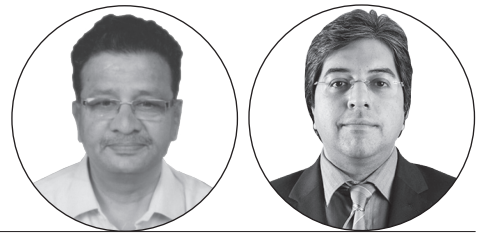
INTERNATIONAL TAXATION

Case Law Update



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A. High Court

1 *PCIT vs. Mckinsey Knowledge Centre India (P) Ltd- TS-518-HC-2021(Del)-TP*

TP adjustment made on delayed AE receivables by ignoring huge advances received from AE - deleted

Facts

i) The TPO had made adjustment on account of notional interest on delayed AE receivables.

ii) The Tribunal deleted the TP adjustment made on account of interest on receivables by relying on coordinate bench ruling in Pegasystems Worldwide India (P) Ltd wherein it was held that in the case of a debt-free company, there is no requirement for making TP adjustment on account of the interest on outstanding receivables. The Tribunal after observing that the assessee had not borrowed any funds for its business activity and that it was a debt-free company, deleted the said TP adjustment.

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

Decision

i) The Hon'ble High Court held that under no transfer pricing norm, principle or evaluation of a"benefit" could there be a one-sided adjustment by taking into account only delayed invoices and at the same time ignoring invoices/payment received in advance. Consequently, factually there could be no notional computation of 'delayed receivables' only ignoring the receivables received in advance

ii) A perusal of the paper book revealed that most of the invoices/receivables had been paid significantly in advance. When the period for which the amounts of receivables received in advance enjoyed by the respondent was seen vis-a-vis the amount received beyond sixty days, it was apparent that the respondent had received significantly more advance rather than outstanding received beyond sixty days.

iii) Consequently, the notional interest relating to alleged delayed payments in collecting receivables from the AE was uncalled for as in fact, there were no outstanding receivables as the amount received in advance far outweighed the amount received late.

iv) The question as to whether in a given case transfer pricing adjustment on 'delayed receivables', could apply even to debt-free company or not, hence did not arise on facts and was left open

v) Accordingly, Revenue's appeal was dismissed.

B. Tribunal

2 *Rajinder Kumar Aggarwal (HUF) vs. DCIT -[2021] 131 taxmann.com 252 (Delhi - Trib.)*

Where assessee appointed Ace, a France based trading company as its agent to procure export orders from France and paid it commission, since no knowledge was provided to the assessee which could be further exploited while services were rendered by a non-resident of procuring export orders for the assessee, payment made for said services could not be held treated/taxed as FTS under India-France DTAA

Facts

i) M/s Ace Trading Company, France (in short 'Ace') was appointed by the assessee in earlier years for assistance in procuring export orders for the assessee in France. In the year under consideration also, the assessee appointed M/s 'Ace' as its agent for procuring export orders in France. The assessee debited a sum of ₹ 1,16,99,172/- as commission paid on export sales & no tax was deducted at source by the assessee on said payment.

ii) According to Assessing Officer, the assessee was required to deduct tax at source on the said payment in accordance with provisions of section 195 of the Act. Thus the AO disallowed the aforesaid payment under section 40(a)(i) of the Act. The AO held that as per the provisions of *Explanation* to section 9 for the purpose of clause (vii) (i.e. fee for technical services), the scope of the income included services rendered outside India also if the same had been utilized in India in so far as the source of payment towards expenditure was in India.

iii) The CIT(A) sustained the aforesaid disallowance of commission expenses. Aggrieved, the assessee filed appeal before the Tribunal

Decision

i) The Tribunal observed that the non-resident M/s Ace was engaged for procuring export order for the assessee in the territory of France and commission had been paid on the export sales, which were procured through the said agent. The assessee has made agreement with the said agent every year, though the scope of the services remained the same. The Learned DR could not bring any evidence as regards to change of scope of services rendered by the said agent in the year under consideration as compared to the earlier year

ii) In the assessment year 2010-11, the Tribunal in ITA No 4142/Del/2015 had dismissed the appeal of the Revenue challenging deletion of disallowance in terms of section 40(a)(i) by observing as under:

