INTERNATIONAL TAXATION
Case Law Update

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A. High Court

1 *Commissioner of Income-tax (IT)-2 vs. Colgate Palmolive Marketing SDN BHD [(2023) 152 taxmann.com 124 (Bombay)]*

Where the assessee, a company incorporated in Malaysia entered into agreement with its Indian AE for use of assessee's SAP system, it was held that the consideration paid by AE to assessee did not amount to royalty under any clause of section 9(1)(vi), since assessee had merely given access to SAP system for a certain specific purpose and there was no transfer of any right in the process or any right or licence in respect of any copyright

Facts

i. Assessee, an entity incorporated in Malaysia, was engaged in the business of marketing, distribution and sale of household products, fabrics and personal care. The assessee along with its Indian AE, Colgate Palmolive India (CPI) entered into an agreement for use of assessee's SAP system, whereby CPI was required to make payments towards consideration for use of system, rendering services comprising of costs of maintenance, upgradation of system to keep it functional and fees for training personnel for using SAP system. The issue pertained to Assessment year 1999-2000. The assessee filed its Return of income for the said AY declaring 'nil' income.

ii. AO held that the payments received on account of use of SAP system were covered under the definition of 'royalty' as defined under Explanation 2 (iii) to section 9(1)(vi) and taxed the same.

iii. Furthermore, AO also observed that payments received on account of rendering services were in the nature of 'fees for technical services'.

iv. The CIT(A) confirmed the order of the AO.

v. The Hon'ble Tribunal reversed the order of the CIT(A) by holding that aforesaid amounts were neither taxable under the Act nor under the India-Malaysia DTAA.

vi. The Revenue filed an appeal before the Hon'ble Bombay HC.

Decision

i. The Hon'ble High Court noted that Clause (i) of Explanation 2 to Section 9(1)(vi) provides that royalty means consideration for the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trademark or similar property. It

held therefore, for the payment by CPI to the assessee to amount to royalty, it would be necessary that there should be transfer of any right in respect of a process or in any of the other things mentioned in clause (i), which was not so in the instant case.

ii. It further held that, as far as Clause (ii) of Explanation 2 to Section (9)(1)(vi) was concerned, the same would apply if there was imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trademark or similar property. In the present case, the assessee had not imparted any information to CPI concerning the working of, or the use of, any process or any of the other things mentioned in Clause (ii). Thus, Clause (ii) was also not applicable.

iii. Further, it noted that clause (iii) of Explanation 2 to Section 9(1)(vi) applies if there is any use of any patent, invention, model, design, secret formula or process or trademark or similar property, and that, in the present case, CPI was only accessing the SAP system of the Assessee and was not using any process of the assessee or any of the other things mentioned in Clause (iii).Thus, Clause (iii) was also not applicable.

iv. The Hon'ble High Court held that, Explanation 6 to Section 9(1)(vi) clarifies that the expression "process" includes and shall be deemed to have always included transmission by satellite, cable, optic fiber or by any other similar technology, whether or not such process is secret. It held that, Explanation 6 includes within the definition of process, live transmission of programs such as channel feed, and not access of the SAP system of the Assessee as done by CPI, which is a standard facility provided by the assessee to CPI and is used for input of data and generation of reports. In these circumstances, Explanation 6 also did not take the case of the Revenue any further.

v. It further held that, the amount paid by CPI to the assessee could not be considered as royalty under Explanation 5 as CPI had been granted a limited access to the SAP system by establishing a communication line at its own cost for use of data available in the SAP system. Thus, payment made by CPI could not be regarded as payment for use of the system and therefore, the same did not amount to royalty under the said Explanation 5.

vi. It relied on ***Engineering Analysis Centre of Excellence Private Limited vs. Commissioner of Income Tax and Anr. reported in (2022) 3 SCC 321*** and held that it was very clear that, for clause (v) to Explanation 2 to apply, it is necessary that there must be a transfer of a right in respect of a copyright as mentioned in Section 14(b), read Section 14(a), of the Copyright Act, 1957. If there is no transfer of any right in respect of any copyright of any literary or artistic or scientific work, then clause (v) to Explanation 2 would not be applicable. In the present case, the Assessee had not transferred any right in respect of any copyright of any literary or artistic or scientific work to CPI and had only given access of the SAP system to CPI.

vii. The Hon'ble High Court further held that even if Explanation 4 to Section 9(1)(vi) is taken into consideration, the same provides that the transfer of all or any rights in respect of any right, property or information includes, and has always included, transfer of all

or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred. For Explanation 4 to apply again there has to be transfer of right to use a computer software. In the present case, the Assessee had not transferred to CPI the right to use any computer software. It had only allowed CPI to access the SAP system. For this reason, on facts, even Explanation 4 is not applicable.

viii. With reference to the issue as to whether the impugned amount could be taxed as business profits in India, the Hon'ble HC held that the assessee did not have a PE in India as defined in Article 5 of the DTAA which defines the Permanent Establishment as inter alia a place of management, a branch, an office, a factory, a warehouse, a workshop etc. Consequently, by virtue of the provisions of Article 7 of the DTAA, the payment received by the assessee from CPI, which would be business profit, was not taxable in India.

ix. Accordingly, Hon'ble HC dismissed the Revenue's appeal.

