INTERNATIONAL TAXATION
Case Law Update


CA Tarunkumar Singhal & Sunil Moti Lala,
Advocates

A. SUPREME COURT

1 ***PCIT vs M/s S.G. Asia Holdings (India) Pvt Ltd.***
[TS-775-SC-2019] – Civil Appeal No. 6144 of 2019

In View of Instruction No. 3/2003 dated 20.05.2003 issued by CBDT, where the aggregate value of International transactions during the year exceeds ₹ 5 crores AO should mandatorily make a reference them to TPO for computation of ALP.

Facts

1. The assessee company was engaged in the business of brokering and dealing in shares and other securities. Return of income was filed on 31.10.2005 declaring total income at ₹ 24,31,82,750/- In the impugned AY it had received certain amount of brokerage from its parent company. After considering the material on record, AO noted that brokerage charged by the assessee was only 0.05% which was lower rate as compared to the prevalent rates in market. The AO, therefore, while computing the Income under Section 143(3) of the act, made an addition of ₹ 2,89,82,746/- under Section 92 of the Act.

2. The CIT(A) confirmed the addition made by AO and dismissed the appeal.

3. On further appeal, the Tribunal set aside the findings rendered by the first two lower authorities and held that transfer pricing adjustment made by the AO was contrary to the mandatory instructions issued by CBDT in its Instruction No. 3/2003 dated 20.05.2003 as no reference was made to the TPO. It also rejected the argument of DR that the case may be set aside to the file of the AO so that he may refer the matter to the TPO holding that the Tribunal being an Appellate authority cannot interfere in the administrative matters which are mandatory as per the provisions of the Act. As reference to the TPO was an administrative matter which was supposed to be followed by the AO which he had failed to do so, the Tribunal cannot make good the such lapse made by the AO.

4. The view so taken by the Tribunal was affirmed by the High Court

5. Aggrieved, the Revenue filed an appeal before the Supreme Court.

Held

1. The Apex Court observed that Instruction No.3/2003 issued by the CBDT contained the following requirement :

"If there are more than one transaction with an associated enterprise or there are transactions with more than one associated enterprise the aggregate value

of which exceeds ₹ 5 crores, the transactions should be referred to the TPO. ... ...".

2. Thus, Tribunal was right in observing that by not making reference to the TPO, the Assessing Officer had breached the mandatory instructions issued by the CBDT.

3. However, it held that Tribunal ought to have accepted the submission made by the DR and the matter ought to have been restored to the file of the AO so that appropriate reference could be made to the TPO. It would therefore be up to the authorities and the Commissioner concerned to consider the matter in terms of Sub-Section (1) of Section 92CA of the Act.

4. Accordingly, the appeal filed by the Revenue was allowed to the aforesaid extent and AO was directed to take appropriate steps in terms of Instruction No. 3/2003.

B. HIGH COURT

2 ***PCIT v Transacend MT Services Pvt. Ltd***
[TS-734-HC-2019] (Del) –ITA 263/2019

Assessment made by AO on an entity which had ceased to exist due to amalgamation was held to be void ab initio

Facts

1. The Assessee was primarily engaged in the provision of IT enabled services in the area of medical transcription to its parent company in the USA and other AE's.

2. The AO had passed final assessment order on 22nd February, 2011 after making Transfer pricing adjustment in conformity with the order of TPO.

3. On assessee's appeal, the CIT (A) directed inclusion of 4 comparables in the final set of comparables and directed the TPO to calculate the ALP accordingly.

4. Aggrieved by the order of the CIT (A), the Revenue filed an appeal in the Tribunal. Also, the Assessee filed Cross Objections before the Tribunal contending that Heartland Delhi Transcription & Services Pvt. Ltd. (HDTS) in whose name the assessment was framed had been amalgamated with Heartland Information & Consultancy Services Pvt. Ltd. (HICS) pursuant to the order dated 25th July 2008 passed by Delhi High Court. Further, the name of the new amalgamated entity got changed to Transcend MT Services Private Limited (TMTS) i.e. the respondent assessee in present appeal. Thus, the assessment framed by AO on 22nd February 2011 on a company that had ceased to exist from 25th July 2008, was void ab initio.

