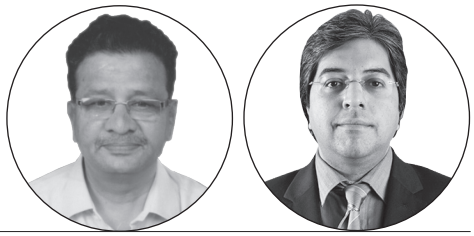
INTERNATIONAL TAXATION

Case Law Update



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A. High Court

1 *Hitachi Hi Rel Power Electronics (P.) Ltd vs. DCIT [129 taxmann.com 304-HC-2021(GUJ)-TP]*

Where the AO proceeded to pass order of reference to TPO, without giving an opportunity of hearing to the assessee, the HC quashed the impugned reference and remitted the proceedings to the AO for fresh consideration

Facts

i) The assessee was engaged in the business of manufacturing Industrial Automation Solution, Rotating Machine Control, Power Controller, Uninterrupted Power Supply and Power Conditioning products. In relation to A.Y. 2017-18, the assessee had availed an unsecured External Commercial Borrowing (ECB) rupee loan from the Hitachi International Treasury Limited, Singapore, for the purpose of working capital. This loan carried an interest @7.19% per annum. The assessee had filed Form 3CEB, wherein there was a requirement in clause 14 to make a disclosure about the loan or borrowing of money and the amount paid/received in the transaction. According to the assessee it had appropriately disclosed the transaction (i.e. interest payment) in the Form 3CEB.

ii) The AO issued a show cause notice dated 18th November 2019, under section 142(1), which inter alia read as under:

"..During the previous year, assessee company has taken loan from Hitachi International Treasury limited to the tune of ₹ 20 Crores @ 7.19% interest. Further same was required to be reported in 3CEB but assessee has failed to do so. Therefore you are requested to show cause as to why penalty u/s 271AA of the Act should not be initiated in your case. In addition to that you are request to show cause as to why your case is not referred to TPO for determination of arm's length on such unreported transaction…."

iii) The assessee, vide its reply dated 25th November 2019, tried to explain to the AO that the disclosure in Form 3CEB was appropriate and the same was not defined in any manner. The assessee stated that it had disclosed the factum

of obtaining loan and the amount of interest paid/payable as well as the method used to determine the ALP of the same. It further clarified that there was no obligation of reporting the "loan transaction" amount in the Form 3CEB. Since only the interest paid on such loan transaction would have a bearing on the profit/loss which alone was required to be reported at clause 14 of the Form 3CEB.

iv) The AO vide order passed by him dated 4th December 2019, over-ruled the objections raised by the assessee and proceeded to make a reference to the TPO who issued impugned notice dated 20th December 2019, under sections 92CA(2) and 92D(3) of the Act.

v) The assessee, being aggrieved with the reference made by the AO to the TPO and also with the notice issued by the TPO under section 92CA(2) read with Section 92D(3) of the Act, filed a writ petition before the Hon'ble Gujarat High Court.

vi) Before the Hon'ble High Court, the assessee submitted that that the A.O. had completely overlooked the jurisdictional requirement of a satisfaction in accordance with para 3.4 of the CBDT instruction 3/2016 that there ought to be an income or a potential of an income arising and/or being affected on determination of the A.L.P. of an international transaction or specified domestic transaction. In the absence of such satisfaction being recorded as to the income or a potential of an income, the entire exercise undertaken by the A.O. could be termed as illegal and without jurisdiction. Neither at the time of issue of show cause notice nor in the order disposing of the objections, there was any whisper of income or a potential income arising and/or being affected on the determination of the A.L.P. of an international transaction of the loan of ₹ 20 Crore. There was no satisfaction on the part of the A.O. that there was any income arising on the determination of the A.L.P. of loan transaction and in such circumstances, it could be said that the A.O. had no jurisdiction to refer the matter to the T.P.O. The transaction of loan being on the capital account, there was no impact on income. The assessee had disclosed the transaction of payment of interest and the same had not been disputed. The transaction of loan separated from income was on the capital account and had no impact on the income and therefore, there was no question of computing the A.L.P. of loan per se. In such circumstances, the very basis of the reference to the T.P.O. was contrary to para 3.4 of the instruction 3/2016 and therefore, illegal. The assessee inter alia relied upon Indorama *Synthetics (India) Ltd. vs. Add CIT [2016] 71 taxmann.com 349 (Delhi)* and the Revenue inter alia relied upon *M/s. Veer Gems vs. Asst CIT [Special Civil Application No. 12648 of 2011 decided on 19th October 2011]*

