


INTERNATIONAL TAXATION

Case Law Update

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A. HIGH COURT

1 ***CIT vs. KPMG***
[TS-602-HC-2019] (Bom) – ITA No. 690 of 2017

Professional fee payments made by the assessee for services rendered to it outside India were not taxable in India in view of the DTAA. (As neither the service providers had PE in India nor did the service make available technical knowledge). Once the above was accepted by the Revenue, it could not urge taxability under the Act

Facts

i) The Assessee was engaged in the business of rendering taxation, audit and other consultancy services.

ii) The Assessee had paid fees for professional services outside India without deducting TDS. The AO had disallowed the said professional fees under Section 40(a)(i) of the Act.

iii) The Tribunal had allowed assessee's appeal and held that the assessee was not liable to deduct tax as the payments were made to service providers for services rendered outside India, which were governed by the respective DTAA's and none of the service providers had a PE in India. Also, none of the services provided had the attribute of making available of any technical knowledge to the assessee in India.

iv) Aggrieved, the Revenue filed an appeal before the High Court

Decision

i) The Court noted that there was no challenge by Revenue to the findings of the Tribunal that the payments made by the Respondent to its service providers were covered by the DTAA. In fact, the only question urged by the Revenue was taxability of the said payments under the Act. The Court held that in terms of Section 90(2) of the Act, it is open to an assessee to adopt either the DTAA or the Act as is beneficial to it. The Revenue having accepted that the service providers were not taxable in view of the DTAA, the occasion to deduct tax at source would not arise.

ii) Accordingly, it dismissed Revenue's appeal as no substantial question of law arose.

2 *PCIT vs. Microsoft Corporation India Pvt. Ltd.*

[TS-914-HC-2019(Del)] - ITA 874 of 2019

M/s. Basiz Fund Services Private Limited was held to be not comparable to a marketing support service provider

Facts

i) The Assessee was engaged in provision of marketing support services (MSS) to MS Corp and affiliated entities in return for a service fee. It had selected the TNMM as the MAM for benchmarking of the international transaction for provision of MSS with a return on total operating cost ("OP/TC") as the Profit Level Indicator (PLI) and computed the PLI of 14 Comparables at 8.95% and concluded that international transaction was at Arm's Length Price as assessee's PLI was 16.75%.

ii) The TPO rejected 5 comparables selected by assessee and thereby made an adjustment of ₹ 51.75 crores. The DRP relying on its own order for the AY 2008-09, directed the exclusion of M/s. Basiz Fund Services Private Limited from the final set of comparable companies.

iii) The Tribunal dismissed Revenue's appeal and held that M/s. Basiz Fund Services Private Limited was functionally dissimilar to the assessee in as much as it was involved in the fund accounting services and possessed significant intangible assets. Also, it had a very significant growth in the revenue - 57.61% and profits - 46.75%.

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

Decision

i) The Court held that even if the supernormal level of profit - 46.75% was not to be considered as a reason to treat the said enterprises as not comparable, the fact remained that the Tribunal concurred with the view of the DRP on functional dissimilarity.

ii) Accordingly, it dismissed Revenue's appeal as no substantial question of law arose.

3 *CIT vs. M/s. Doowon Automotive Systems Pvt. Ltd.*

[TS-942-HC-2019(MAD)] - Tax Case Appeal No.722 of 2019

TPO's order passed after the issue of Directions by DRP was invalid

Facts

i) The Assessee company was engaged in the business of manufacturing automotive components. The TPO had rejected the TNMM adopted by the assessee as the MAM and also rejected the three comparables selected by the assessee. However, the DRP had accepted the TNMM selected by the assessee as the MAM and directed the AO to apply TNMM after making working capital adjustment. But consequent to the direction of the DRP, the TPO had passed another order dated 22-01-2014 and subsequently the AO had given effect to the order of the TPO dated 22-01-2014.

