INTERNATIONAL TAXATION
Case Law Update

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A. SUPREME COURT

1 *Johnson Matthey Public Ltd. Company vs. CIT (International Taxation) - [2024] 167 taxmann.com 395 (SC)*

The Hon'ble SC dismissed assessee's SLP against High Court ruling that where the assessee, a non-resident company, provided guarantee to various banks to extend credit facilities to its Indian subsidiaries, such guarantee fee would not fall within expression "interest" in article 12 of India UK DTAA, since guarantee charges were not received by assessee in respect of any debt owed to it by its Indian subsidiary.

2 *CIT (International Taxation) vs. Gracemac Corporation - [2024] 166 taxmann.com 659 (SC)*

The Hon'ble SC dismissed Revenue's SLP against impugned order of HC ruling that where payments were made by an Indian company to a non-resident company which was a computer software manufacturer/supplier for resale/use of computer software through distribution agreements, said payments did not amount to royalty for use of copyright in computer software, and consequently, the same did not give rise to any income taxable in India.

B. HIGH COURT

3 *Hyatt International Southwest Asia Ltd. vs. ADIT - [2024] 166 taxmann.com 466 (Delhi)*

The Full Bench of the Hon'ble HC held that where assessee had a PE in India, it would be liable to pay tax on income attributable to that PE notwithstanding that assessee had suffered a loss at an entity level.

Facts

i. The assessee, a company incorporated in UAE, filed its return of income declaring nil income.

ii. The assessee had filed appeal before Division Bench of High Court contending that assessee's case was squarely covered by ***CIT (International Taxation) vs. Nokia Solutions and Networks OY [2023] 147 taxmann.com 165/455 ITR 157 (Delhi)*** wherein it was held that in case an enterprise at an entity level had suffered a loss in relevant assessment year, no profit or income attribution would be warranted insofar as PE in India was concerned.

iii. The Division bench of High Court doubted the correctness of the view expressed in ***Nokia Solutions (supra)*** and made a reference before the Full Bench of High Court.

Decision

i. The Hon'ble Full Bench of the HC held that the concept of a PE is based upon the undertaking of economic activity in a particular State irrespective of the residence of an enterprise. Any entrepreneurial activity which gives rise to income or profit thus becomes liable to be taxed at source irrespective of the ultimate recipient or owner of that income. Source here would mean the location which gives rise to the accrual of profits or income or which is the location where the same arises. The PE principle thus enables the assignment of tax to the State which constitutes the source. Once the DTAA confers an independent identity upon the PE, it would be wholly erroneous to answer the question of taxability basis either the activities or profitability of the parent or the entity which seeds and sustains the PE.

ii. The Contracting State in which this imagined entity is domiciled and undertakes business thus becomes identified as an independent profit or revenue earning center which is liable to be taxed. Once such an entity is found to exist in one of the Contracting States, it is viewed as a unit which contributes to the economic life of that State and is thus be liable to tax. It is these basic precepts which debunk the theory of taxation in the source State being dependent upon a global profit or taxation being subject to income or profit having been earned at an entity level.

iii. Article 7 of the DTAA postulates that the profits of an enterprise shall be taxable only in that State. It thus, and as a matter of first principle, restricts the taxation of profits of an enterprise only to and in the State of which it may be a resident. However, it then proceeds to expand the scope of taxability by taking into consideration the activities that may be undertaken by such an enterprise in the other Contracting State through a PE situate therein. This is further explained with article 7(1) prescribing that if the enterprise were carrying on business through a PE situate in the other Contracting State, its profits would become liable to be taxed in the other State, restricted however, to the extent that those profits are attributable to that PE.

iv. As article 7 is read, it becomes evident that paragraph (1) clearly envisages the profits of a PE being liable to be independently taxed notwithstanding that PE being a constituent of a larger enterprise which may be domiciled in the other Contracting State. Article 7(1) thus in clear and unequivocal terms constructs a dichotomy between the profits that may be earned by an enterprise on a global scale and those which are attributable to a PE situated in the Contracting State. This becomes further evident from a reading of paragraph (2) of article 7 which stipulates that where an enterprise carries on business through a PE in the other Contracting State, profits would be liable to be attributed to that PE as if it were a distinct and separate enterprise engaged in similar activities and independent of the enterprise of which it may be a part.

v. This aspect is further amplified when article 7(2) employing the phrase "dealing wholly independently with the enterprise of which it is a permanent establishment". Article 7(2) thus clearly bids to view the PE as a distinct and separate entity engaged in undertaking business activity in its own right in a Contracting State. It would consequently and on a fundamental plane be incorrect to fuse the incomes generated by an enterprise as a whole with the income that may be earned by a PE in one of the Contracting States.