Decision

i) The Hon'ble High Court held that the following two questions arose for consideration:

1. Whether it was incumbent on the A.O. to have given the writ applicant an opportunity of being heard before making a reference to the T.P.O. under section 92CA(1) of the Act?

2. Whether the Assessing Officer could be said to have overlooked the jurisdictional requirement of a satisfaction in accordance with para 3.4 of the instruction No. 3 of 2016 that there ought to be an income or a potential of an income arising and/or being affected on determination of the A.L.P. of an international transaction or specified transaction? In the absence of recording of such satisfaction, as to the income or potential of an income, could it be said that the entire exercise undertaken by the A.O. is illegal?

ii) The Hon'ble Gujarat High Court noted that apparently, the Delhi High Court in Indorama Synthetics (India) Ltd. v. Add CIT (supra) disagreed with the decision of the Jurisdictional High Court (i.e. Gujarat) rendered in the case of M/s. Veer Gems (supra) on the issue whether the A.O. must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise. The Delhi High Court relying on the decision of the Bombay High Court in Vodafone India Services (P) Ltd held that an opportunity of hearing must be given to the assessee by the AO before he makes a reference to the TPO. Whereas, the Gujarat High Court in M/s. Veer Gems (supra) took the view that having regard to the provisions under Chapter X, the A.O. is not obliged in any manner to hear the assessee. The only obligation on the part of the A.O. is to consider the objections of the assessee and only thereafter make a reference to the T.P.O. to compute the Arm's Length Price.

iii) The Hon'ble High Court held that it would not have taken even a minute to reject the contention raised by the assessee as regards the opportunity of hearing not being given to his client by following the dictum as laid by this High Court in M/s. Veer Gems (supra). However, it noted that in the judgement rendered by the Delhi High Court in the case of Indorama Synthetics (supra) in para 20 the Court noted that the C.B.D.T. had accepted the legal proposition as explained by the Bombay High Court in ***Vodafone India Services (P) Ltd's case (supra***) and had not gone by the decision of the Gujarat High Court in M/s. Veer Gems's case (supra). The Delhi High Court proceeded to note in para 20 that the instruction No. 15 of 2015 dated 16th October 2015 issued by the C.B.D.T., which sets out, inter alia, the procedure to be followed by the A.O. had since been replaced by the instruction No. 3 of 2016 dated 10th March 2016. The Delhi High Court, thereafter, proceeded to quote para 3.4 of the instruction No. 3 of 2016, after referring to para 3.4 of the instruction, and concluded that the A.O. must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise.

iv) The Hon'ble Court noted that if the C.B.D.T. itself had accepted the dictum as laid by the Bombay High Court in Vodafone India Services (P) Ltd (supra) and followed by the Delhi High Court in Indorama Synthetics (supra), then, there was no good reason to take the view that no opportunity of hearing is required to be given to the taxpayer by the A.O. before recording his satisfaction or otherwise. Undoubtedly, in the case on hand, a show cause notice was issued by the A.O. and reply was filed by the assessee and considering the

reply, the A.O., thereafter, proceeded to pass the order of reference to the T.P.O. The Hon'ble High Court concluded that an opportunity of hearing should have been given by the A.O. before he proceeded to overrule all the objections and refer the matter to the T.P.O.

v) The Hon'ble High Court referred to the CBDT instruction No. 2 of 2015 dated 29th January 2015 and observed that the following was discernible from the aforesaid:

(a) The tax can be charged only on income and in the absence of any income arising, the issue of applying the measure of Arm's Length Pricing to the transactional value/consideration itself would not arise.