5. The Tribunal relying on *PCIT vs. Maruti Suzuki India Limited (2017) 397 ITR 681 (Del)* as well as *Spice Infotainment vs. CIT (2012) 247 CTR (Del) 500* [which was affirmed by the Supreme Court in C.A. 285 of 2014 *CIT vs. Spice Enfotainment*] held that the assessment framed by the AO on a non-existent company would be void ab initio. Thus, Tribunal quashed the assessment whilst allowing the cross objections of the Assessee.

6. Aggrieved, the Revenue filed an appeal before the High Court

Held

1. The Court noted that there was indeed a letter dated 19th October, 2008 filed with the AO informing him that pursuant to the order dated 25th July, 2008 of Delhi High Court, HDTS had amalgamated with HICS. The said information was also given to the CIT (A). Copies of those letters were also placed before the Tribunal. Despite this, the assessment order was framed on 22nd February, 2011 against the erstwhile company i.e. HDTS.

2. Thus, the Court held that clearly there was no question of a mere clerical error warranting invocation of Section 292B of the Act. There

was a sea change with the original entity against which the assessment was framed viz., HDTS as it had long ceased to exist at least three years prior thereto and had got amalgamated with HICS and then amalgamated entity was re-named as TMTS.

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

3 ***PCIT vs Torus Business Solution Pvt Ltd*** *[TS-756-HC-2019(Del)] - ITA 207 of 2019*

Infosys BPO Ltd., TCS E-serve International Ltd, TCS E-serve Ltd, Accentia Techonologies Ltd, E4e Healthcare Business Services Pvt. Limited were held to be not comparable to a Captive Simple ITes service provider

Facts

1. The Assessee was engaged in the business of knowledge process outsourcing, data processing service and rendering back office support services to Torus group.

2. The assessee had selected 13 Comparables in its TP Study report and arrived at a margin of 14.13%. The TPO rejected all comparables selected by assessee and selected 10 new comparables thereby arriving at a margin of 31.73%. DRP rejected the objection raised by the assessee for exclusion of the comparables. Thus final assessment order was passed by AO in conformity with the order of TPO.

3. The Tribunal allowed assessee's appeal and excluded following comparables - Infosys BPO Ltd TCS E-serve International Ltd, TCS E-serve Ltd, Accentia Techonologies Ltd, E4e Healthcare Business Services Pvt Limited

4. Aggrieved, the Revenue filed an appeal before the High Court.

Held

1. The Court noted that it had in a recent judgement [*M/s. Avaya India Pvt. Ltd. vs. ACIT, ITA 532 of 2019*] given detailed reasons as to why on the facts of that case, which were more or less similar to the facts on hand, such comparables ought to have been excluded. It also noted that Tribunal had in the impugned order explained in detail as to why these comparables were be excluded. Following were the reasons for exclusions :-

- Infosys BPO Ltd – as it was engaged into high end integrated services and Infosys brand resulted in higher operating profits.
- TCS E-serve International Ltd – as annual report of the company did not provide any segmental information related to ITES as well as software development services. Also it owned intangibles of substantial amount and it was making payment for the use of Tata Brand.
- TCS E-serve Ltd – as in addition to BPO services, it was also engaged in technical services such as software testing, verification and validation. Also, Segmental data was not available and it was making payment for the use of Tata Brand
- Accentia Techonologies Ltd – as it was engaged into diversified activities such as Knowledge Process outsourcing(KPO), Legal process outsourcing(LPO), Data process Outsourcing(DTO) and high end software services. Also, Segmental data was not available and company had undergone business restructuring during the year under consideration thereby giving rise to extraordinary circumstances.
- E4e Healthcare Business Services Pvt Limited - as it was also into software development services and segmental information was not available. The company was also a 100% EOU

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

4 ***PCIT vs. Symphony Marketing Solutions India Pvt Ltd***

[TS-783-HC-2019 (Del)] - ITA No.414 and 717 of 2018

Infosys BPO cannot be considered as comparable to an entity providing simple ITes services captively

Facts

1. The assessee was engaged in the business of providing marketing data management services to customers of Symphony Marketing Solutions, USA.

