical plan or design. Therefore, the view taken by the AO that negotiation with customers to finalize the contract could not be done without sharing the technical knowledge or know-how was perverse.

vi. The Hon'ble High Court held that the Hon'ble Tribunal had noted in para 14 of its order that the scope of the work was to generate customer leads using/subscribing customer data base, market research, analysis, and online research data and rightly held that the service provider had not made available any technical knowledge, experience, know-how, process or developed and transferred technical plan or technical design.

vii. The Hon'ble High Court held that the case of ***GVK Industries Ltd vs ITO [(2015) 54 taxmann.com 347/231 Taxman 18 (SC)]*** relied by the Revenue was distinguished as the advice of a Company called NRC was taken by GVK Industries Ltd for financial structure and with its advice GVK Industries had approached Indian Financial Institutions with IDBI Bank acting as lead financier for its Rupee loan requirement and for a part of its foreign currency, whereas in the instant case the services were rendered and utilised in USA.

viii. The Hon'ble High Court relied on the case of ***DIT vs. Lufthansa's Cargo India [(2015) 60 taxmann.com 187/233 Taxman 218/375 ITR 85 (Delhi)]*** wherein it was held that "The exception carved out in the latter part of clause (b) [to s. 9(1)(vi) and 9(1)(vii)] applies to a situation when fee is payable in respect of services utilized for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income by the Indian assessee i.e. the payer, for the purpose of making or earning any income form a source outside India. On a studied scrutiny of the said Clause, it becomes clear that it lays down the principle what is basically known as the "source rule", that is, income of the recipient to be charged or chargeable in the country where the source of payment is located, to clarify, where the payer is located. The clause further

mandates and requires that the services should be utilized in India."

ix. Thus, the Hon'ble High Court upheld the order of the Hon'ble Tribunal and dismissed the appeal filed by the Revenue.

C. TRIBUNAL

4 *DCIT vs. Total Oil India (P.) Ltd. [(2023) 149 taxmann.com 332 (ITAT - Mumbai (SB))]*

Dividend declared by a domestic company to a non-resident should be taxed at the rate given under section 115-O and not the beneficial rates given under DTAA for non-residents unless the Contracting State to the treaty intends to extend the treaty protection to the domestic company (AY 2016-17)

Facts

i. The assessee, M/s Total Oil India Private Limited, an Indian Company, declared/ paid dividend for AY 2016-17. One of the shareholders to whom dividend was to be paid was a Non-resident (Tax resident of France). [It may be noted that there were more than one assessee in the matter before the Hon'ble SB].

ii. Under Section 115-O of the Act a domestic company (the assessee is a domestic company), is required to pay additional income tax on any amount declared, distributed or paid by way of dividend.

iii. However, as one shareholder was a non-resident, the assessee raised a plea that the rate at which tax u/s. 115-O had to be paid could not be more than the rate at which dividend could be taxed in the hands of the Non-resident shareholder in India under the DTAA between India and France as the rate of tax prescribed in the DTAA is generally less than the rate prescribed in Section 115-O.

iv. The assessee placed reliance on the decision of the Hon'ble Delhi Tribunal in the case of ***Giesecke & Devrient India Pvt Ltd vs. ACIT [120 taxmann.com 338 (Del)]*** wherein it was held that the rate of tax prescribed in the DTAA has to be applied in preference to the higher rate of tax prescribed in Sec.115-O.

v. The line of reasoning adopted in the case of ***Giesecke & Devrient India Pvt. Ltd. (supra)*** was that a) DDT is a levy on the dividend distributed by the payer company and the same being an additional tax, falls within the definition of 'Tax' as defined u/s 2(43) of the Act, which is subject to the charging section 4 of the Act and charging section itself is subject to the provisions of the Act thereby bringing it within the sweep of section 90 of the Act b) payment of dividend distribution tax u/s 115-O by the Domestic Company was for and on behalf of the shareholder and in discharge of shareholders liability to pay tax on dividend distributed. Reliance was also placed on the decision of Kolkata Bench in the case of ***DCIT vs. Indian Oil Petronas Pvt Ltd. [127 taxmann.com 389],*** wherein similar view was taken.

vi. Revenue also made an application for reference of a similar issue in the case of Maruti Suzuki Private Limited and also in the case of Gujarat Gas Co. Ltd.

vii. Hence, in the backdrop of the above, a Special Bench was constituted by the Hon'ble President for considering the said issue.