(b) If income is noticed, chargeable to tax under the normal provisions of the Act, then, alone Chapter X of the Act could be invoked.

vi) The Hon'ble High Court accepted the contention raised by the assessee that the A.O. had overlooked/ignored the jurisdictional requirement of a satisfaction in accordance with para 3.4 of the instruction No. 3 of 2016 referred to above that there ought to be an income or potential of an income arising and/or being affected on determination of the A.L.P. of an international transaction or specified domestic transaction. In the absence of such satisfaction being recorded in the order while disposing of the objections, the reference to the T.P.O. would also be without jurisdiction. The Court took notice of the fact that though in the objections, a specific plea in this regard was taken, there was not a word in this regard in the order disposing of the objections.

vii) In light of the above, the Hon'ble High Court quashed the impugned reference by the AO to the TPO and the notice dated 20th December 2019, issued by TPO and remitted the proceedings to the A.O. for fresh consideration of the matter with the direction to give an opportunity of hearing to the assessee and thereafter, proceed to pass a reasoned order or a speaking order dealing with the objections of the assessee in accordance with law.

2 *CIT vs. M/s SSL-TTK Ltd. [TS-385-HC-2021(MAD)-TP]*

In order to invoke the power under Section 271G of the Act, the authority, viz. the Assessing Officer or the TPO or the Commissioner (Appeals) has to render a finding that there was a total failure by the assessee to furnish information called under Section 92D(3) of the Act

Facts

i) The assessee, a public limited company was engaged in the business of manufacturing of foot care and footwear products to the domestic and export markets. It was a joint venture between a UK Company and an Indian Company.

ii) The assessee filed it's return of income admitting loss for AY 2006-07 (the year under consideration). The case was referred to the TPO by the AO under section 92CA for computing the Arms Length Price. The TPO held that there was no need for adjustment and the AO, in his order, accepted the total income(loss) filed by the assessee in the return.

iii) However, the AO levied penalty on the assessee under Section 271-G on the alleged ground that the assessee did not comply with the letter issued by the TPO dated 25th November 2008, directing the assessee to furnish the information in terms of Section 92D and Section 92E, till 24th December 2008. Accordingly, the AO levied a penalty of 2% of the value of the international transaction.

iv) On appeal by the assessee against the order of the AO, the CIT(A) allowed the appeal. Aggrieved by the same, the Revenue preferred appeal before the Tribunal, which was dismissed.

v) On Revenue's appeal before the Hon'ble Madras HC, the HC held as under:

Decision

i) The Madras High Court ('HC') observed that though the AO made a reference to the TPO, the TPO, on going through the documents filed by the assessee, was satisfied and passed the order stating that no addition was required to be made. The AO had accepted the income(loss) filed by the assessee. It was thereafter that the AO had levied penalty under Section 271G on the Assessee.

ii) The HC further observed that in the appeal before the Tribunal, the Tribunal noted that the TPO's notice dated November 25, 2008, was a notice issued under Section 92D(3).The above mentioned section requires any person entering in an international transaction to furnish the information or the documents mentioned within a period of thirty days.

iii) The HC, noted that the penalty proceedings were not initiated by the TPO but by the AO and observed that the out of the 16 documents which the assessee was called upon to furnish by the TPO, 12 of them had infact been complied with by the assessee. This conduct of the assessee could be considered as a reasonable act of an organization acting with prudence under normal circumstances without negligence or inaction or want of *bonafides*.

iv) The HC, however, did not accept the explanation given by the assessee, of being a novice to transfer pricing transactions, for not properly complying with the letter of the TPO. Further, the HC did not accept the contention of the assessee that the notice issued by the TPO was not a valid notice under Section 92D(3).

v) However, the HC concluded that there was no finding recorded by the AO to prove that the conduct of the assessee lacked *bonafides* or that there was supine indifference on the part of the assessee in not producing the records called for by the TPO.

vi) In light of the above, the HC upheld the order of the Tribunal deleting the penalty levied under Section 271G.