vi. It would also be incorrect to interpret article 7 as requiring to ignore the income that may be generated pursuant to activities undertaken by a PE in one of the Contracting States and making the exercise of attribution dependent upon the profits or the income that the enterprise may otherwise earn at an entity level. In fact, article 7(1) itself excludes the profits of an enterprise from being subjected to tax till such time as such an entity carries on no business in the other Contracting State through a PE. Consequently, even though a PE may be merely a part of the larger entity, the profits generated from its activities undertaken in the other State becomes subject to taxation. The view taken above also finds support from the OECD Commentary on article 7. The source State is ultimately concerned with the income or profit which arises or accrues within its territorial boundaries and the activities undertaken therein. As those commentaries pertinently observe, the profits attributable to a PE are not liable to be ignored on the basis of the performance of the entity as a whole.

vii. Global income, as a fundamental precept, has always been invoked in respect of residents of a Contracting State. Most Nations have ultimately reverted to the source rule for purposes of taxation. Thus, one is called upon to deal with a regimen which concerns itself with the source from which income accrues or arises. This precept also stands mirrored in section 5 and which jettisons the principle of territoriality only in respect of income earned by a resident. Thus, taxation based on worldwide income stands confined to natural residents. However, no Nation avows or waives its right to tax capital or transactions which are anchored to its own territory. It is this basic precept of source which continues to bind.

viii. If the submission of the assessee were to be accepted, the revenue would be recognised to have the power to tax even in a situation where although the entity be profitable, the PE may have incurred a loss. If the aforesaid logic were to be applied, in a converse situation, the Contracting State would be countenanced to have the right to tax only if the assessee at a global level were found to have earned profit. That is clearly not the import of article 7 of the DTAA. In fact, article 7 itself restricts the taxability of the enterprise to the extent of income or profit attributable to the PE. Thus, the argument of global income or profit being relevant or determinative is totally unmerited and misconceived. The submission is clearly contrary to the weight of authority which has been noticed hereinabove.

ix. Regard must also be had to the fact that article 7 does not expand its gaze or reach to the overall operations or profitability of a transnational enterprise. It is concerned solely with the profits or income attributable to the PE. The taxability of income earned by a PE existing in a Contracting State is not even remotely linked or coupled to the overall operations of the enterprise of which it may be a part. The argument of world-wide income is thus rendered wholly untenable.

x. The Division Bench in these appeals rightly doubted the correctness of taxation being dependent upon profits or income being earned at the "entity level". Article 7 cannot possibly be viewed as restricting the right of the source State to allocate or attribute income to the PE based on the global income or loss that may have been earned or incurred by a cross border entity. Thus, the reference was answered by holding that the tentative view expressed by the Division Bench in these set of appeals as well as the doubt expressed with respect to the findings rendered in Nokia Solutions was well founded and correct.

4 *PCIT vs. Sony India (P.) Ltd.- [2024] 167 taxmann.com 549 (Delhi)*

Where assessee, engaged in import and distribution of various products, outsourced manufacturing activities to OEMs and paid royalty to its AEs for use of licensed patents, know-how and trademarks which was disallowed by the TPO on ground that since goods were manufactured by OEMs the same did not justify any payment of royalty by assessee to its AE, the Hon'ble HC upheld the order of the Tribunal deleting the said disallowance on the ground that the assessee was also entitled to get products manufactured through sub-contractors. It was further held that TPO is not required to examine the efficacy of commercial transactions and his role is confined to determining the price or value of the transactions on an arm's length basis.

Facts

i. Assessee was engaged in import and distribution of various products under the brand name 'Sony' and there were certain categories of products where manufacturing activities were outsourced to OEMs (original equipment manufacturers).

ii. Assessee had obtained license for manufacturing and selling of various products and paid royalty to its Associated Enterprises (AEs) for use of licensed patents, know-how and trademarks.

iii. TPO proposed that royalty was to be bench-marked at nil on the ground that as goods were manufactured by OEMs, the same did not justify any payment of royalty by assessee to its AE's.

iv. The DRP upheld the TPO's order.

v. However, the Hon'ble Tribunal set aside the aforesaid TP adjustment w.r.t royalty paid in respect of Sony products manufactured by (Moser Bear India Ltd. (hereafter MBIL) and Competition Team Technology [India] Pvt. Ltd. (hereafter CTTL) as original equipment manufacturers (OEMs).

vi. Aggrieved, the Revenue filed appeal before the Hon'ble HC.