ii) The Tribunal allowed assessee's appeal and remanded the issue back to the file of AO with a direction that AO shall refer the matter once again to the DRP and the DRP shall pass a clear and specific order, after calling for a remand report from the TPO, if necessary. The Tribunal observed that when the mandate of Section

144C(13) was passing of an assessment order by AO in conformity with the directions of the DRP, the TPO had no role to pass a subsequent order after the direction was given by the DRP. The AO was expected to pass an assessment order in conformity with the directions of the DRP without any intervention either by the TPO or by any authority. Therefore, there was a clear violation of the procedure prescribed u/s 144C of the Act. If the DRP found that any further investigation was required by the TPO, it was open to the DRP to keep the matter pending and call for remand report from the TPO and upon receiving such remand report, pass order u/s 144C(5) of the Act directing the Assessing Officer to make the adjustment as provided under the scheme of the Income-tax Act.

iii) Aggrieved, the Revenue filed an appeal before the High Court.

Decision

i) The Revenue contended that in Para 6 of the order passed by the Tribunal it had expected the DRP to pass fresh orders under Section 144(5) of the Act, but towards the end of the order, the matter was again remanded back to the AO, which was incorrect. Thus, it was unclear as to which lower authority the matter was remanded.

ii) The Court noted that the Tribunal wanted a fresh order from the DRP under Section 144(5) of the Act, but it had remanded the matter back to the AO. But, AO under the said order of the Tribunal was free to refer the matter back to the DRP in terms of the order passed by the Tribunal. Therefore, either way DRP had to pass a fresh order in terms of the order passed by the Tribunal.

iii) Nevertheless, Assessee/Revenue were free to approach the Tribunal to issue necessary clarification as to which authority they wanted the matter to be remanded back. However, no substantial question of law arose from the said order of the Tribunal.

iv) Accordingly, it dismissed Revenue's appeal.

4 *P.D.R SOLUTIONS FZC vs. DRP*

[TS-601-HC-2019(Del)] - W.P.(C) 10387/2019

Where the directions were issued by the DRP without considering the basic contention of the assessee, the Court issued writ and set aside the same

Facts

i) The assessee, a tax resident of UAE, was engaged in the business of sale of domain names to global customers and was also providing web hosting services whereby server spaces were given on lease/hire to clients.

ii) The AO had passed a draft assessment order under Section 144C of the Act, holding that the assessee's income arising from Domain Name Registration Services and Web Hosting Services was taxable under the provisions of the Act and also under the India-UAE DTAA.

iii) The assessee being aggrieved by the said order filed its objections before the DRP, *inter alia* objecting that its income arising out of domain name registration services and web hosting services was not taxable under the India-UAE DTAA. The case of the assessee was essentially that the definition of Royalty under the Act was wider than that provided in the Treaty since under the Act "transfer of rights in property similar to trademark" was also covered, whereas under the Treaty, only the "transfer of right to use trademark" was covered and not "rights in property similar to trademark".

iv) The DRP had not adjudicated on assessee's categorical objections on the taxability under the India-UAE DTAA and had instead followed Delhi Tribunal ruling in GoDaddy.com LLC (ITA No. No.1878/Del/2017) (A.Y 2013-14) without appreciating that the taxability in GoDaddy.com (*supra*) was decided under the provisions of the Act and not under any DTAA.

v) Aggrieved, the assessee filed a writ petition before the High Court.

Decision

i) The Revenue contended that since there was an alternate efficacious remedy available to the assessee under Section 253(1)(d) of the Act, whereby the assessment order passed by AO in pursuance of the DRP directions could be challenged in appeal before the Tribunal, the assessee could not be allowed to file the present petition. It also contended that no assessee could be aggrieved merely by the directions of the DRP, since it does not culminate into an order until the AO incorporated it and passed an assessment order.

ii) The Court noted that the power under Article 226 was to be exercised judiciously, considering the facts of the case. It observed that normally a writ petition under Article 226 was not to be entertained, if alternate statutory remedy was available.