B. Tribunal

3 *Telenor ASA vs. Dy. CIT [129 taxmann.com 198-ITAT-2021(Delhi)]*

Fee received by the assessee, a tax resident of Norway, pursuant to business service Agreement (BSA) with Indian Company (Unitech Wireless) for providing services under Independent SOFs (i.e. Service Order Forms) was taxable as business profit and

not as FTS as the assessee had a Service PE in India in terms of article 5(2)(l) of the India- Norway DTAA on the grounds that a) all the activities of assessee were inter-connected and inter laced b) the time spent by employees of assessee in India (i.e. 260 days) during relevant year, while rendering services to Unitech Wireless, exceeded threshold provided in that article (i.e. 6 months)

Facts

i) The assessee, a tax resident of Norway, entered into Business Service Agreement with Unitech Wireless (Tamil Nadu) India P. Ltd effective from April 1, 2009. As per the BSA, the assessee provided services under independent SOFs (i.e. Service Order Forms) to Unitech Wireless (UW). Such income, as per the assessee was in the nature of "fees for technical services" (FTS) and so offered to tax @10% on gross basis, relying on Article 13 of DTAA between India and Norway.

ii) The AO held that the assessee had a PE in India in terms of Article 5(2)(l) of the Treaty on the following grounds:

(i) The employees of assessee had stayed in India for a period of 260 days, which exceeded the threshold provided in item (l) to Paragraph (2) of Article 5 of the treaty;

(ii) The consultancy services rendered by various employees were for the same project, in as much as the SOFs were in accordance with the Agreement and were governed by the provisions of the said Agreement;

(iii) The SOFs were in nature of job orders where the activities to be performed, its details and persons rendering such services were mentioned and the clauses of the SOFs bound it to the Agreement only;

(iv) The arrangement of rendering services and payment of fee were made in accordance with para 3 read with para 4 of the Agreement only. Accordingly, it was concluded that the SOFs were not separate agreements;

(v) Fee received from Unitech Wireless (UW), which was in the nature of 'fees for technical services' (FTS) was "effectively connected" with the PE of the assessee and in terms of Article 13(5), income of the assessee was liable to be taxed as per Article 7 of the Treaty read with section 44DA of the Act

iii) The AO held that the time spent by employees of the assessee in India during the relevant year, while rendering services to Unitech Wireless, exceeded the threshold provided in that Article and attributed 100% of the receipts to the PE of the assessee in India and computed the income of the PE of the assessee at ₹ 8,26,76,663 in relation to the service fee received from Unitech Wireless after allowing deduction of expenses @40%.

iv) The DRP upheld the AO's order. Aggrieved, the assessee filed appeal before the Hon'ble Tribunal.

Decision

The Hon'ble Tribunal after going through the Business Service Agreement, copies of invoices, details of employees, project wise agreements, details of activities, scheme of billing, working of split time, commentary on

Article 5 regarding PE and various case laws supported by both the parties, held as under:

i) With regard to assessee's contention that services specified in various SOFs constituted specific project and that mere mention of the varying services and common agreement did not make it consolidated project, the Tribunal found the said contention to be incorrect on the facts of the case, particularly in the light of the agreement dated 18-8-2010 between the assessee namely Telenor SA and Uninor which defined the mutual obligations and implementation. There was no other inter-se agreement with any of the parties or among the parties. Thus, the business service agreement was a single unified agreement.