B. Tribunal

2 *Baker Huges Energy Technologies UK Ltd vs. ACIT (IT) [(2023) 151 taxmann.com 78 (ITAT - Delhi)]*

Where assessee, a U.K. based company was awarded a contract for offshore manufacture and supply of equipment and parts to ONGC, it could not be taxed in India u/s 44BB in the absence of a PE

Facts

i. The assessee was a company incorporated in, and a tax resident of United Kingdom (UK) and a part of Baker Hughes Group of companies. The assessee along with four other consortium members was awarded a contract by ONGC for manufacture and supply of sub-sea production system components.

ii. The assessee contended that the proceeds from offshore manufacture and supply of equipment and parts to ONGC was not taxable in India since neither the assessee had a Permanent Establishment (PE) in India nor could provisions of Section 44BB be applied to sale of equipment made from outside India.

iii. The Assessing Officer held that the "consortium member is working on behalf of the Assessee Company which forms the PE of the Assessee Company". The AO further held that the assessee was also involved in survey, installation and commissioning of the equipment in India and since the payments could not be bifurcated, the entire receipt of the assessee was taxable in India under Section 44BB of the Act. The findings of the AO were based on information said to be provided by ONGC under Section 133(6) of the Act.

iv. Before the DRP, the assessee contended that the AO had failed to point out which consortium member and which office constituted PE of the assessee. It also contended that the AO had failed to point out, the nature of PE, when such PE was constituted. It was also argued without prejudice that section 44BB does not apply to offshore sale of equipment.

v. The DRP held that Section 44BB applied to sale of equipment in this case and

the issue of PE was academic in nature. Also, the DRP placed reliance on the decision of the Supreme Court in ***ONGC vs. CIT (2015) 59 Taxmann.com 1***, to hold that offshore supplies were also covered within the ambit of Section 44BB. (Author's Note – The said Supreme Court decision dealt with provision of service and not off-shore supply of equipment)

vi. Aggrieved by the order of the DRP, the assessee filed an appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal noted that, as rightly contended by the assessee, a reading of the section 44BB showed that the said section provided that notwithstanding anything contained in sections 28 to 41 and section 43 & 43A, 10% of the gross receipt of a non-resident engaged in the business of providing services or facilities or supplying plant & machinery on hire which was used in prospecting for or extraction of mineral oils should be deemed to be the profits & gains of business.

ii. It held that though section 44BB provides a presumptive taxation rate for computation of profits, it does not override provisions of sections 5, 9 or section 90 of the Act. It relied on ***Sedco Forex International vs. CIT 399 ITR 1 (SC)***.

iii. It further held that it is a settled proposition that unless Revenue is able to prove that the assessee has a PE in India, its business profits cannot be subject to tax in India. It observed that the judgement by the Hon'ble Delhi Tribunal in the case of R&B Falcon Offshore Ltd. fully supported this view wherein it was clearly held that in absence of a PE, section 44BB had no application.

iv. The Hon'ble Tribunal noted that the AO has not identified when did the specific PE came into existence or how the offshore supply of equipment was attributable to the PE. The Hon'ble Tribunal also noted the argument of the assessee's counsel that there was no finding in the assessment order as to which consortium member and which office of such consortium member constituted PE of the assessee in India.

v. It further added that the DRP had not addressed the issue as it considered it to be academic and its findings were contradictory to the view taken by the Hon'ble Tribunal in the decision mentioned above.

vi. It also relied on the decision of the Hon'ble Apex Court in the case of ***ADIT vs. E-Funds (2018) 13 SCC 294***, wherein it was held that the burden of proving the existence of PE was on the Revenue, which was not done in the given matter.

vii. The Hon'ble Tribunal thus deleted the addition on the basis that, as there was no finding of PE in this case, section 44BB was not applicable.

C. Tribunal

3 *ADM Agro Industries Kota & Akola (P.) Ltd. vs. Assistant Commissioner of Income-tax, Circle 1(1) [(2023) 151 taxmann.com 232 (Delhi - Trib.)]*

Where the assessee computed its profit level index (PLI) using value added cost as base and it was found functionally comparable to business auxiliary service providers, the PLI adopted by the assessee was upheld, by rejecting the action of the TPO to add cost of goods in the denominator of the PLI for comparable companies for computing ALP.