iii) The Court noted that if the DRP had considered the relevant materials, then such a decision of the DRP even if considered by the assessee as "wrong" would not be amenable to Writ Jurisdiction and such wrongs can and should be corrected by resorting to the statutory mechanism of appeal. However, if while deciding, the DRP did not consider the relevant material, the only inference one can draw was that the DRP had failed to exercise its jurisdiction and it reflected non-application of mind. If such a situation emerged, then such an order was amenable to the writ jurisdiction of the High Court, since it would be a case of failure of the statutory authority to exercise its jurisdiction.

iv) In the facts of the present case, the DRP had blindly followed the decision of GoDaddy.com LLC wherein it was held that receipt on account of Domain Name Registration Charges was royalty u/s. 9(1)(vi) of the Act. Further, the DRP held that the Web Hosting Services were interlinked with domain name registration and thus were ancillary and subsidiary to the application or enjoyment of the right for which amount was received as royalty. Thus, the payments received for Web Hosting Services were also considered as royalty under Section 9(1)(vi) of the Income Tax Act, 1961.

v) From the above directions of the DRP, it was starkly noticeable that the main contention, or to say the basic argument, raised by the assessee with respect to the non-taxability of its income under India-UAE DTAA had not been noticed or discussed, much less adjudicated upon.

vi) Thus, if the plea of the assessee was not even looked at/ examined by the DRP, it would tantamount to a jurisdictional error. Hence, the Court held that the DRP had completely failed to exercise its jurisdiction and had rendered the entire process of the dispute resolution as per the scheme of the Act farcical.

vii) Accordingly, the writ petition was allowed and the impugned directions of the DRP were set aside. Consequently, the matter was remitted back to the DRP for considering the objections raised by the assessee in detail, and for passing a fresh order on merits and in accordance with law by giving reasons and findings.

B. TRIBUNAL DECISIONS

5 ***Lahmeyer International GmbH vs. ACIT***
[TS-630-ITAT-2019(DEL)]
[Assessment Year: 2001-02]

India-Germany DTAA – Article 12 - Taxability of Fees for Technical Services – Invocation of Force of Attraction Principle by Revenue-Rejected by the Tribunal on facts of the case – Held in favour of the Assessee

Facts

i) M/s Lahmeyer International GmbH, the assessee is a non-resident company incorporated in Germany, engaged in engineering consulting services such as planning, designing and consulting in relation to complex infrastructure projects in India. The Assessee had been rendering engineering consulting services mainly in relation to 10 power projects in India by entering into contracts with State Govt./ Semi Govt. Undertakings. During relevant AY, the assessee earned total revenues [which were classified as Fees for technical services/FTS which were offered to tax in the following manner:

   a) A certain portion was offered to tax at the rate of 20% on a gross basis u/s. 115A, in respect of the contracts where a Permanent Establishment ("PE") was formed in India; and

   b) The remaining portion was offered to tax at the rate of 10% on a gross basis under Article 12 of the India-Germany DTAA, in respect of the contracts where no PE was formed in India.

ii) During the course of assessment proceedings, the assessee contended that it constituted a PE in India only w.r.t Phase II of the contract with Jammu and Kashmir State Power Development Corporation ("JKSPDC")["Baglihar Project PE"] by virtue of carrying out the work from a project office in India, and accordingly, revenues earned from JKSPDC-Phase-II were offered to tax at the rate of 20% (gross basis), whereas, revenue earned from all other projects were offered to tax at 10% (gross basis).

iii) The AO rejected the plea of the assessee and passed an assessment order u/s. 143(3), wherein the entire receipts of the assessee were subjected to tax at the rate of 20% by applying the principle of "Force of Attraction [FOA]" under the Treaty.

iv) On further appeal, the CIT(A) dismissed the appeal of assessee.

Aggrieved, the assessee filed an appeal before Delhi ITAT.