Decision

i. The Hon'ble Tribunal noted that the word "Dividend" has its origin from the Latin word "Dividendum". It means a thing to be divided. Dividend means the portion of the profit received by the shareholders from the company's net profit, which is legally available for distribution among the members. Therefore, dividend is a return on the share capital subscribed for and paid to its shareholders by a company. Dividend defined under section 2(35) of the Companies Act, 2013, includes any interim dividend. It is defined under section 2(22) of the Act. It further noted that Dividend is share of profits declared as distributable among the shareholders, it does not mean that the character of the profits distributed by the company as dividend retain the same character when it reaches the hands of the shareholders.

ii. It held that though dividend is income in the hands of the shareholder, its taxability need not necessarily be in the hands of the shareholder. The sovereign has the prerogative to tax dividend, either in the hands of the recipient of the dividend or otherwise. It further held that there are two ways of taxing dividend i.e. Classical/Progressive System or Simplistic System. The provisions of Sec. 115-O shows that it creates a charge to additional income tax on any amount declared, distributed or paid by domestic company by way of dividend for any assessment year. The tax so charged is in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year.

iii. The Hon'ble Tribunal after considering few judgements (viz ***Godrej & Boyce Mfg. Co. Ltd vs. DCIT [394 ITR 449 (SC)], Small Industries Development Bank of India vs. CBDT [133 taxmann.com 158(Bom HC)], B.M Amin Umma vs. ITO [26 ITR 137 (Mad HC)], Balaji vs. ITO [1962 AIR 123 (SC)]*** concluded that DDT was a tax on the distributed profits of a domestic company and was a tax on profits of the domestic company and not on the shareholder and that the shareholder did not enter the domain of DDT at all.

iv. The Hon'ble Tribunal further held that the purpose of DTAA was to avoid double taxation/allocation of taxing rights between two Sovereign nations and DDT was a tax not on the shareholder but on the amount declared, distributed, paid as the case may be, by way of dividend and being a tax on income of the company, there was no double taxation of the same income. Hence, domestic company u/s.115-O did not enter the domain of DTAA at all.

v. Also, it further added that if domestic company has to enter the domain of DTAA, the countries should have agreed specifically in the DTAA to that effect. For eg. in the DTAA of India-Hungary, the treaty protection was extended to the dividend distribution tax. It has also been specifically provided in the protocol to the Indo-Hungarian Tax Treaty that, when the company paying

the dividends was a resident of India, the tax on distributed profits shall be deemed to be taxed in the hands of the shareholders and it shall not exceed 10 per cent of the gross amount of dividend.

vi. Thus, the Hon'ble Tribunal on basis of the above discussion concluded that where dividend was declared, distributed or paid by a domestic company to a non-resident shareholder(s), which attracted Additional Income Tax (Tax on Distributed Profits) referred to in Sec.115-O of the Act, such additional income tax payable by the domestic company shall be at the rate mentioned in Section 115 O of the Act and not at the rate of tax applicable to the non-resident shareholder(s) as specified in the relevant DTAA with reference to such dividend income.

vii. It also added that wherever the Contracting States to a tax treaty intend to extend the treaty protection to the domestic company paying dividend distribution tax, only then, the domestic company can claim benefit of the DTAA, if any.

5 *Shangri-La International Hotel Management Pte. Ltd vs. ACIT [(2023)148 taxmann.com 3(ITAT - Delhi)]*

Reimbursement of cost received by the assessee (Singapore entity) could not be treated as FTS under article 12(4) of the India-Singapore DTAA. Also, Management consultancy and other related services provided by the Singapore entity to Indian hotels could not be treated as FTS as they did not make available any technology, experience etc. which inter alia was evident from the fact these services were rendered on a continuous basis year on year which showed that the service recipient was not capable of independently performing such services without the help of the assessee.

Facts

i. The assessee, a non-resident corporate entity, incorporated under the laws of Singapore and a tax resident of Singapore, was engaged in the business of rendering management consultancy and other related services to hotels.

ii. Further, it was the authorized licensee of the 'Shangri-La' brand and related intellectual property for India. It had entered into three separate agreements with third party Indian hotels and earned revenue towards management fee and license fee. In return of income filed for impugned assessment years, assessee offered management fee as FTS and license fee as royalty in terms of article 12 of India-Singapore DTAA, on gross basis.

iii. During the course of assessment proceedings, the Assessing Officer noticed that in addition to management fee and license fee, the assessee had receipts from Indian hotels on account of marketing and reservation receipts and reimbursement receipts. However, the assessee had not offered them as income. The assessee submitted that marketing and reservation receipts were for service provided from outside India and were in the nature of business receipts. Therefore, in absence of a Permanent Establishment (PE) in India, they were not taxable.