2. The assessee included 8 comparables in its TP Study with an average profit margin of 14.34% on cost. Thus the margin earned by the Assessee at 15.95% on total costs was treated as being at arm's length. The draft order of the Assessing Officer (AO) on the basis of TPO's order proposing additions was passed. The Assessee filed objections before the DRP who confirmed the action of the TPO in selecting new comparables.

3. On appeal by assessee, the Tribunal directed the exclusion of the comparables agreeing with the Assessee that they were not functionally similar to the Assessee.

4. Aggrieved, Revenue filed an appeal before the High court for exclusion of Infosys BPO Ltd .

Held

1. The Court noted that Infosys BPO provided business process management services to organisations over a wide range of industries whereas the Assessee was a routine captive service provider. The valuation of goodwill of Infosys BPO for AY 2009-10 and 2010-11 was INR 19.03 crores and there was no comparable value for the Assessee. The brand promotion expense for Infosys BPO for AY 2009-10 was INR 70.26 lacs and for 2010-11 INR 69.16 lacs and the corresponding figures for the Assessee were Nil. Also, Infosys BPO had incurred significant selling and marketing expenses for the two AYs in question whereas there was no such expense incurred by the Assessee.

2. The Court also noted that the Assessee provided IT services only to its US based AEs whereas Infosys was among top 10 third party BPO companies in India. Thus, even the risk profiles of both the companies were different as Infosys BPO was a full-fledged risk taking enterprise, whereas the Assessee undertook minimal risks as 100% services were being provided to its AEs.

3. The Court further noted that in case of *PCIT vs. M/s.Sanvih Info Group Pvt. Ltd. [ITA 420 of 2019*] which had similar facts Infosys BPO Ltd was excluded.

4. Accordingly, the appeal filed by the Revenue was dismissed.

5 ***Pr.CIT vs. Nomura Structured Finance Service Pvt Ltd.***

[TS-816-HC-2019(BOM)-TP] – ITA NO. 738 OF 2017

The Court derided Revenue for filing routine appeals and directed CBDT to issue appropriate directions. Ruled on comparability for entity providing ITeS services to its AE by excluding Coral Hubs (Vishal Informations) and including CG VAK as comparables

Facts

1. The assessee was engaged in the business of providing information technology enabled services (ITeS) to its AEs. During AY 2009-10, assessee adopted TNMM and used operating profit by operating cost (OP/OC) as PLI to benchmark its international transaction. The PLI of the assessee company was computed by the assessee at 16.25% whereas the average PLI of the comparables was computed at 16.22% as per the analysis in the transfer pricing report. Thus, assessee claimed its international transactions to be at ALP.

2. On a reference being made to TPO, a revised search process was conducted with the final list having several comparables and the PLI was computed at 29.16%. The TPO had included Coral Hubs (Vishal Information Technology Ltd.) as comparable and excluded CG Vak Software & Exports as comparable noting that it was a consistently loss making company.

3. The DRP and the Tribunal ruled on selection of comparables and excluded Coral Hubs and included CG Vak Software as comparables.

4. Aggrieved, the Revenue filed an appeal before the High Court.

Held

1. The Court noted that the Tribunal had rightly noted that assessee sought exclusion of Coral Hubs (Vishal Information) from the list of comparables, since this company's business model was radically different from the industry norms, as evident from the fact that employee cost was only 2% of total cost, which implied that work was being outsourced. Thus, the Tribunal accepted assessee's submissions and stated that various co-ordinate benches including in the case of Maersk Global Service Centre had held this company to be incomparable, inter alia, on the ground that it had outsourced ITeS work and directed exclusion of this comparable.

2. Regarding comparability of CG-VAK Software, the High Court stated that the concurrent finding of fact by DRP and the Tribunal i.e CG-VAK software could not be excluded from the list of comparables as it has made profits in financial year 2008-09 had not been shown to be perverse. Therefore, the question as framed did not give rise to any substantial question of law.