Decision

The Tribunal observed and held in favour of the assessee as under:

i) The assessee argued that there was no device to avoid tax by entering into different agreements, as each agreement was different and was entered into with different parties. Moreover, the condition of involvement of PE was not met in the present case, as there was no finding that 'Baglihar Project PE' was in any way involved in any other projects across the Indian territories.

ii) The assessee further contended that Baglihar project was in respect of hydro-power and its PE cannot be said to be involved in projects in the field of water management [E.g., a project located in Vishakhapatnam] or thermal power. Also, even on account of geographical reasons, Baglihar project PE was located in Jammu & Kashmir and, thus it could not be involved in other projects at far off places throughout India

iii) The assessee further contended that for the project located in Vishakhapatnam, the key personnel to be deputed to provide consultancy services were agreed in advance and without the prior approval of the respective contracting party, the said personnel could not have been deputed to the Baglihar PE project, and therefore, they could not be said to be involved in rendering services. Also, in the Tamil Nadu project, it was agreed that services were to be rendered either at the Tamil Nadu site or at assessee's German office.

iv) On the other hand, Revenue argued that the mere fact that the terms of contract were different or for that matter the parties or geographical locations were different was not material for deciding the applicability of the FOA rule. In this regard, Revenue contended that the twin conditions proposed by the assessee, i.e. there is a need for being 'an extension of the PE' or to be 'effected through the PE' are neither mandated in the UN Model Convention nor in the Protocol to the India-German DTAA, and thus, there an attempt being made by the assessee to misguide the Bench by artificially splitting the projects.

v) The Tribunal took note of assessee's argument that the FOA rule was inapplicable to it, owing to the fact that as per the conditions set out in the protocol 1(c) to the subject Treaty, the force of attraction rule restricted the application of the rule to a case where, the PE was involved in the transaction and the transaction is restored to avoid taxation in the source state, and that both the conditions needed to be satisfied so as to attract the rule.

vi) The Tribunal further observed that the assessee constituted PE on account of undertaking supervisory activities as provided in Article 5(2)(i) of the Treaty in relation to construction of Hydro Power Projects at Baglihar in the state of Jammu & Kashmir. Accordingly, ITAT accepted assessee's argument that in respect of the balance contracts, based on specific contract requirements, the assessee's personnel either performed service at the client's location or at its home office in Germany, wherein the assessee provided contract-wise, the location wherein the activities were undertaken.

vii) The Tribunal remarked that, "The above fact as per the assessee clearly demonstrates that owing to geographical region, the PE on account of JKSPDC Phase-II projects (executed in the state of Jammu & Kashmir) could not play a part or be involved in any project in India. These contracts have been carried out by the assessee by using different teams at a given point of time.

viii) The Tribunal held that "the details of the project managers/ project engineers who visited India in connection with the execution of different contracts clearly shows that distinct PE of technician were involved in the execution of various projects in India."

ix) The Tribunal observed that the teams of the project managers/project engineers, in relation to various projects, visited India in connection with the execution of these projects at different points of time. Also, the scope of work, liabilities and risk involved in each of the contracts were independent of those stated in the other contracts executed with the different parties.

x) The Tribunal noted that the assessee under various independent contracts entered into by it, was required to undertake specific activities as per the terms of each contracts. The activities undertaken by the assessee were independent of the others since their performance was not interlinked with each other.

xi) The Tribunal further noted that as per RBI's stipulation, a separate project office was to be set up for each independent project. Further, the funds of the project office were to be used only to meet the expenses of the specific projects which has been approved and could not be used for any other purpose in India.

xii) Thus, the Tribunal remarked that "The location where the activities would be performed by the assessee in respect of the specific projects was dictated by the client's project site or as agreed with the clients and was undertaken outside India…. Further, restriction on the activities which may be undertaken by project office is stipulated in the approval issued by the Government. Therefore, it cannot be said that the PE constituted in India by the assessee under Phase-II of the contracts with JKSPDC was involved in any way in the earning of income from technical services rendered by the assessee and other contracts in India.

xiii) The Tribunal further enunciated that for applying force of attraction, there should be some common link to each of the contracts/projects such as the common expats, the common nature of the contract/projects, the commonality of the location, the common contracting parties etc. "which are absent in the present case."

