INTERNATIONAL TAXATION
Case Law Update

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A. HIGH COURT

1 *Johnson Matthey Public Ltd. Co. vs. CIT [2024] 162 taxmann.com 865 (Delhi)*

Where assessee, a UK resident provided guarantee to various banks to extend credit facilities to its Indian subsidiaries, it was held that the guarantee fee charged by it would not fall within expression of 'interest' in article 12 of India-UK DTAA and the same would be assessable as 'other income' under Article 23 of the said DTAA

Facts

i. The assessee, a tax resident of United Kingdom, was engaged in manufacture of specialty chemicals. During the relevant year, assessee had extended guarantees to various overseas branches of foreign banks on a global basis in relation to credit facilities extended by those financial institutions to its Indian subsidiaries.

ii. In its return of income, the assessee had characterized amount of guarantee fee as interest and, thus, taxable under Article 12.

iii. The AO held that said sum would be liable to be taxed as other income under Article 23(3) of the India-UK DTAA.

iv. Before the Hon'ble Tribunal, the assessee (a) assailed the correctness of the view as taken by the AO as well as the DRP and reiterated its stand with respect to guarantee fee being liable to be taxed as interest under Article 12 of the DTAA (b) without prejudice to its other submissions argued that the income was not taxable at all, since its source was outside India. (c) alternatively, argued that the receipt of guarantee charges would also fall within the ambit of 'business income' governed by Article 7 of the DTAA and that in the absence of the assessee having a Permanent Establishment in India, the said business income would not be chargeable under the DTAA.

v. The Hon'ble Tribunal upheld the stand of the AO that guarantee fee could not be treated as interest under Article 12 of the DTAA. It further held that the said income had arisen in India but the same could not be treated as business income under Article 7 of the DTAA since it was nobody's case that the assessee did

business of providing corporate/bank guarantee recharge to earn income on regular basis.

Decision

(a) Whether guarantee fee could be treated as Interest under Article 12 of the DTAA

i. The Hon'ble HC noted that the expression 'interest' is defined by Article 12(5) to mean income from "debt-claims of every kind" irrespective of whether they be secured by a mortgage or carry a right to participate in the debtor's profit and that the guarantee charges were not received by the appellant in respect of any debt owed to it by its Indian subsidiary. Also it could not possibly be acknowledged to be income derived from claims that the appellant may have had against its Indian subsidiaries as the guarantee charges were received in connection with the credit facilities which were extended by the overseas branches of foreign banks to its Indian subsidiaries. Since the assessee had guaranteed the repayment of the loans so extended to its subsidiaries, it received charges as per the stipulations contained in the Intra Group Agreement. Thus, the Tribunal had correctly found that the assessee was neither a party to the loan agreements that may have been executed nor was there any privity of contract that could be said to exist. It was the aforesaid undisputed facts which weighed upon the Tribunal to hold that the payments received by the assessee would not fall under Article 12 of the DTAA.

ii. The guarantee charges that the Assessee received was a remuneration for the assurance that it had offered to lending entities who may have extended credit facilities to its Indian subsidiaries. The debt that it owed was to those financial institutions. It would be those institutions which could have a claim against the assessee. The Intra Group Agreement also did not envisage any claims that the assessee could have laid against its own subsidiaries in the eventuality that they were to default. The Indian subsidiaries owed no debt to the assessee so as to recognise the guarantee charges as income derived from a debt or a claim which constitutes the determinative factor for the purposes of examining the applicability of Article 12 of the DTAA. The guarantee charges were levied for the service of providing parent company guarantees and counter indemnification of the liabilities of the Indian subsidiaries. On an overall conspectus of the aforesaid, the guarantee charges could not be viewed as 'interest' under Article 12 of the DTAA.

iii. Guarantee charges being interest would also not sustain even when tested on the anvil of Section 2(28A) of the Act which reads as under:

" "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized".

iv. As manifest from the above, the expression interest is defined to mean amounts payable in respect of any

monies borrowed or debts incurred. The income that the assesse received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall the assessee in case its Indian subsidiaries were to default in their repayment obligations to the banks (and not to the assessee). It thus became apparent that the guarantee fee would neither fall within the ambit of Article 12 of the DTAA nor Section 2(28A) of the Act.