"7… .. As pointed out by the Ld. AR the issue is covered in favour of the assessee in case of ***DIT vs. Panalfa Autoelektrik Ltd. 378 ITR 205*** wherein it is held that commission paid by the assessee to its foreign

agent for arranging of export sales and recovery of payments could not be regarded as Fee for Technical Services u/s 9(1)(vii). In the present case, the commission was paid to ACE Trading, a non-resident agent (payee) who is a tax resident of France. The payee was simply assisting procuring export orders for the Assessee in his ordinary course of business in France. The commission was paid for activities of the payee outside India and the amount is received by the payee outside India through normal banking channels. Section 5(2) states that total income of a person, who is a non-resident, includes income from all sources which (a) is received or deemed to be received in India; (b) accrues or arises in India; or (c) is deemed to accrue or arise in India. In the present case, the commission income paid to the foreign agent neither accrued in India nor deemed to be accrued in India as per deeming provisions of section 9 and nor the same was received nor deemed to be received in India....."

iii) Further, the Tribunal observed that the non-resident could invoke the DTAA between India and France if provisions of the same were more beneficial to the non-resident. The Tribunal relied on the judgement of the Hon'ble Delhi High Court in the case of ***Steria India Ltd. vs. DCIT, 255 Taxman 110 (Delhi) (HC)***, wherein it was held that the Most Favoured Nation (MFN) clause of the protocol forms an integral part of India France DTAA and that it would be automatically applicable. In view of the Most Favoured Nation (MFN) clause, the beneficial provision of the DTAA between India and other OECD country, i.e., UK would automatically extend to the India-France DTAA. In India-UK DTAA fee for technical services (FTS) excludes the term 'managerial services' and provides for 'make available clause'. However, in the services rendered by the non-resident of procuring export order for the assessee, no knowledge had been provided to the assessee which could be exploited further by the assessee. In such circumstances, the services rendered by the non-resident could not be held as 'FTS' under the India-France DTAA. Thus, such services would not be taxable and, therefore, no liability to deduct tax would arise. Consequently, payment to said non-resident was not liable to disallowance under section 40(a)(i) of the Act.

3 *Ikea Services India Pvt Ltd vs. ACIT -TS-474-ITAT-2021(Del)-TP*

TP adjustment on recharacterization of support services as trading activity-deleted

Facts

i) The assessee company was a 100% subsidiary of Ingka Pro Holding BV Netherlands and was primarily engaged in the provision of sourcing support services to its Associated Enterprises [AEs]. The assessee operated on an assured return revenue model undertaking minimal/limited risk, making the service of the assessee having the least complex operations with a lesser share of risks. In the course of the provision of sourcing support, the assessee was not involved in making any strategic sourcing decisions and was primarily involved in identification and search of suppliers, obtaining offers and

quotations, managing logistics and quality control check in performing its day-to-day functions. The AE(s) undertook functions like strategy formulation for its sourcing business, selection and approving new suppliers, negotiations with suppliers, claim management etc.

ii) The TPO proceeded on the premise that the business model of the assessee was akin to that of a trader and on this premise formed a belief that the assessee's compensation model must include Free on Board [FOB] value of goods sourced from India. Consequently, the TPO selected comparables identifying traders as comparables viz Shopppers Stop Ltd, Isha Natural Beauty Products & Wellness Pvt Ltd, Lifestyle International Pvt Ltd, Future Enterprises Ltd, Bioworld Merchandising (India) Pvt Ltd, Avenue Supermarts Ltd, V 2 Retail Ltd, and Parin Furniture Ltd, having a median margin of 5.97%. The TPO noted that the FOB value of goods procured through the assessee from India was ₹ 22,60,34,01,600/- & took this FOB value as a cost base to calculate the remuneration of the assessee. By applying the median rate of 5.97% on the FOB value of 2260.34 crores, the TPO computed the arm's length remuneration at ₹ 1,34,94,23,076/-. Since the assessee had received compensation of ₹ 91,92,25,248/- the same was deducted and the balance amount of ₹ 43,01,97,828/- were added.

iii) The Assessee raised objections before the DRP but the same were dismissed.