xiv) The Tribunal rejected Revenue's plea that the FTS received by the assessee from rendering of technical services and other contracts was directly or indirectly to the PE constituted in India under the contract with JKSPDC and hence it was formed for the purpose of deliberate avoidance of tax.

xv) The Tribunal concluded by stating that "We find force in the contention of the assessee, that the PE constitute in India by the assessee under Phase-II of the contract with JKSPDC did not play any role or contributed in any manner to the execution of the other contracts or earning of FTS under other contracts and cannot thus be said to be involved with any other projects in India."

Thus, ITAT accepted the treatment given by assessee for offering tax @20% in one project and 10% in rest of the projects.

6 ***JCIT vs. Merrill Lynch Capital Market Espana SA SV***

[TS-612-ITAT-2019(Mum)]

Assessment year: 2014-15

India-Spain DTAA – Articles 14(4) and 23(3) – Taxability of Capital Gains on sale of 7% stake in listed Indian Real Estate Companies - Based on specific facts, Tribunal held that

capital gains on sale of shares in an Indian company, carrying on real estate business, were not taxable in India under India-Spain tax treaty

Facts

i) The assessee, a tax resident of Spain and registered as a foreign institutional investor, held approximately 7% stake in six Indian real estate companies forming part of the BSE realty index.

ii) The assessee earned capital gains on sale of approximately 2% stake in such listed Indian real estate companies. Further, the assessee had also earned income on account of gain on foreign exchange transaction (i.e. gains on settlement of forward exchange contracts).

iii) The Tax Officer (TO) assessed the capital gains on sale of shares as taxable under Article 14(4) of the India-Spain tax treaty stating that the value of shares of such companies were derived from immovable properties held by it. The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the appeal in favour of the assessee stating that the capital gains are not taxable in India under Article 14(4) of the India-Spain tax treaty..

iv) Article 14(4) of the India-Spain tax treaty provides that capital gains on sale of shares of company, the property of which consists, directly or indirectly, principally of immovable property situated in India, would be taxable in India.

v) Article 23(3) of the India-Spain tax treaty provides that items of income not dealt by any other Article of the India-Spain tax treaty and arising in India would be taxable in India.

Decision

On appeal, the Tribunal held in favour of the assessee, on the facts of the case as under:

i) The Revenue contended that the listed companies were dealing in real estate sector including development of properties, residential as well as commercial, and the share value was derived from the immovable properties held by it. Whether such immovable properties held as investments or stock-in-trade was immaterial.

ii) The assessee contended that the stake in such companies was approximately 7%, there was no effective right to occupy the immovable properties of such companies. As per UN Model Convention commentary, the provisions of Article 14(4) come into play only in case of indirect transfer of ownership of immovable property by transfer of shares owning these properties. The value of listed shares is based not only on the extent of immovable property held as stock-in-trade but on several other factors such as capital adequacy, projects in the pipeline, current profits and future prospects.

iii) Article 14(1) deals with the taxability of gains arising on sale of immovable property. Article 14(4) is only an extension of Article 14(1) to nullify the impact of corporate structures used for ownership of immovable properties.

iv) The Tribunal held that interpretation of Article 14(4) must essentially remain confined to the shares effectively leading to control of the company or which gives the right to enjoy the underlying immovable property owned by the company, and such property is what the company principally holds.

v) The Tribunal held that the business model of companies in question is to make commercial gains by way of real estate development rather than holding the immovable properties.

vi) In the present case, since the assessee held approximately 7% (sold approximately 2%) stake in the companies, the question of holding controlling interest or even significant interest in these companies does not arise.

vii) Further, the Tribunal held that the TO did not bring any material to prove that the Indian companies in which the assessee was holding shares were "principally" holding the immovable properties.

viii) The Tribunal observed that the expression "principally" is not specifically defined in the India-Spain tax treaty, and drawing support from various commentaries of Model Convention, interpreted threshold for the term "principally" as 50% or more of the aggregate value of assets.