3. Further, the Court also held that the above appeal by department was filed in a normal course, without considering whether the issue gave rise to a substantial question of law, to be challenged in appeal. The Court referred to co-ordinate bench ruling in case of Barclays Technology Centre India where Revenue's appeal was dismissed since it failed to show any perversity in Tribunal's orders. The Court noted that despite the same, Revenue continued to file appeals in respect of the TP issue as a matter of routine and/or standard operating procedure even when no substantial question of law arose. The Court thus stated that *"We trust that the authorities would examine this issue at the highest level and ensure that no unnecessary appeals such as this, which are factual in nature, without being perverse are, filed to this Court"*. The Court thus directed the Registry to forward a copy of this order to the CBDT, so that the appropriate directions could be given to the Commissioners of Income Tax.

4. Accordingly, the appeal filed by the Revenue was dismissed.

6 *Pr.CIT vs. Nokia Siemens Network India P Ltd*

[TS-733-HC-2019 (Delhi)] - ITA No. 692 of 2019

The Court upheld inclusion of loss making comparables considering industry trend of declining revenues and held mere loss or decline in revenues could not be a ground to reject otherwise comparable companies from the set of comparables

Facts

1. The assessee, was engaged in the business of inter alia manufacturing and trading of telecom equipment and other related services. On reference to TPO, it excluded three companies viz., ITI Ltd., Punjab Communications and Himachal Futuristic Communications Ltd. on the grounds of persistent losses and declining revenues and the same was upheld by CIT(A).

2. On appeal by assessee, the Tribunal differed from the view expressed by the TPO and directed inclusion of the three companies.

3. Aggrieved, Revenue filed an appeal before the High court.

Held

1. The Court upheld Tribunal's decision which had accepted assessee's submissions that the finances of these companies with reference to its annual report, did show that there was a general trend in the industry of either loss-making or declining revenues. However, in the absence of any dissimilarity as to the functions performed, assets utilized and reasons undertaken, mere loss making or decline in revenues could not be a ground to reject otherwise comparable companies from the set of comparables and the Tribunal had followed jurisdictional HC ruling in Chryscapital Investments Advisors. Thus, the Court opined that the opinion expressed by the Tribunal was a plausible one in the light of facts and circumstances of the case.

2. Accordingly, the appeal filed by the Revenue was dismissed.

7 ***Bank of Tokyo Mitsubishi Ltd. vs. Commissioner of Income-tax, (International Taxation) -***
[2019] 108 taxmann.com 242 (Calcutta) -ITR NO. 39 OF 1998

Since clause 24(2) of DTAA agreement between Indian and Japan provides that a permanent establishment of an entity of one country in other country shall not be subjected to less favourable terms than an assessee carrying on similar activities in other country, assessee a permanent establishment of a Japanese company was liable to pay tax at the same rate as Indian companies carrying on same activities for relevant assessment year and not 65%

Facts

1. In the instant case, the assessee was a permanent establishment of a Japanese company in India and in respect of assessment year 1991-92, the assessee herein was assessed as not being a domestic company and the tax rate of 65% was imposed. The same view was upheld by the Commissioner and the Tribunal.

2. Aggrieved, the Assessee filed an appeal before the High Court.

Held

1. The Court held that there was no dispute that an Indian company which was a domestic company would have been charged to tax at a lower rate than the 65% which was imposed on the assessee by virtue of it not being regarded as a domestic company. The disparity between the rates applicable to Indian and foreign companies was not in issue. However, since clause 24(2) of the DTA agreement between the two countries i.e India and Japan provided that a permanent establishment of an entity of one country in the other country shall not be subjected to less favourable terms than an assessee carrying on similar activities in the other country, the assessee in this case was liable to pay tax at the same rate as the Indian companies which were carrying on the same activities for the relevant assessment year.

2. The Court concluded that the stand taken in the Tribunal's order could not be appreciated or accepted since a similar clause in the double taxation avoidance agreement between India and the Netherlands was similarly interpreted by the Central Board for Direct Taxes and a circular was issued to that effect. The Tribunal in the present case had held that since there was no similar circular for DTAA of India and Japan, the said benefit could not be extended to the assessee under the India- Japan Treaty.

