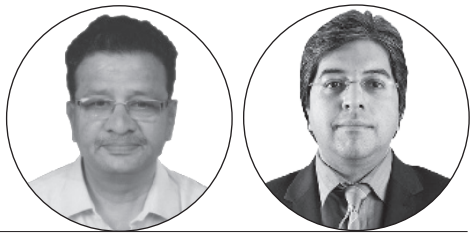

INTERNATIONAL TAXATION

Case Law Update

CA Tarunkumar Singhal & Dr. Sunil Moti Lala

A. High Court

1 ***DIT vs. Jeans Knit Pvt Ltd***

(I.T.A. No. 383 OF 2012) ([TS-472-HC-2020(KAR)]

Services rendered by a non-resident, in nature of quality testing of fabrics would not be in nature of fees for technical services u/s 9(1)(vii) of the IT Act when the non-resident was neither involved in the selection of the fabric nor in the identification of the vendor from whom the fabrics were required to be purchased

Facts

i) The assessee, a domestic company, was engaged in the business of manufacturing and export of garments. The choices of fabrics and accessories to be used for the production of final products was done by the assessee in consultation with its customers and in most of the cases the customers had tie-ups with international manufacturers of denim fabrics from whom the fabrics were required to be imported by the assessee.

ii) For the above purpose, the assessee had engaged Sharp Eagle International Ltd. (SEL), a company incorporated in Hong Kong, to ensure that the imports were received in India on time and in the correct quantity so that the production schedule could be met and garments could be shipped to its customers as per the commitment given by the assessee.

iii) SEL rendered various services such as inspection of fabrics at the time of imports, timely dispatch of material etc. and the assessee paid 12.5% of the imported value of fabrics as consideration for the services rendered by SEL, without withholding any taxes at source.

iv) The AO initiated proceedings u/s 201 and observed that since no DTAA was executed between India and Hongkong, the taxability had to be determined under the provisions of the IT Act. The AO held that the payments made to SEL were in nature of fees for technical services u/s 9(1)(vii) of the IT Act, by observing as under:

a. Services rendered by SEL i.e. inspection of fabrics was not a simple job and required technical knowledge/skills in the field of textiles and also it required experience to inspect and analyze the fabrics/materials and to point out defects therein. Therefore, the services rendered by SEL were in the nature of technical services.

b. SEL was required to advise on the defects detected in the fabrics/materials and further had to clarify whether the same was to be imported or not. Thus, the said services were in the nature of consultancy services.

c. SEL was also required to manage/attend the work given by the assessee and thereby SEL was also rendering managerial services.

v) The AO passed order u/s 201(1), thereby holding the assessee as 'assessee in default' for not withholding taxes @ 10% u/s 115A(1)(b)(BB) r.w.s 9(1)(vii) of the IT Act. The action of the AO was upheld by the CIT(A).

vi) On appeal, the Tribunal held that the impugned payments were not in nature of fees for technical services u/s 9(1)(vii) of the IT Act, by observing as under:

a. The services rendered could not be termed as 'consultancy services', since, in terms of the agreement between assessee and SEL, SEL was not involved in the identification of the vendor from which the fabrics were required to be purchased or in the selection of the material and negotiating the price.

b. The services could not be termed as 'technical services' since the quality of the material was already determined by the assessee and SEL was only required to make a physical inspection of the material to verify whether it resembles the quality/samples specified by the assessee, and thus elementary knowledge of the type of material and fair sense of identifying the correctness of the quality was sufficient. Accordingly, SEL did not require any technical knowledge nor any skilled technical personnel was required to discharge its obligation under the agreement, and thus the services were not in nature of 'technical services'.

c. Further, the services could also not be termed as 'managerial services', since SEL was acting on behalf of the assessee as its agent and thus, there was no independent application of thought process in any of the activities to be carried out by SEL i.e. it had only to act at the behest of the assessee and also discharge its commitments as per the direction of the assessee.

vii) On further appeal by Revenue, the Karnataka HC held as under.

Decision

i) The Karnataka HC held that the expression 'managerial', 'technical' and 'consultancy services' employed in Explanation 2 to Section 9(1)(vii) of the Act have neither been defined under the IT Act nor under the General Clauses Act, 1987 and thereby the aforesaid words have to be understood in the

sense in which they are understood by the persons engaged in the business and by the common man who is aware and understands the same.

ii) The HC, by relying on the decision in case of ***Santhosh Hazari vs. Purushottam Tiwari (2001) 3 SCC 179*** and decision in case of ***CIT vs. Soft Brands Pvt. Ltd. (2018) 406 ITR 513***, observed that it is a well-settled legal proposition that Income Tax Appellate Tribunal is a fact-finding authority and decision on facts rendered by the Income Tax Appellate Tribunal could be gone into by the High Court only if a question is referred to the High Court, which says that the findings of the Income Tax Appellate Tribunal are perverse.

iii) The HC observed that SEL was neither involved in the identification of the vendor from which the fabrics were required to be purchased nor in the selection of the material and negotiating the price. The quality of the material was also determined by the assessee and SEL was only required to make a physical inspection to verify whether it resembles the quality/sample specified by the assessee. In view of the same, for rendering the aforesaid service, no technical knowledge was required.

iv) The HC also observed that the Tribunal had recorded a finding that SEL was not rendering any consultancy services to the assessee and therefore, the same would not fall within the services contemplated u/s 9(1)(vii) of the Act.

v) Further, the HC observed that since the findings of the Tribunal were based on meticulous appreciation of evidence on record and no ground with regard to the perversity of the aforesaid findings was raised, the said findings could not be termed as perverse and thus, the substantial questions of law framed were to be answered against the Revenue.