Decision

i. The Hon'ble HC noted that the assessee had furnished the agreements with the concerned parties and that Sony Corporation, Japan had not licensed any technology to MBIL and CTTL but had only set out terms and conditions, which would govern the transactions between Sony Corporation or any of its subsidiaries with MBIL and/or CTTL. The assessee had also set out the commercial arrangement between the assessee and the AEs, which required payment of royalty.

ii. The Tribunal referred to the decision of this Court in ***CIT-I vs. M/s Cushman and Wakefield (India) Pvt. Ltd., Neutral Citation No. 2014: DHC:2764-DB*** and faulted the learned TPO for ignoring the commercial expediency and benchmarking the payment of royalty at Nil. It also accepted that Sony Corporation or any of its subsidiaries had invested significant amount for intangible properties, which the assessee had the license to use on payment of royalty @ 2% on net sales.

iii. The Tribunal concluded that MBIL and CTTL were manufacturing sub-contractors and the assessee had been granted the license for use of the license patents, license know-how, and license trademarks. The assessee was also entitled to get the products manufactured through sub-contractors. The Tribunal also observed that it was not the Revenue's case that MBIL and CTTL had paid royalty to Sony Corporation, Japan for manufacturing their products and using the licensed patents, know-how and trademarks.

iv. The Hon'ble HC noted that the aforesaid finding of fact was not controverted. It further held that the learned TPO is not required to examine the efficacy of commercial transactions and its role is confined to determining the price or value of the transactions on an arm's length basis. Accordingly, the Hon'ble HC upheld the conclusion of the Tribunal and dismissed the Revenue's appeal.

5 ***Alcatel Lucent India Ltd. vs. DCIT [2024] 167 taxmann.com 595 (Delhi)***

a) Where assessee-company rendered software development services, the Hon'ble HC held that a company which derived its revenue from both software development services and sale of software products, could not be selected as comparable.

b) Where the business model followed by selected company was largely outsourcing its activities and sub-contracting services and yet however the Hon'ble Tribunal held that the selected company was a comparable entity as it did not fail employee cost filter as per annual report, the Hon'ble HC directed exclusion of the said company from the comparables list.

c) Where assessee-company contested certain comparables and submitted detailed contentions against each of such companies and yet however, the Hon'ble Tribunal inadvertently did not adjudicate upon inclusion/exclusion of said companies in the final set of comparable, the Hon'ble HC remanded back the matter to the Tribunal for deciding afresh assessee's objections.

C. TRIBUNAL

6 ***Ashok Kumar Pandey vs. ACIT [2024] 167 taxmann.com 286 (Mumbai-Trib)***

Where assessee, an Indian citizen, claimed himself to be a resident of USA as his family was US national holding US passport and he was overseas citizen of India, the Hon'ble Tribunal held that the assessee was a resident of India in terms of article 4(2)(a) of Indo-US - DTAA and all his income derived in USA, was chargeable to tax in India by virtue of provisions of section 5 since;

a) He had an active involvement in a running of business of a private limited company in India which he had set up along with his wife.

b) He did not have any active involvement in USA for earning wages, remuneration, profit therefrom.

Facts

i. The assessee, an individual deriving income from capital gains, dividend, interest income and income from house property filed his return of income for assessment year 2013-14.

ii. The assessee claimed that he was a resident but not ordinarily resident for assessment year 2009-10 and a resident since assessment year 2010-11. For the relevant year, the assessee had claimed that he was resident in India as well as in the United States of America and thus, the residential status of the assessee was required to be determined in accordance with the provisions of Double Tax Avoidance Agreement (DTAA) between India and USA.

iii. The assessee had also stated that he had a permanent home in India as well as in the USA and, therefore, his residential status would depend upon his personal and economic relation and its closeness (centre of vital interest) which according to the assessee lay in the USA and, therefore, in terms of article 4(2)(a) he was a resident of the USA.

iv. The AO in view of his findings, given below held, that the assessee's centre of Vital Interest, i.e., personal and economic interest, were closer to India and, therefore, the claim of the assessee that he was a resident of the United States of America for tax purposes was rejected. The AO found that;

a. The stay of the assessee in India was more than 183 day and that he was staying with his wife and children in India,

b. The assessee was a Managing Director with shareholding of more than 50 per cent in an Indian company in whose affairs he was actively participating.

c. The assessee had made investments in mutual funds and also shares in India deriving dividend and capital gains therefrom.

d. Income derived by the assessee from the US such as interest, dividend, house property, and capital gain were passive income for which active involvement was not required.