ii) With regard to assessee's contention that different services under SOFs were not inter related and were unique, the Tribunal held that it was necessary to go through the entire activity of the assessee with relation to the UNINOR . UNINOR services were launched simultaneously in the circles Tamil Nadu, Kerala, Karnataka, Andhra Pradesh, Uttar Pradesh East, Uttar Pradesh West and Bihar (including Jharkhand), making it the widest coverage operator within India. The launch of UNINOR services happened after Telenor Group finalized the transaction with Unitech Group and made the first investment into UNINOR. The statement of the Stein-Erik Vellan, Managing Director of UNINOR at the time of launch "with launch in seven circles and roaming agreements in place for the rest, we have started our service in India on day one as a pan-Indian national operator. This is a proud achievement of a committed and talented team. While our launch today is indeed a milestone in a longer journey to become a significant operator in India, we are delighted to have made such a strong start" augmented the fact that there were only two entities involved UNINOR and Telenor, the assessee.

iii) With regard to the scheme of billing, the Tribunal noted that the bills were raised on quarterly basis and consolidated invoices raised irrespective of the SOFs under which the services were rendered. The common billing by the recipient and the common payments gave rise to a conclusion that it was one single contract.

iv) The Tribunal went through the various SOFs which involved sourcing activities, marketing activities, ITeS activities, network activities, project activities and relied on the following extract commentary of the OECD with regard to the Article 5(2)(l):

"The reference to an "enterprise ... performing these services for the same project" should be interpreted from the perspective of the enterprise that provides the services. Thus, an enterprise may have two different projects to provide services to a single customer (e.g. to provide tax advice and to provide training in an area unrelated to tax) and whilst these may be related to a single project of the customer, one should not consider that the services are performed for the same project.....

The reference to 'connected projects' is intended to cover cases where the services are provided in the context of separate projects carried on

by an enterprise but these projects have a commercial coherence .The determination of whether projects are connected will depend on the facts and circumstances of each case but factors that would generally be relevant for that purpose include:

— Whether the projects are covered by a single master contract;

— Where the projects are covered by different contracts, whether these different contracts we concluded with the same person or with related persons and whether the conclusion of the additional contracts would reasonable have been expected when concluding the first contract;

— Whether the nature of the work involved under the different projects is the same;

— Whether the same individuals are performing the services under the different projects.

Sub-paragraph (b) requires that during the relevant periods, the enterprise is performing services through individuals who are performing such services in that other State. For that purpose, a period during which individuals are performing services means a period during which the services are actually provided, which would normally correspond to the working days of these individuals. An enterprise that agrees to keep personnel available in case a client needs the services of such personnel and charges the client standby charges for making such personnel available is performing services through the relevant individuals even though they are idle during the working days when they remain available".

v) While answering the above hypothetical questions, the Tribunal held that the activities of the assessee with regard to the recipients for services could be said to be inter-connected, inter laced, sequential technical services. It could not be said that they were unrelated to each other as none of the activity could stand in isolation with the other activity and no single activity could give rise to performance and achieving of the purpose of the recipient. Thus, based on the unified agreement, consolidated billing pattern, the Tribunal held that the activities being inter related as found in the preceding paras, the existence of the PE of the assessee was undeniable.

vi) The issue of determination of the profits was remanded back to the file of the Assessing Officer to pass an order by taking into consideration, the services rendered by the assessee from India and also from Norway and the evidence of the expenses incurred as submitted by the assessee. However, the Tribunal agreed with the assessee that revenues raised out of the services rendered from Norway could not be attributed to the PE of the assessee.