3. The Court in response concluded that when there was no dispute that there was a double taxation avoidance agreement in place between India and the country of origin of the assessee in the present case and when such agreement contains a lucid clause as apparent from Article 24(2) and when Section 90 of the Act itself recognises such an agreement and creates a special status for the relevant permanent establishments, there was no room for either the Commissioner to wait for any dictat from the high command of the CBDT or for the Tribunal

to demonstrate similar servile conduct in not appropriately interpreting and giving effect to the clear words of the agreement between the two countries

4. Thus, the Court held that the Tribunal was incorrect in holding that the rate of tax applicable to the assessee was 65% and concluded that the Tribunal ought to have held that the rate applicable to the assessee was such rate as applicable to a domestic company carrying on similar activities.

C. Tribunal Decisions

8 ***Adidas India Marketing (P.) Ltd vs. ITO***
[TS-439-ITAT-2019(DEL)]

Assessment Year: 2010-11

Insurance compensation received by a Foreign Parent Company to protect its financial interest in Indian subsidiary is not taxable in India

Facts

i) The Assessee, a resident Indian company, was engaged in the business of sourcing, distribution and marketing of products under brand name 'Adidas' in India. During the tax year under consideration, the Assessee received insurance claim from an Indian insurer on account of loss of stock and fixed assets by fire in its premises in India.

ii) F Co, a German company, is the ultimate parent/holding company of the Assessee. Under a global policy, F Co has entered into various GIPs with a foreign insurer to protect the financial interest in subsidiaries world-wide, including India.

iii) In respect of loss incurred by the Assessee, F Co also received insurance compensation under GIP from its insurer in Germany for loss in economic value of the financial interest in the Assessee. The compensation received was reduced by the amount of compensation received by the Assessee from Indian insurer. Further, F Co paid taxes in Germany on the compensation received under GIP.

iv) The Assessing Officer contended that the insurance compensation received by F Co was in respect of loss of stock of the Assessee. Further, the e-mail correspondences of between the Assessee and F Co indicated that all receipts from insurance, relating to physical loss, business interruption and mitigation cost belongs to the Assessee. Thus, the Assessing Officer contended that there is a direct business relationship of the overseas compensation received with the business activities of the Assessee and insurance claim received abroad should be taxed in India in the hands of the Assessee.

v) The Dispute Resolution Panel (DRP) also held that insurance compensation was taxable in the hands of the Assessee as the profit foregone on the lost stock and loss suffered on other assets are part and parcel of the business of the Assessee in India.

vi) Aggrieved by the above, Assessee preferred an appeal before the Tribunal.

Decision

The Income-tax Appellate Tribunal held in favour of the assessee as follows:

1. The Assessee contended before the Tribunal as under:

    a) The insurance compensation received by the Assessee and the F Co were under two separate and distinct contracts of insurance with unrelated third-party insurers. The premium was paid separately by the respective claimants without any cross charge.

    b) The GIP covered only the financial interest of F Co in the Assessee and not the assets owned by the Assessee. Whereas, the insurance policy taken by the Assessee exclusively covered the risk arising out of loss of stock and fixed assets owned by it.

c) The privity of the insurance contract in India was with the Assessee and the GIP was with F Co. The Assessee was not a contracting party to the GIP.

d) Income "accrues" to the Assessee only when the Assessee acquires the right to receive it. In the present case, in the absence of actual or constructive receipt, such income should not be taxable in India in the hands of the Assessee.

e) Further, no income accrued to the Assessee as the Assessee had not acquired any unconditional and absolute right to receive claim of compensation under the GIP.

f) F Co had undertaken the GIP with the foreign insurer for all its investments worldwide, including India.