(b) Whether guarantee fees accrued or arose in India

v. By relying upon the judgements of the Hon'ble HC in ***Seth Pushalal Mansinghka (P) Ltd. vs. CIT [1967 SCC Online SC 222]*** and ***E.D Sassoon and Company Ltd. vs. CIT [26 ITR 27,51]***, the Hon'ble HC held that as evident from a reading of the principles enunciated in the said two decisions the expression 'arise' or 'accrue' means a periodical monetary return being received with some regularity. In the context of the Act, it held that income accruing would not be dependent upon actual receipt but would be governed by the principle of a 'right to receive'. Thus, the moment a right to receive came into existence, income would be deemed to have arisen or accrued.

vi. It further held that, when tested on the aforesaid precepts, it was clear that the income in the form of guarantee charges had in fact accrued and arisen in India. The guarantee charges clearly answered to the description of income accruing and which was explained by the Supreme Court to constitute "a periodical monetary return Coming in' with some sort of regularity, or expected regularity, from definite sources". From the Intra Group Agreement, it was evident and apparent that the foundational source of those payments was the assessee's agreement to provide the service of parent company guarantees and counter indemnification facilities. These were services offered to the Indian subsidiaries to avail for their "own commercial benefit". The charge was envisaged to be levied on a quarterly basis and the annual rate at the time of execution of the Intra Group Agreement was prescribed to be 1.125%. The annual rate was to levied on the "Recipient's" [the Indian subsidiaries] "outstanding balance of parent company guarantees and counter-indemnification obligations as at each Quarter Day".

vii. It was thus evident that the guarantee charges became leviable every quarter at a rate already agreed upon by parties and on the outstanding balance. Thus, not only was the payment ordained to come from a specified source, it was also envisaged to become payable with sufficient regularity. The payment was to be invoiced every Quarter Day and liable to be paid as per the instructions of the assessee. The Intra Group Agreement also provisioned for consequences which would ensue in case the Indian subsidiary were to default in payment of those charges by stipulating that in such an event, it would be open to the assessee to suspend the provision of services. Thus, in case the Indian subsidiary were to fail to honor any invoice raised in respect of guarantee charges, it would have been open for the assessee to discontinue the service of extending guarantees.

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viii. Further, the obligation to pay was incurred in India, was in respect of services utilized in India and was agreed to arise with regularity as per the stipulations forming part of the Intra Group Agreement. The guarantee charges were solely on account of the assessee having guaranteed repayment of debts owed to third parties by the Indian subsidiaries. The source and fountainhead of the receipt was thus indelibly connected and confined to the Intra Group Agreement and the obligations of the assessee in connection therewith. Taxability of income is concerned solely with income accruing or arising. It is clearly not concerned with the ultimate destination of that income or the use to which it may be put. That the guarantee charges may be utilized by the assessee to meet its liabilities to overseas financial institutions would be wholly irrelevant for the purposes of examining whether income had arisen or accrued in India. In this regard, reliance was placed on the judgement of the Hon'ble Supreme Court in ***Tuticorin Alkali Chemicals & Fertilizers Ltd. vs. CIT (1997) 6 SCC 117***.

ix. Further, it disagreed with the view taken by the Hon'ble Tribunal in the case of ***Capgemini S.A vs. ADIT (ITA No. 7198/Mum/2012)*** relied upon by the assessee after taking note of the contrarian view taken by the Hon'ble Tribunal in ***Lease Plan India Pvt. Ltd. vs. Deputy Commissioner of Income Tax 2020 SCC Online ITAT 4377*** while dealing with an identical question.

(c) Whether guarantee charges would constitute business income under Article 7 of the DTAA

x. The issue whether guarantee charges would constitute business income under Article 7 of the DTAA (and thus not taxable in the absence of a PE) was kept open to be addressed in an appropriate case. (as the Tribunal had not adjudicated on the issue of existence/absence of PE and also the said issue/question had not been raised in the appeal memo filed before the Hon'ble HC, though the same was orally raised and argued.)

xi. The Revenue's appeals were thus dismissed.

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2 *CIT (International Taxation) vs. Bank of Tokyo-Mitsubishi UFJ Ltd. [2024] 162 taxmann.com 872 (Delhi)*

Where assessee, a Permanent Establishment of an overseas bank, had received interest from deposits kept with its overseas branches and head office abroad, it was held that the same would not be taxable in India as branch offices were not separate personalities or juridical entities and that one person could not earn profit from itself. Explanation to Section 9(1)(v) which introduces a statutory fiction by ordaining that a PE of a banking enterprise in India would be deemed to be a person separate and independent of the non-resident person of which it is a PE would have no application (to the impugned AY), since it came into effect only from 01 April 2016 by virtue of Finance Act, 2015.