e. The assessee was residing in India for a major part of the year (and was married to an Indian, also living in India along with his spouse and one child, while the other child was in the US for study purposes only).

v. Thus, according to the AO, as per clause-2 of article 10 of DTAA, the assessee was liable to offer the entire amount as income where he was resident and then avail DTA benefit. Since no taxes had been withheld in the USA w.r.t the entire dividend income, the same was considered as income of the assessee by applying a conversion rate of ₹ 53.98 per $ and ₹ 40,39,358 was added back.

vi. Further, the assessee had earned taxable interest income of $ 5695 and since the assessee had not paid any tax in the US as it was less than the minimum income chargeable to tax, applying article 11(2), the AO made addition of the said income.

vii. On appeal, the CIT (A) held that as per section 5, if an individual was residing for more than 183 days in India, he would be considered as a Resident in India and his entire global income would be taxable in India, though he would be allowed credit of tax paid in the United States in Indian tax returns. As the assessee had not paid any tax in the USA, the computation of total income made by the Assessing Officer was upheld.

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

Decision

i. The Hon'ble Tribunal noted that the assessee was staying in India with his wife, son and daughter for more than 183 days in the current year and therefore according to the domestic law, he was to be considered a resident of India. His other daughter was staying in USA for the purpose of study. The stay of his extended family including parents in USA was not so much relevant to decide whether his personal relationship was close to USA or not, because, though his parents were USA National, but his brother and his sisters were also staying there. He had a home in India and though he also had a home in USA, purchased by mortgage loan, the same was let out on rent.

ii. Regarding the assessee's economic interest, the Hon'ble Tribunal noted that he had come back to India for carrying on business in a private limited company which was set up by him and his wife in 2009 for distribution of films and which had a work in progress of approximately ₹ 69,152,085/– and long-term unsecured borrowing from the directors of ₹ 81,256,726/–. Further, he held 50 per cent of the shares and the balance 50 per cent of the shares were held by assessee's wife. The loan amount of ₹ 81,256,726/– invested in the above company which was mostly tied up in the work in progress as well as the bank balance, was also financed by the assessee. Assessee had attended along with his wife five Board meetings of the above company. Therefore, the assessee had an active involvement in running of this company in India. In India he also had operative bank accounts with Union Bank of India and ICICI bank. (He also had investment in mutual funds. However, the Hon'ble Tribunal clarified that operating a bank account and having an investment in mutual funds may not have any vitality of economic relationship because these are passive investments and may flow to any country irrespective of the residence if the other laws permit, based on rate of return.)

iii. It further noted that, from USA, assessee was deriving rental income where his house property was rented out, he had investments in bank accounts as well as alternative investments. He had also other investments where dividend income accrued along with the increase in market price of the investment. Thus, he did not have any active involvement in the USA for earning wages, remuneration, profit.

iv. The Hon'ble Tribunal therefore concluded that on comprehensive appraisal, the personal relationship and economic relationship of the assessee, tilt more in favour of being close to India then the US. Consequently the assessee was a resident of India in terms of article 4(2)(a) of the Indo-US – DTAA and all his income derived in the USA, was chargeable to tax in India by virtue of the provisions of section 5 of the Act. Further, since the income tax return of assessee filed by him in USA, did not show that he had paid any tax there, no credit was available against tax payable by the assessee in India.

v. Accordingly, appeal filed by the assessee was dismissed.

7 *Transkor Global Pte Ltd. [TS-742-ITAT-2024 (Del)]*

The Hon'ble Tribunal held that income derived by a Singapore based company (assessee) on account of services rendered towards technical non-invasive inspection and integrity assessment/scanning of off-shore pipelines under the sea or surface through Magnetic Tomography Method (MTM) technology to Indian Companies did not constitute FTS under Article 12(4)(b) of India-Singapore DTAA, since it did not satisfy the 'make available' clause. Further, the said income could also not be taxed as business income under Article 7 of the said DTAA in the absence of PE. It also rejected Revenue's reliance on Section 90(i)(b) introduced with effect from April 01, 2021 alleging that assessee was engaged in treaty shopping arrangement holding that the said allegation was not made before the CIT(A) and that the Revenue could not improve its case by stating new facts or allegation. It further held that Section 90(i)(b) is applicable only from AY 2021-22 and could not be made applicable for the relevant AY i.e. 2019-20.

8 *GKN Driveline (India) Ltd. vs. ACIT (OSD) [2024] 167 taxmann.com 124 (Delhi-Trib)*

The Hon'ble Tribunal held that where assessee's margin was much higher than comparables' margin, no TP adjustment could be made on account of interest on outstanding receivables from AEs.

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