2. The Tribunal held that insurance compensation received by F Co under GIP was not taxable in India in the hands of Assessee for the following reasons:

a) Insurance policy between the Assessee and the Indian insurer was to secure stock-in-trade which is a tangible asset, whereas the GIP between the F Co and the foreign insurer was for securing investment made or financial interest in subsidiaries, which is an intangible asset. Thus, the interest insured by the Assessee and F Co are two different interests.

b) The insurance contracts entered by Assessee and F Co were separate and independent, as i) the premium was paid separately by the claimants and no part of the premium on GIP was allocated to the Assessee; ii) the privity of contract was with respective parties.

c) As the Assessee does not have any right or obligation in GIP and was not a party to the GIP, the Assessee did not have any right to receive the claim of insurance or the said claim was not vested in the Assessee for the same to be regarded as accruing in the hands of the Assessee. Reliance was placed on the Supreme Court's decision in the case of ED Sassoon [26 ITR 27(SC)].

d) The claim under GIP was in respect of insured financial interest of F Co in its subsidiaries and compensation was also settled for diminution in financial interests. Merely because the computation of the claim was with reference to loss on fire of the stock or profit which could have been earned if such stock was sold cannot be construed to mean that the claim was in respect of loss of tangible property in the form of stock of the Assessee. The claim was in respect of the intangible asset in the form of financial interest of F Co and thus the claim of insurance cannot be said to have any "business connection" in India.

e) The insured interest of F Co in its subsidiaries cannot be said to be through or from any property in India or through or from any asset or source of income in India. F Co has entered into contracts in Germany for insuring the intangible asset in the form of financial interest in its subsidiaries, which is quite distinct from the physical stock-in-trade of the Assessee, lost in fire. Thus, the claim received by F Co cannot be treated as income deemed to accrue or arise in the hands of the Assessee in India.

f) Further, the e-mail correspondences were exploring the modes of transfer of money from F Co to the Assessee, in order to restore the financial interest in the Assessee and the same cannot determine the tax liability. Such correspondences were related to application of money and do not indicate in whose hands the same was taxable.

g) The GIP was taken to cover the contingent losses that may or may not arise in future. Further, as F Co has actually paid premium in respect of GIP from time to time and also paid tax in Germany in relation to the insurance claim, there was no colorable device adopted by the Assessee for evading taxes in India.

9 *CAE Flight Training (India) Pvt. Ltd vs. ACIT*

[TS-440-ITAT-2019(Bang)]

Whether CCDs are Debts or equity and interest on it is allowable or not? - Tribunal Rejects TPO's application of 'Thin Capitalisation' principle to disallow interest, in the absence of specific thin capitalization rules in India, and held that re characterization of Debt Capital as equity Capital and disregarding of interest was not in order - Tribunal rejects TPO's reliance on RBI's FDI policy which reckons fully and mandatorily convertible debentures within a specified time as equity, observes that RBI's definition of convertible debentures is in context of FDI policy to exercise control on future repayment obligations in convertible foreign currency and was inapplicable in the context of allowability of interest on CCDs

Assessment Years: 2009-10 to 2013-14

Facts

a) Assessee (CAE Flight Training (India) Pvt Ltd) paid interest at the rate of 15% upon issue of Compulsory Convertible Debentures (CCDs) to its three associated enterprises (AEs) namely, Flight Training Mauritius, Emirates Dubai and CAE Hungary during AYs 2009-10 to 2013-14. These three international transactions, in respect of such interests paid, were referred by the AO to the TPO for determination of their respective arm's length prices. TPO characterised CCDs as equity capital and disallowed interest thereon.

b) Aggrieved by TPO's addition, assessee filed an appeal before CIT(A) for AY 2009-10 and 2013-14, who held that CCD's were debt and not equity and allowed interest of 12.62% and @ 13.25% respectively, instead of assessee's claim of 15%. For AY 2010-11, assessee approached DRP who similarly held that CCD's were debt and not equity and determined the ALP at LIBOR Plus rate and granted additional risk adjustment of 1%. For AY 2011-12 and 2012-13, however DRP held that the CCD's were equity and not debt and held that interest on CCDs was not allowable.

Aggrieved, both the assessee and the Revenue filed appeal before the Tribunal.

Decision

The Tribunal held in favour of the assessee as under:

A) Re: Applicability Thin Capitalisation Principle invoked by the TPO/AO.

i) The Tribunal noted the CIT (A)'s finding that Mumbai ITAT in case of Besix Kier Dabhol, SA [TS-19-ITAT-2010(Mum)] ruled in assessee's favour holding that in the absence of specific thin capitalization rules in India, re characterization of Debt Capital as equity Capital and disregarding of interest was not in order. Tribunal held that even if thin capitalization Principle was on Statute book of the other country, no disallowance could be made in India by applying this principle. Tribunal thus upheld the finding of CIT (A) by respectfully following this order.