B. Tribunal

2 *BOEING India Pvt. Ltd*

[TS-404-ITAT-2020(DEL)]

Section 195 of the IT Act would not be applicable to reimbursement of salary expenses of seconded employees to F Co. if the I Co. had withheld taxes u/s 192 of IT Act

Facts

i) The assessee, a domestic company, during the year under consideration, reimbursed the salaries of expatriates employees deputed to it, by its AEs without withholding any taxes u/s 195 of the IT Act.

ii) During the course of assessment proceedings, the AO referring to the terms of Secondment Agreement and drawing support from the decision of the Hon'ble Delhi High Court in the case of Centrica India Offshore India Ltd (364 ITR 336), held that taxes were required to be withheld by the assessee at the time of making payments to its AEs and accordingly made a disallowance u/s 40(a)(i) of the Act. The action of the AO was upheld by the DRP.

iii) Accordingly, the present appeal was filed by the assessee before the Tribunal.

Decision

i) The Tribunal perused the Secondment Agreement and observed that the seconded employees had expressed their willingness to be deputed under the assessee and its AE had agreed to release the said seconded employees to the assessee. Further, it was also provided that the AE would facilitate payment of salaries in the home country of the seconded employee on behalf of the assessee and the seconded employees would be working for the assessee, under supervision, control and management of the assessee as an employee of the assessee.

ii) The Tribunal observed that the seconded employees were, in fact, in the employment of the assessee and the assessee had just reimbursed the salaries to its AE, since in terms of the Secondment Agreement the AE were paying salaries of the seconded employees in their home country. Accordingly, these facts clearly demonstrated that the assessee had paid salaries to its own employees and this fact alone clearly distinguished the facts in the case of Centrica India Offshore Ltd. (supra)

iii) The Tribunal also perused the TDS certificates, Forms 15CA and 15CB, and observed that the assessee had deducted tax at source u/s 192 of the Act and hence provisions of section 195 of the Act would not be applicable.

iv) In view of the above, the Tribunal deleted the disallowance made by the AO.

Note:

i. In the aforesaid case, a merger u/s 233 of the Companies Act, 2013 was notified for amalgamation of an amalgamating company with the amalgamated company (i.e. the assessee being the successor of the said amalgamating company) and the said merger was duly notified to the AO by the assessee. However, the AO passed a draft assessment order u/s 144C in the name of the non-existent amalgamating company. On appeal by the assessee, the Tribunal held that since the draft order framed u/s 144C was in the name of a non-existent company it was void–*ab initio*, and thus all the subsequent proceedings were non-est. However, for sake of completeness, the Tribunal adjudicated the other issues on merits.

ii. The Tribunal adjudicated the issue pertaining to TP adjustment on outstanding receivables from AEs. The Tribunal observed that the assessee was a debt-free company; it was a 100% captive service provider and neither any interest was charged from non-AE transactions nor interest was paid to its creditors/suppliers. In view of the above, the Tribunal deleted the interest adjustment qua outstanding receivables from AEs.

3 ***Goldman Sachs Investments (Mauritius) Limited***

[TS-496-ITAT-2020(Mum)]

Capital Losses brought forward by an assessee, being a tax resident of Mauritius, could not be adjusted against the capital

gains (short term and long term) earned from transactions executed in India which are exempt from taxation in India under India-Mauritius DTAA

Facts

i) The assessee, a tax resident of Mauritius, was registered with the Securities and Exchange Board of India (SEBI) as a Foreign Institutional Investor (FII) for carrying out portfolio investment activity in Indian capital market. During the year under consideration, the assessee had earned capital gains which inter alia included long term capital gains (LTCG) to the tune of INR 5.63 crores, short term capital gains (STCG) to the tune of INR 392.44 crores and incurred long term capital loss (LTCL) to the tune of INR 12.08 crores. The assessee, being a tax resident of Mauritius, claimed the capital gains earned on transfer of securities in India, as exempt from taxation in India under Article 13 of the India-Mauritius DTAA.

ii) Further, the assessee also had brought forward short term capital loss (STCL) to the tune of INR 3926.37 crores and LTCL to the tune of INR 7.64 crores. However, in the return of income for the year under consideration, the assessee neither set-off the brought forward losses nor current year LTCL against the capital gains earned during the subject year as the capital gains were exempt under Article 13 of the India-Mauritius DTAA. Accordingly, the assessee carried forward the entire brought forward losses from earlier years as well as the current year LTCL u/s 74(1).