3 *PCIT vs. EDS Electronics Data System India (P) Ltd. [2024] 162 taxmann.com 761 (Delhi)*

i. It was held that a company who had failed employee cost filter and also went into amalgamation during the year could not be considered as a comparable.

ii. Where assessee was rendering services including voice and communication, data entry and financial management, it was held that a company who had outsourced services to be rendered by it had followed a different business model and thus could not be accepted as a comparable

4 *PCIT vs. Phoenix Comtrade (P) Ltd. (2024) 162 taxmann.com 99 (Bom)*

Where the assessee exported rice to its AE and followed TNMM to ascertain ALP and the TPO simply rejected the said method by applying CUP based on prices mentioned in the Bloomberg database without appreciating the assessee's contentions that Bloomberg database was not reliable and that in any case assesse's export price was more than Indian custom's quoted rate, the addition deleted by the Tribunal was held to be justified

Facts

i. The assessee had exported rice to its AE and followed TNMM to ascertain ALP.

ii. The TPO collected the details of export prices of rice from Bloomberg database and compared the same with the price realized by assessee in respect of each of exports. Wherever the difference was +/- 5 per cent, the TPO considered the same as at ALP and, accordingly, the TPO proposed an addition to be made to the international transaction.

iii. The DRP accepted the (without prejudice) contention of assessee that the rates prevailing on the date of entering into the agreement should be compared and not the rates that prevailed on the date of invoice. Accordingly, the rectification resulted in an adjustment.

iv. On appeal, the Hon'ble Tribunal observed that the TNMM adopted by assessee would be more appropriate and that the one to one comparison adopted by the TPO was not appropriate. Accordingly, the Hon'ble Tribunal, directed the AO to delete the addition made on account of TP adjustment.

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

Decision

i. The Hon'ble HC noted that the Tribunal had accepted that there were mistakes in the order of TPO, inasmuch as the TPO without realizing the factual aspects had simply rejected the method adopted by Assessee.

ii. It noted that the Tribunal had also recorded that assessee's contentions that Bloomberg database was not reliable and also that assessee's export price was more than the Indian Custom's quoted rate and accordingly, exports were at ALP even under CUP method-had not been controverted by the Departmental Representative.

iii. In the circumstances, the Hon'ble HC dismissed the Revenue's appeals by holding that no substantial questions of law arose.

Note

The TPO had also made another addition which was deleted by the Tribunal by appreciating the facts and the Revenue's appeal was dismissed by the Hon'ble HC since no substantial question of law arose.

B. TRIBUNAL

5 *Little Fairy Ltd. vs. CIT, International Tax [2024] 162 taxmann.com 766 (Delhi-Trib.)*

The Tribunal held that where assessee, a Cyprus based company, had complete right to receive interest income on compulsorily convertible debentures (CCDs) and there was no compulsion or contractual obligation to simultaneously pass on same to another entity, assessee was to be held as beneficial owner of interest income on CCDs from Indian entity and, thus, same would be taxable @10 per cent as per Article 11 of India-Cyprus DTAA.

6 *CLSA vs. ACIT [2024] 162 taxmann.com 863 (Mumbai-Trib.)*

i. Where assessee had entered into an agreement with its AE for reimbursement of indirect expenses and used TNMM to benchmark said transaction and the TPO rejected same on the ground that assessee had failed to substantiate its claim by any documentary evidences, the consequent addition made by the TPO was held to be unjustified since the TPO had not applied any of the prescribed methods to determine ALP of the said transactions.

ii. Where assessee, a stock broker, charged higher brokerage from its non-AEs as compared to AEs and TPO adopted CUP method as MAM to benchmark the said transaction, as against TNMM adopted by the assessee, it was held that since assessee was required to provide broader range of services to its non-AE FII clients as compared to the services provided to its AE FII clients and TPO had not given a specific finding as to what was similarity in services rendered to AEs and non AEs provided by assessee, TNMM was to be accepted as MAM for benchmarking said transaction.

iii. Where assessee paid brand fee to its AE for use of its brand name and adopted TNMM to bench mark the same whereas the TPO applied CUP and disallowed the same on the ground that no other group entities of CLSA had paid any royalty for use of its brand, it was held that since different group entities had different arrangements with CLSA, there was no necessity of payment of royalty in those cases and thus, TNMM was to be accepted as MAM for benchmarking the said transaction.

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