ix) The Tribunal also mentioned that merely because a company is dealing in real estate development, it does not imply that over 50% of its aggregate assets consist of immovable properties.

x) Further, the Revenue's contention that every company listed on BSE realty index is a company, the property of which principally consists of immovable properties, is incorrect.

xi) The Tribunal agreed with the CIT(A)'s view and held that capital gains on sale of shares would not be covered under Article 14(4) of the India-Spain tax treaty, and thus, are not taxable in India.

xii) In connection with gains arising on foreign exchange transaction, the Tribunal held that where such gains are dealt in other Articles of the India-Spain tax treaty and not taxable under such other Articles, it does not imply that such gains would be covered under Article 23(3) of the India-Spain tax treaty.

xiii) Accordingly, such gains would not be covered under Article 23(3) of the India-Spain tax treaty and would not thus be taxable in India.

7 ***M/s. BancTec TPS India Private Limited vs. Pr. Commissioner of Income Tax***
[TS-579-ITAT-2019(Mum)]
(Assessment Year : 2012-13)

Section 79 – Carry forward and set off of brought forward losses - Tribunal held that the condition under section 79 of the Income-tax Act, 1961 (Act) for carry forward and set-off of loss, is said to be satisfied if the beneficial shareholders of the company during the year when the loss was incurred, directly or indirectly holds at least 51% shares in the said company during the year of set-off – in favour of the assessee

Facts

i) The assessee had set-off brought forward loss during assessment year 2012-13. The assessee had entered into a scheme of amalgamation with a fellow subsidiary which then subsequently merged with the assessee. Pursuant to the scheme, the assessee issued shares to the shareholders of the transferor's fellow subsidiary, which also was a fellow subsidiary of the assessee. Consequently, the immediate holding company of the assessee, who was holding 100% 1ITA No. 2366/ Mum/ 2019 shares in the assessee, continued to directly hold 42.19% shares in the assessee and indirectly continued to hold balance 57.81% shares through its subsidiaries.

ii) The Assessing Officer completed the assessment without allowing set-off of the brought forward losses. However, on a rectification application, the TO allowed the set-off of the brought forward losses to the assessee.

iii) Subsequently, the Commissioner of Income-tax invoked his revisionary jurisdiction under section 263 of the Act directing the Assessing Officer to disallow the losses of earlier years on the ground that the assessee had violated the provisions of section 79 of the Act and cancelled the order under section 154 of the Act.

Decision

The Tribunal held in favor of the assessee as under:

i) The provisions of section 79 of the Act were not violated, as even after the scheme of amalgamation, the original shareholder, directly and indirectly, continued to exercise 100% voting rights over the assessee.

ii) The Revenue contended that the immediate shareholding and not the ultimate ownership of shares that needs to be considered for section 79 of the Act as held by the Mumbai bench of the Tribunal in the case of *M/s Tainwala Trading and Investments Company Limited vs. ACIT [ITA No. 5120/Mum/2009],* and the Delhi High Court in the case of *Yum Restaurants (India) Private Limited vs. ITO [2016] 237 Taxman 652 (Delhi).*

iii) The Tribunal held that the case of the assessee was fully covered by the Ahmedabad bench of the Tribunal's ruling in the case of *CLP Power India Private Limited vs. DCIT [2018] 170 ITD 744(Ahd)* and the Karnataka High Court's decision in the case of *CIT vs. AMCO Power Systems Limited [2015] 379 ITR 375 (Karnataka),* wherein it was held that beneficial ownership and not legal ownership is relevant for the purposes of satisfying the conditions prescribed in section 79 of the Act. Section 79 of the Act only mandates that the existing shareholders should beneficially hold the shares. Since, the beneficial owner pre-amalgamation continued to remain the beneficial owner of 100% shares, partially directly and indirectly through its subsidiary, even after the amalgamation, the assessee complied with the provisions of section 79 of the Act.

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