iv) Aggrieved, the assessee filed appeal before the Tribunal

Decision

i) The Tribunal minutely noted all the services performed by the assessee which comprised of- searching of suppliers, obtaining offers, placing of orders and quality control, transport and logistics, payment to suppliers, and coordination. The Tribunal concluded that the assessee did not have any market risk, product liability risk, service liability risk, credit risk and Price risk.

ii) The assessee also did not take part in Purchase decisions, nor was it engaged in the activity relating to maintaining any stock of merchandise manufactured by vendors and/ or reselling the same to the group's retail entities on its own account.

iii) There was a glaring fallacy in the approach of the TPO in adopting FOB cost of goods procured from India by the AEs through the assessee as cost base. This approach of the TPO was in complete disregard to the functional profile of the assessee. Since the assessee operated in a limited risk environment providing routine support services to group entities, it was entitled to be remunerated based on assured return.

iv) The Tribunal relied on the judgement of the Hon'ble High Court of Delhi in the case of Li and Fung India Ltd ITA No. 306 of 2012, wherein it was held

"39 …This Court is of opinion that to apply the TNMM, the assessee's net profit margin realized from international transactions had to be calculated only with reference to cost incurred by it, and not by any other entity, either third party vendors or the AE. Textually, and within the bounds of the

text must the AO/TPO operate, Rule 10B(1)(e) does not enable consideration or imputation of cost incurred by third parties or unrelated enterprises to compute the assessee's net profit margin for application of the TNMM. Rule 10B(1)(e) recognizes that 'the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise ...' (emphasis supplied). It thus contemplates a determination of ALP with reference to the relevant factors (cost, assets, sales etc.) of the enterprise in question, i.e. the assessee, as opposed to the AE or any third party. The textual mandate, thus, is unambiguously clear."

v) The Tribunal noted that the aforesaid Hon Jurisdictional High Court judgement was followed by the coordinate bench in the case of Mitsubishi Corporation India Pvt Ltd vide ITA No. 5042/DEL/2011. wherein it was held

"81. Clearly, therefore, it is impermissible to make notional additions in the cost base and thus take into account the costs which are not borne by the assessee. It is so opined by Hon'ble jurisdictional High Court on a careful analysis of rule 10B(1)(e)(i). It is, therefore, no longer open to the revenue authorities to reconstruct the financial statements of the assessee by including the cost of products incurred by the AEs, in respect of which services are rendered....."

vi) Thus, considering the facts of the case in totality, and in light of the decision of the Hon'ble High Court of Delhi [supra], the Tribunal set aside the TP adjustment made by the Assessing Officer and directed him to delete the addition of ₹ 43,01,97,828/-

4 *Infosys BPO Ltd vs. DCIT [TS-983-ITAT-2021(Bang)]*

Payments to Polish law firm, a limited partnership firm towards legal service rendered to assessee- Not taxable/FTS under Article 13(4) of the India-Poland DTAA

Facts

i) The assessee was an Indian Company engaged in the business of providing business process outsourcing services. It made payments to non-residents in USA for (retainership and site License subscription fee) and Poland (for legal services). During the year under consideration, it grossed up the invoice amount, deducted TDS under section 195A of the Act but the TDS certificates were not issued to the non-residents, as the TDS was deducted and deposited by the assessee under protest.

ii) The assessee filed appeals before the Ld. CIT(A) under section 248 of the Act, seeking a declaration, that no tax was deductible on payments made to the non-residents in USA and Poland.

iii) **W.r.t Legal fees paid to Polish Law firm**: The CIT(A) observed that the assessee had made payments to a Law firm in Poland, a limited partnership firm, who was a tax resident of Poland. The CIT(A) was of the opinion that the payment made by the assessee came under the ambit of "Royalties and fee

for technical services" as defined in Article13(4) & were chargeable to tax in India under section 9(1)(vii) of Income tax Act, as well as Article 13(4) of DTAA between India and Poland. The Ld. CIT(A) therefore denied declaration to the assessee on this issue.