B) Re: Applicability of RBI's comments on CCDs under FDI policy

ii) However Tribunal observed that the objections of AO/TPO were not merely on the basis of thin capitalization principle but on the basis of FDI policy of RBI. TPO had relied on certain comments of RBI in 2007 Policy on convertible debentures in which it was stated that fully and mandatorily convertible debentures into equity within a specified time would be reckoned as equity under FDI policy. Noting that TPO's decision was based on RBI policy of FDI, Tribunal observed that RBI policy of FDI was governed by future repayment obligation in convertible foreign currency and since, CCDs did not have any repayment obligation, RBI considered the same as equity for FDI policy. In view of this RBI Policy, the TPO had concluded that these CCDs were equity and not debt and therefore, interest on it was not allowable u/s 36(1)(iii).

iii) Tribunal held that such treatment given by RBI for FDI policy cannot be applied in every aspect of CCDs. Tribunal stated that holder of CCDs did not have voting rights nor could it receive any dividend on such CCDs before its conversion. Applying the same logic, Tribunal opined that till the date of conversion, for allowability of interest u/s 36(1)(iii) also, such CCDs are to be considered as Debt only and interest thereon has to be allowed and it cannot be disallowed by saying that CCDs are equity and not debt.

iv) Thereafter, Tribunal noted that Revenue relied on Special Bench ruling in case of Ashima Syntex Ltd where the issue in dispute was allowability of expenses incurred on issue of such debentures unlike in case of assessee, which is allowability of interest on CCDs for a period before conversion. ITAT thus opined that the ratio in case of Ashima Syntex Ltd was not applicable to assessee's case.

v) Tribunal noted that Revenue reiterated the same arguments which were adopted by the TPO in its order i.e. regarding RBI Master Circular on Foreign Investment in India dated 02.07.2007 and 01.07.2008. Tribunal observed that such circular in the context of FDI policy of RBI was in a different context i.e. regarding future re-payment obligations in convertible foreign currency and to have control over such future re-payment obligations, the RBI was exercising strict control so that such future re-payment obligations do not go beyond a point. Tribunal held that since in the case of fully convertible debentures, there was no future re-payment obligation, the same was considered as equity for the purpose of FDI policy.

vi) Tribunal opined that any definition of any term is to be considered keeping in mind the context in which such definition was given. ITAT stated that this definition of convertible debentures given by RBI was in the context of FDI policy to exercise control on future re-payment obligations in convertible foreign currency and was inapplicable in assessee's case where the context was allowability of interest or payment of dividend or granting of voting rights to the holders of such convertible debentures before the date of conversion.

vii) Tribunal held that dividend cannot be paid on such convertible debentures in a period before the date of conversion and such holders of convertible debentures cannot be granted voting rights at par with voting rights of shareholders during pre-conversion period. On the same analogy, Tribunal opined that interest paid on convertible debentures for pre-conversion period cannot be said to be interest on equity. ITAT thus held that interest on debentures was allowable u/s. 36(1) (iii).

C) Re: ALP of interest on CCDs

i) Tribunal noted that for the initial year i.e. AY 2009-10, there was no discussion or decision on ALP aspect by TPO and AO. Tribunal observed that CIT (A) in that year had held in a very cryptic manner that 15% interest claimed by the assessee was not at arm's length because as per SBI Corporate Office Website, it was 12.25% on 01.01.2009 and 13.00% as on 10.11.2008. Tribunal found that CIT (A) directed the AO/TPO to rework the ALP at 12.62% which appeared to be average of these two lower and upper rates of SBI PLR as noted. ITAT further found that in later years, DRP adopted ALP of interest at LIBOR plus but in those years also, TPO had not decided the ALP aspect.

ii) Tribunal noted assessee's claim that ALP of interest should be decided in AY 2009-10 itself, being the initial year in which CCDs were issued. Tribunal found that there was no decision of any of the lower authorities in any year. Tribunal thus considered it appropriate to restore the issue of ALP to AO/TPO for all of these years for a decision as per law after providing adequate opportunity of being heard to the assessee.

iii) Tribunal thus remitted the issue of whether interest should be bench marked in A. Y. 2009-10 only being the year of issue or in each year, whether it should be bench marked on the basis of LIBOR plus or PLR and if LIBOR is adopted then whether Risk Adjustment is to be allowed or not and if it is to be allowed, at what rate.