iv. The Assessing Officer however observed that the receipts were for services ancillary and subsidiary to the trade mark license agreement for use of trade mark and brand name, which was in the nature of royalty, hence, it would fall within the ambit of FTS under article 12(4)(a) of the India-Singapore DTAA. He thus, brought the entire receipts to tax by treating it as FTS.

v. The Assessee raised objections before the DRP. However, the same were rejected.

vi. Further, in the draft assessment order the AO alleged that the assessee did not provide the breakup of reimbursement and copy of bank statement and hence the AO treated the reimbursement of expenses also as FTS.

vii. The Assessee raised the objection before the DRP. However, without giving any independent finding the DRP rejected the objection raised by the assessee.

viii. Aggrieved, the assessee filed an appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal noted that under the Hotel Marketing and Reservation Services agreement, the assessee had receipts like Marketing receipts, frequent guest program receipts, joint advertising co-ordination fund contribution and reservation fee.

ii. It further noted that the marketing receipts were for marketing and promotional services undertaken by the assessee for the promotion of Shangri-La hotel, including, third party Indian Hotels. The services included development of marketing plan and budget and marketing consultancy services rendered outside India.

iii. It noted that the expenditure incurred towards marketing and promotional activities were primarily aimed at public recognition, promotion of the hotels in source markets outside India to bring international business to Shangri-La Hotels across the world including India. The marketing receipts were utilized for common benefit of all hotels and were expended on general advertising, marketing activities including market intelligence, communication and publicity, production of promotional literature and other sales program.

iv. It further noted that there was a Frequent Guest program operated by Shangri-La group on a no loss/no profit basis and receipts from participating hotels on account of Frequent Guest program were utilized for making payment to hotels, which provide rooms pursuant to points redeemed by hotel guests who were Frequent Guests program members, recruiting staff members to manage and promote the program and on-going administrative expenses.

v. It also noted that the assessee collected reservation fee from hotel owners towards services provided by CRS and reservation fee was charged from hotels on a per transaction basis. The centralized reservation allowed a customer or a third party travel intermediary anywhere in the world to access the availability status, the room rates to make booking easily.

vi. The Hon'ble Tribunal concluded that the marketing and reservation activities performed by the assessee were not only distinct and different from the license fee but they were done under two distinct and separate agreements. Therefore, the marketing and reservation receipts could not be treated to be ancillary and subsidiary to the license fee. Hence, such fee would not fall under article 12(4)(a) of the treaty.

vii. The Hon'ble Tribunal added that the nature of services rendered did not demonstrate that they were in the nature of managerial, technical or consultancy services. Even if, to some extent they might involve consultancy services, however, there was nothing on record to demonstrate that while rendering the services, the assessee had made available technical knowledge, experience, skill, know-how or processing etc. to bring it within the ambit of FTS under article 12(4)(b) of the treaty.

viii. The Hon'ble Tribunal also relied on the decision of the co-ordinate bench in the case of ***Starwood Hotels & Resorts Worldwide Inc vs. ACIT (International Taxation) [(2022) 140 taxmann.com 231(ITAT - Delhi)*** and noted that in the said case the appeal filed by the Revenue against the decision of the Hon'ble Tribunal was dismissed by the Hon'ble Delhi High Court.

ix. It further observed that the recipients were receiving such services on a continuous basis from year to year, which showed that the recipients were not capable of independently performing such services without the aid and assistance of the assessee.

x. Thus, the Hon'ble Tribunal directed the AO to delete the addition made and allowed the appeal of the assessee.

xi. Further, w.r.t reimbursement of cost, the Hon'ble Tribunal noted that reimbursement of cost included cost like frequent flyer program and other miscellaneous expenses, such as, courier charges, media monitoring charges, e-mail campaign charges and translation of web site to local language of hotels etc.

xii. It further added that these services were routine services in nature without involving any technical or strategic expertise or involvement of any advisory services. Further, these services were neither ancillary and subsidiary to royalty nor there was anything on record to demonstrate that while rendering such services, the assessee had made available any technical knowledge, know-how, skill etc. to the third party Indian hotels.

xiii. It thus concluded that the reimbursement of cost received by the assessee, could not be treated as FTS under Article 12(4) of the India-Singapore DTAA, at least, based on the facts involved in the impugned assessment years and directed the AO to delete the said addition.

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