iv) **W.r.t software license payments made to U.S entity**: The CIT(A) by relying on the judgement of Hon'ble Karnataka High Court in case of Samsung Electronics- (2012) 345 ITR 494 held that some payments made to the U.S entity were in the nature of software licenses and were Royalty in the hands of the non-resident. The Ld. CIT(A) also observed that the said U.S entity (i.e. Zintro) provided periodic training of Infosys trainers who would then train new analysts etc and thus held that certain services rendered by the said entity were in the nature of technical services under section 9(1)(vi)/(vii) and Article 12 of India US DTAA.

v) Consequently, an appeal was filed before the Tribunal

Decision

W.r.t Legal fees paid to Polish Law firm:

i) The Tribunal crystalized the following issues for consideration

- Whether the Partnership firm was not eligible for benefit under India Poland DTAA, on the ground that assessee was a fiscally transparent entity not liable to tax in Poland in its own right and
- Whether the Partners are fully taxable in respect of their shares of income in Partnership Firm as per CIT?
- If the answer to the above two issues are in affirmative then;

Whether payments made to the law firm in Poland is in the nature of Fee for technical services under section 9(1)(vii) of the Act as well as Article 13 of India Poland DTAA?

ii) The Tribunal observed that payee was a resident of Poland.

It referred to the definition of "Person" as per Article 3(1)(e) which provides that

"the term "person" includes an individual, a company and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;"

The Tribunal noted that the above definition specified that the provisions of DTAA are applicable to 'persons' who are taxable under the domestic taxation laws of the contracting states.

The Tribunal also noted the definition of 'resident of a contracting state', as set out in

Article 4(1), which provides that

"For the purposes of this Agreement, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State."

The Tribunal further noted that as per Article 1(1) of the India Poland DTAA,

the treaty can only apply to a 'person' who is resident of one or both the contracting states. Therefore, in view of the provisions of Article 4(1) read with Article (1) and Article 3(1)(e), unless the payee is taxable under domestic laws of Poland, treaty benefits cannot be extended. It held that the Law firm was a non-taxable entity as per the domestic laws and therefore treaty benefit could not be extended to the firm.

iii) Though the Law firm was a transparent entity, and could not be taxed in its own right, the Tribunal held that its partners who represented the partnership in Poland would be taxable as was evident from the Tax residency Certificate (TRC) issued by the Polish government to the partners. By placing reliance on ***Linklaters LLP vs. ITO- (2010) 40 SOT 51 (Mumbai Tribunal), ING Bewaar Maatschappij I BV vs. DCIT- (2019) 112 taxman.com 21*** and OECD commentary, the Tribunal concluded that the partners of the law firm were taxed on the income received by the Partnership Firm in Poland. (consequently, treaty benefits could be availed.)

iv) With respect to taxability of the income, as FTS as per Article 13(4), the Tribunal noted that Paragraph 4 of Article 13 of the DTAA excludes services mentioned in Article 15 & 16. Since the partners were taxable in Poland as per the Personal Income Tax Act, Article 15 of India Poland DTAA was to be looked into. Therefore, the Tribunal concluded that services rendered by the non-resident law firm could not be treated as FTS under Article 13(4).

v) Further, the Tribunal noted that the non-resident payee had given a certificate that there was no fixed place of business/ PE in India & nothing had been brought on record by the revenue to establish that the non-resident payee had any fixed place of business PE in India. The Tribunal thus concluded that the income ceased to be taxable in India.

vi) Further, respectfully following the decision of Hon'ble Supreme Court in ***UOI vs Tata Chemicals Ltd, in (2014) 43 taxman.com 240***, the Tribunal held that the deductee was entitled to interest on refund of tax deposited under section 195 of the Act.

W.r.t to software license payments to U.S entity

vii) The Tribunal noted that the decision of the Hon'ble Karnataka High Court in the case of ***Samsung Co. Ltd (Supra)*** on the basis of which the revenue authorities concluded that the payment to non-residents were in the nature of royalty and FTS, now stood overruled by the decision of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P) Ltd [TS-106-SC-2021]. It thus remanded the issue to the CIT(A) to examine the terms of the agreement under which services were rendered to the assessee & directed the CIT(A) to analyse in the light of the provisions of the DTAA and principles laid down by Hon'ble Supreme Court, as to whether the same would amount to Royalty and FTS.

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