Facts

i. Assessee undertook merchanting trade in agricultural commodities between its AEs. It had benchmarked such activities by applying TNMM using Operating Profit (OP)/Value Added Cost (VAC) as Profit Level Indicator (PLI) and selected 13 companies in business auxiliary services segment as comparables and as against margin shown by assessee at 604.17%, average margin of comparables worked out to 5.51% - 11.12%, Assessee, thus claimed said transactions to be at arm's length.

ii. TPO, however, did not accept assessee's claim and he observed that while PLI of comparables was Operating Profit(OP)/ Operating cost(OC), PLI of assessee was OP/VAC and, thus, he observed, that PLI of OP/VAC, otherwise known as Berry ratio, had rendered benchmarking of assessee flawed - Adopting OP/ OC as PLI of assessee, he proceeded to determine arm's length margin of assessee qua comparables and proposed an adjustment.

iii. The DRP upheld the action of the TPO.

iv. The assessee filed an appeal to the Hon'ble ITAT.

Decision

i. The Hon'ble Tribunal held that in merchanting trades, the assessee had entered into a purchase contract with one of its overseas AE, viz, ADM Sarl and sold the purchased goods to another overseas AE, ADM Asia Pacific. Though, technically, the assessee had entered into purchase and sale contracts for buying and selling goods, however, in reality, the assessee merely acted as a facilitator of buying and selling of goods between the two AEs. As per the business model, the goods purchased from ADM Sarl were sold to ADM Asia Pacific in high seas without entering the custom barriers of India. Thus, essentially, the goods were transferred in the high seas from original seller of goods to the ultimate buyer without entering into the territorial waters of India. Thus, factually, the goods never came to assessee's inventory and stored in any warehouse in India. In fact, the aforesaid purchase and sale transactions between the two overseas AEs through the assessee took place instantaneously on back-to-back basis. Even, the entire logistics of loading and unloading the commodities were managed by the overseas AEs, viz., ADM Sarl and ADM Asia Pacific.

ii. It held that the assessee was neither engaged in arranging logistics nor in packaging or labelling of the commodities. These facts were clearly demonstrated from the purchase and sale invoices, where, the purchase and sale transactions were completed in a single day, instantaneously. It is also a fact on record that both the seller and buyer were pre-determined, and prices

of the commodities were pre-fixed. The assessee only provided certain administrative functions. Hence, the role of the assessee was limited. Thus, to recover the administrative cost with little mark-up, the assessee was remunerated at 10 basis points of the purchase invoice.

iii. It Hon'ble Tribunal concluded that it was clear that the functions performed, and risk undertaken by the assessee was that of a business auxiliary service provider and not different from them. It was further established from the fact that the comparables selected by the assessee were business auxiliary service providers and the TPO had found them to be functionally similar to the assessee. That being the functionality of the assessee and the comparables, it needs to be examined whether PLI adopted by the assessee is acceptable. The TPO had rejected the PLI of OP/VAC on the ground that it is not in conformity with Rule 10(B)(1)(e). The DRP had endorsed the view of the TPO.

iv. It held that, on a holistic reading of Rule 10B(1)(e), it becomes clear, that the computational mechanism is in several steps. In the first step, the net profit margin of the enterprise (in the present case, the assessee) realised from the international transaction with AE has to be computed in relation to cost incurred or sales effected, or assets employed or to be employed by the enterprise or having regard to any other relevant base. In the second step, the net profit margin realised by an enterprise (in the present case, comparables) from a comparable uncontrolled transaction or several such transactions is computed having regard to the same base. The net profit margin of the assessee can be computed not only in relation to cost incurred, or sales effected or assets employed, but, having regard to any other relevant base also. The expression "any other relevant base" is wide enough to align the computation of margin of the assessee and the comparables.

v. It further held that, if we go by the provision of rule 10B(1)(e), the return on value added cost, otherwise known as berry ratio, is not completely excluded from its purview. It can be a relevant base for computing the margin. The berry ratio in simple terms means a ratio of gross profit to operating expenses. Therefore, where operating expense is considered as a relevant base, there would be no difficulty in using berry ratio as PLI in terms of Rule 10(B)(1)(e). It relied on the case of ***Sumitomo Corporation India(P) Ltd. vs. CIT (TS-493-HC-2016(DEL)-TP)***.

vi. It concluded that the only variation made by the TPO to the PLI of the assessee was to add the cost of goods to the denominator. However, it was a fact on record that the operating cost of the comparables were not inclusive of cost of goods, as they were business auxiliary service providers, hence, they did not have any cost of goods. Since, the assessee was found to be functionally comparable to the business auxiliary service providers, it was established that the assessee had undertaken limited functions and risk in the merchanting trades segment and earns a fixed profit margin. Therefore, the cost of goods could not be included in the denominator of the PLI.

vii. Accordingly, the Hon'ble ITAT directed the AO to compute the ALP by applying PLI of operating profit to value added cost, excluding the cost of goods.

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