10 *AGR Matthey of Western Australia Through representative assessee PEC Limited vs. ADIT*

[TS-456-ITAT-2019(DEL)]

Article 11(2) of India-Australia DTAA- Interest on Letter of credit (LC) (with respect to bullion sale to Indian entity) as 'income from other sources' (IFOS) without allowing deduction for discounting charges on LCs- interest had not arisen out of a loan facility, but it was part of transaction of high-seas sale of bullion and assessee had discounted LCs within day or two of usance of LCs for which it incurred identical amount of discounting charges- held that "such interest partakes of the character of the purchase price itself and could not have been put to tax under the residual head of income from other sources- Revenue erred in ignoring live link between interest income and discounting charges and grossly picked one ignoring the other - Article 11(2) cannot be invoked as relevant credit does not qualify as 'interest' within the meaning of Sec 2(28A) so as to allow taxation under Article 11(2) India Australia DTAA – Held: In favour of the assessee

Assessment Year: 2005-06

Facts

i) AGR Matthey of Western Australia (assessee), a foreign company sells gold/bullion to PEC Ltd, a Govt. of India undertaking against issuance of letters of credit (LC). PEC Ltd is also the representative assessee for filing the return of the assessee. During the AY 2005-06 PEC Ltd issued LC's against the supply of gold by the assessee, which are accepted through the assessee's bankers in Australia. The assessee was entitled to charge an interest on the LCs at the rate LIBOR +0.5% margin p.a.

ii) The assessee, in its return of income for AY 2005-06 declared interest income of ₹ 25.71 Cr and claimed an equal amount against such income as discounting charges on various LC's issued by PEC Ltd. The AO disallowed the claim of the discounting charges on the LC's discounted and taxed the entire interest income under the head "Income from Other Sources".

iii) Upon appeal, CIT(A) agreed with the AO's contention of taxing the interest income in terms of Article 11(2) of the India-Australia DTAA, in the source country (i.e. India) and dismissed the appeal of the assessee.

Decision

On assessee's appeal, the Tribunal held in favour of the asseessee as under:

i) Tribunal noted that there is no interest credit arising to the assessee as the LC's are discounted with the bankers at Australia within two days of Usance of LC. Tribunal observed that the AO himself admitted in the assessment order that "…Interest in this case is not interest simplicitor, i.e., it does not arise out of a loan liability. The interest is in the context of a transaction of high-seas sale of bullion, a part of the cost of such bullion itself. Thus, the same is in the nature of business expenditure and incurred only to facilitate the transaction of sale of bullion."

ii) Tribunal opined that the revenue authorities erred in giving findings contrary to their own narration of the facts. ITAT noted the live link between the interest income and discounting changes Relying on the SC judgement in the case of Coconada Radhaswami Bank Ltd and Delhi HC's judgement in the case of Cargill Global Trading (P) Ltd., Tribunal further noted that such interest forms part of the transaction value itself and could not be taxed under the head 'income from other sources' as contended by the Revenue.

iii) Further, Tribunal observed that the revenue disregarded Article 7 of DTAA between India and Australia, as per which no tax liability can be determined in the absence of a permanent establishment in India. Tribunal noted that in order to invoke Article 11(2) of the DTAA, an onus is cast to establish how the income is taxable "according to the laws of the state" which in this case is India. Tribunal observed that the relevant receipt was not covered under the definition of interest under section 2(28A) and hence, cannot be taxed as income from other sources.

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The Valuers
YARDI PRABHU
The Consultants
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Please Contact

YARDI PRABHU CONSULTANTS & VALUERS PVT. LTD.

T: 022 67970100 upto 198 & 61435200 upto 299 • M: 7045903249
Email : info@valuersindia.in • Web : www.valuersindia.in