iii) During the course of assessment proceedings, the AO proposed to reject the claim of the assessee to carry forward the total losses (i.e. of the current year as well the losses brought forward from the earlier years) on the ground that:

a. The assessee had not set-off the brought forward capital losses against the capital gain earned during the year under consideration, which violated the very purpose for which the capital losses were being brought forward and carried forward u/s 74.

b. Since the capital gain derived by the assessee were exempt in India under the India-Mauritius DTAA, the question of carry forward of capital losses from such transactions would not arise at all either in India or Mauritius.

c. Pursuant to the India-Mauritius DTAA, the "capital gains" arising to the assessee, a resident of Mauritius, was not chargeable to tax in India, therefore, the assessee was neither required to show income under that head in its return nor entitled to file a return showing "capital losses" merely for the purpose of getting the same computed and carried forward to the subsequent years.

d. Section 74 was not applicable to the assessee since the capital gains was not computed under the head 'capital gains' and the capital loss which were exempt under India-Mauritius DTAA did not fall within the term "total income".

e. Since the assessee claimed that the capital gains were not taxable

in India under the India-Mauritius DTAA, therefore, it would not be permissible on its part to revert back to the provisions of the IT Act to carry forward the capital losses derived from transactions executed in India.

iv) The assessee filed objections before the DRP against the draft of the AO proposing to reject the claim of the assessee to carry forward the total losses. The DRP gave partial relief to the assessee, as follows:

a. W.r.t the STCL brought forward from the earlier years, the DRP observed that since the carry forward was allowed in the previous years by the AO (which had already been computed and allowed to be carried forward to subsequent years by the A.O in his order passed u/s 143(3) for A.Y 2012-13), it was not within the jurisdiction of the AO to review the same and reject it in the year under consideration. However, the DRP held that the STCL brought forward from A.Y.2012-13, was required to be first adjusted against the STCG for the year under consideration i.e. A.Y 2013-14, and only the balance amount of STCL would be available for being carried forward to the subsequent years.

b. W.r.t the LTCL brought forward from earlier years, the DRP held that the same had to be adjusted against the current year LTCG and only the net should be allowed to be carried forward.

c. W.r.t the LTCL incurred during the year under consideration, the DRP held that the same could not be carried forward to the subsequent years, since loss from an exempt source (i.e. Article 13 of the India-Mauritius DTAA) could neither be allowed to be set-off nor could be allowed to be carried forward and absorbed against income from a taxable source in the subsequent years.

v) Accordingly, the present appeal was filed by the assessee before the Tribunal.

Decision

i) The Tribunal observed that the direction of the DRP i.e. the brought forward STCL be first adjusted against exempt short term and long term capital gains, and only the balance amount of brought forward STCL be carried forward to the subsequent years, was bereft of any reasoning and did not merit acceptance. The Tribunal observed that when admittedly the short term and long term capital gains earned by the assessee from transfer of securities during the year under question were exempt under Article 13 of the India-Mauritius DTAA, there would be no occasion for seeking adjustment of the brought forward STCL against such exempt income. In this regard, the Tribunal placed reliance on the co-ordinate bench decision in case of ***Flagship Indian Investment Company (Mauritius) Ltd. vs. ADIT (2010) 133 TTJ 792 (Mum)***.

ii) W.r.t the claim of the Revenue that by virtue of India-Mauritius DTAA, section 45 of the IT Act was rendered unworkable in respect of "capital gains"

derived by the assessee from transfer of securities in India, and that therefore, the "capital losses" would also not form part of the assessee's "total income" and thus, could not be computed under the Act, -- the Tribunal observed that the Revenue had lost sight of the fact that the "capital losses" in question had been brought forward from the earlier years and had been determined and allowed to be carried forward by the AO while framing the assessment for AY 2012-13, and had not arisen during the AY 2013-14. Accordingly, the claim of the AO that the "capital losses" bought forward from the earlier years, pertaining to a source of income that was exempt from tax was thus not to be carried forward to the subsequent years, was devoid of any merit, and liable to be rejected.

iii) The Tribunal also observed in case the assessee during one year does not opt for the DTAA, it would not be precluded from availing the benefits of the said DTAA in the subsequent years. Reliance in this regard was placed on the decision of Pune Bench in case of ***DCIT vs. Patni Computer Systems Ltd (2008) 114 ITD 159 (Pune).***

iv) Thus, the Tribunal concluded that the brought forward capital losses would not be adjusted against the capital gains earned during the year under consideration and directed the AO to allow carry forward of the brought forward STCL and LTCL to the subsequent years.

Note: It seems that the issue pertaining to carry forward of current year LTCL was not raised by the assessee before the Tribunal.

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Man is supposed to be the maker of his destiny. It is only partly true. He can make his destiny, only in so far as he is allowed by the Great Power.

Mahatma Gandhi

Never think there is anything impossible for the soul. It is the greatest heresy to think so. If there is sin, this is the only sin; to say that you are weak, or others are weak.

Swami Vivekananda

Never stop fighting until you arrive at your destined place - that is, the unique you. Have an aim in life, continuously acquire knowledge, work hard, and have perseverance to realise the great life.

A. P. J. Abdul Kalam