4 *DHR Holding India Pvt Ltd vs. JCIT [TS-370-ITAT-2021(DEL)-TP]*

Amortisation of goodwill and non-compete fees, being non-operating in nature, should be excluded for TNMM margin computation

Facts

i) The Assessee, a Danaher Group Company, setup in 2007, was engaged

in the business of trading of various medical instruments and products. The assessee also rendered business support services and marketing support services to its Associated Enterprises (AE) and benchmarked the aforesaid two transactions separately by applying TNMM as the most appropriate method by taking operating profit/operating cost as the PLI.

ii) The TPO considered business support services and distribution of marketing services as a single segment, on the ground that they were similar in nature. The TPO further observed that the assessee had considered 'amortization of goodwill' and non-competing fees paid as non-operating item. The TPO was of the firm belief that since depreciation on intangible asset was charged to the profit therefore, amortization of goodwill should also have been considered as part of operating cost like depreciation. He thus recomputed the margin by aggregating the aforesaid two segments and treating amortization of goodwill as well as non-compete fees paid as an operating item.

iii) The order of the TPO was upheld by the DRP. The assessee filed an appeal before the Tribunal.

Decision

i) The Tribunal noted that the assessee had acquired certain business operations from third party. As a result of this acquisition, the assessee recognized a part of the purchase price as goodwill and non-compete fees in its balance sheet and for computation of tested party margins, the assessee considered amortization of goodwill and non-compete fees as non-operating expenses as these did not pertain to the provision of services to the AEs.

ii) The Tribunal referred to Rule 10B(1)(e) of the ITAT Rules which states as under:

"(e) transactional net margin method, by which,-

(i) the net profit margin realized by the enterprise from an international transaction [or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base"

iii) The Tribunal observed that, as evident from the above Rule, only cost incurred in relation to international transaction for provision of service to the AEs should be considered in computation of operating margin and that the same was in line with the Guidelines of OECD, which at para 2.80, mentions as under:

"2.80 Non-operating items such as interest income and expenses and income taxes should be excluded from the determination of the net profit indicator. Exceptional and extraordinary items of a non-recurring nature should generally also be excluded."

iv) Further, the Tribunal relied upon the co-ordinate bench decision in the case of:

a) Imsofer Manufacturing India Pvt. Ltd (5158/DEL/2015 and 1049/DEL/2016), wherein it was held as under:

"7. In our considered opinion a provision for impairment of assets is not a depreciation charge nor amortisation of fixed assets but it is a provision made to the carring amount of the fixed assets which is reversible in nature. Moreover section 92 (1) of the Act requires that any income arising from an international transaction/allowance for any expenses shall be computed having regard to arms length price. In our considered view impairment of assets cannot be related as international transaction of the assessee. Further the provision for impairment of assets is not regular business expenditure since it is not recurring in nature and is not related normal business operation and hence not in the nature of operation expenses, therefore, in our considered opinion the same cannot be treated as operating expenditure for the calculation of PLI of the assessee. We accordingly direct the AO/TPO to exclude provision of impairment of assets as operating expenditure. This ground is accordingly allowed..."

b) Ericsson India Ltd (ITA No. 168/DEL/2015) wherein it was held as under:

"...Perusal of the order passed by ld. DRP available at page 2681 relevant portion at page 2691, shows that amortization of goodwill is an extra-ordinary item and is not pertaining to the regular operation of the assessee, and hence non-operating in nature. So, in these circumstances, we direct the TPO to verify the facts and treat the amortization of the goodwill as non-operating expenditure in order to compute the operating margin of the assessee..."

v) Further, the Tribunal also noted that, in subsequent AYs, the TPO had considered amortization of goodwill and non-compete fees as non-operating expenses.

vi) Considering the facts of the case in totality, in light of the decisions of co-ordinate bench, the Tribunal directed the AO to treat amortization of goodwill and non-compete fees as abnormal and non-recurring expense and exclude them while computing TNMM operating margin earned from provision of services to AEs.

vii) Since, post the exclusion of amortization of goodwill and non-compete fees from operating expenses while computing TNMM margin, the margin of the assessee would be at ALP, the Tribunal did not find it necessary to dwell into the issue relating to the comparables.

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