VERENDRA KALRA & CO
CHARTERED ACCOUNTANTS

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COMMUNIQUE

INTERNATIONAL TAX

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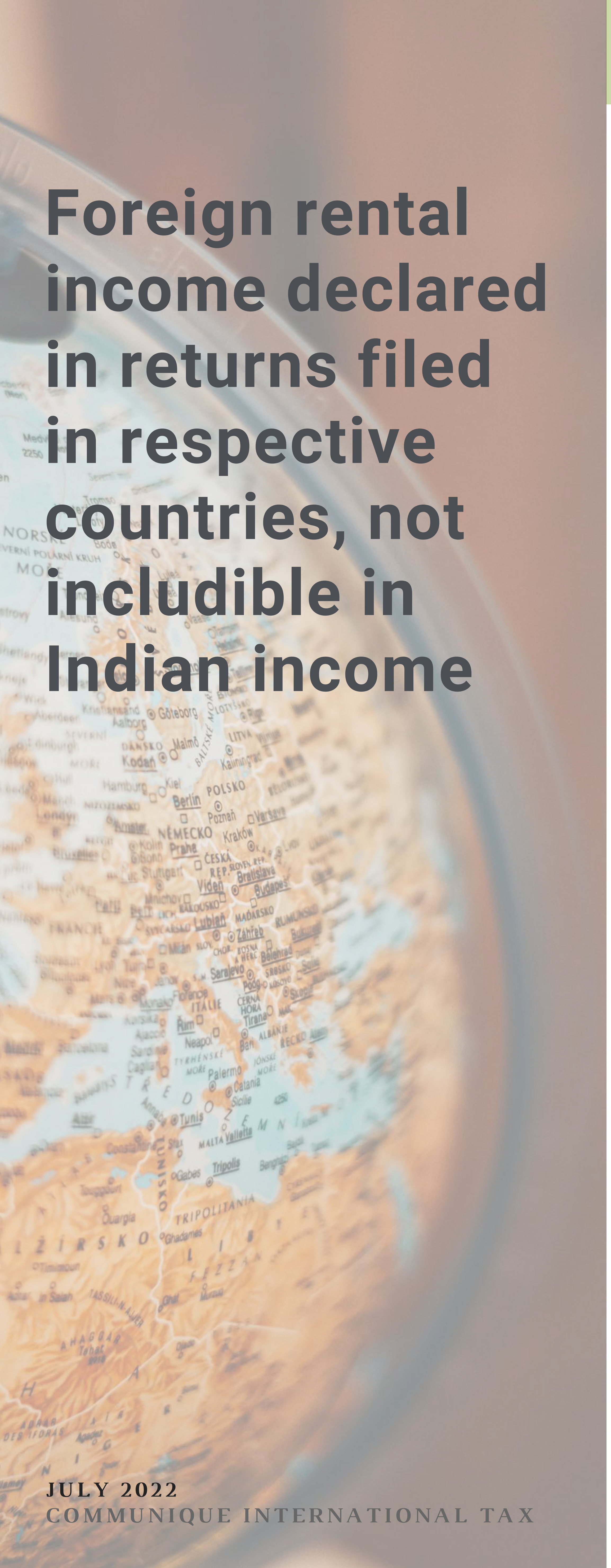
Inside this edition

Foreign rental income declared in returns filed in respective countries, not includible in Indian income



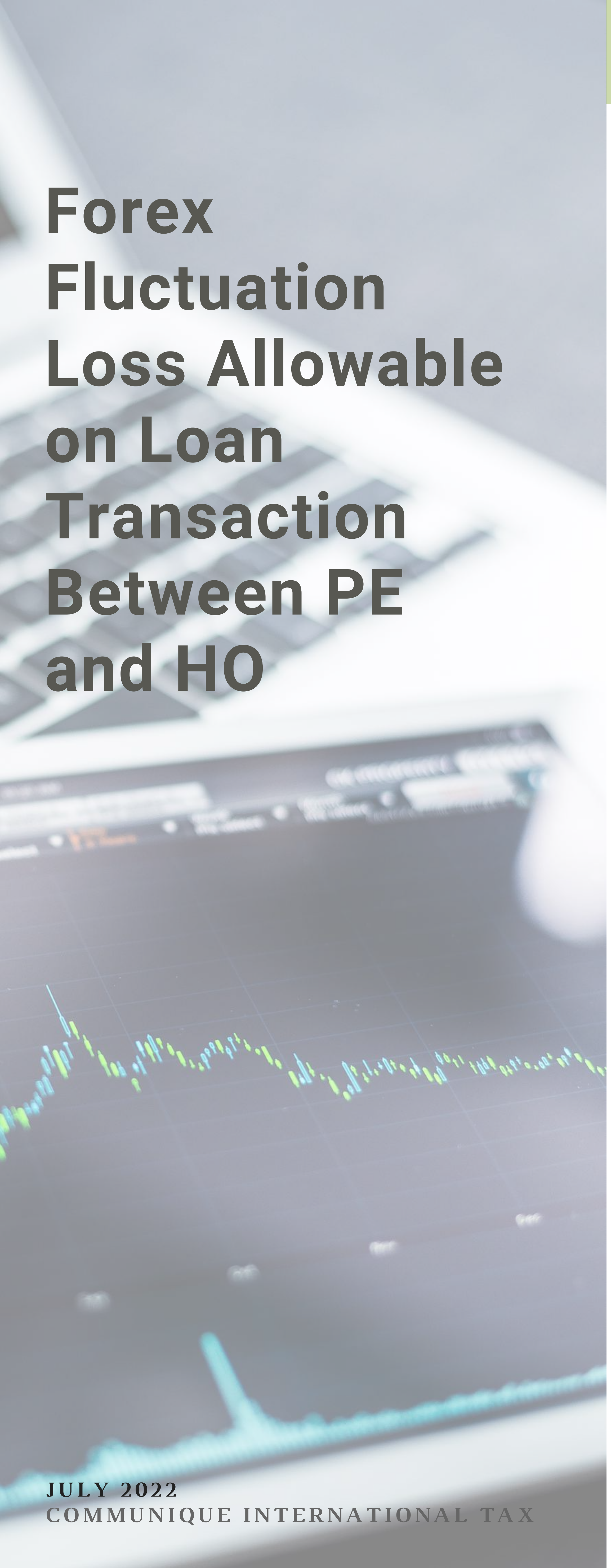
Facts

The assessee was a tax resident of India and was receiving rental income from the properties held by her in England and Australia. She declared that her this rental income received by her was filed in her return of income in England and Australia respectively. The Assessing Officer {*hereinafter referred to as 'AO'*}, however, brought this rental income to tax by overlooking the fact that the assessee had previously declared the income as rental income from properties situated in England and Australia. The AO relied upon Article 6(1) of the DTAA between UK and India which states that income from an immovable property may be taxed in the contracting state that the property is situated in. The AO further relied upon Notification No. 91/2008 dated 28.08.2008 and took the words "may be taxed" as "shall be taxed".

Ruling

The tribunal ruled in favor of the assessee by allowing her appeal. In order to reach its decision, the tribunal relied upon section 90 (1) (a)(i) of the Income Tax Act 1961, {*hereinafter referred to as 'the Act'*}. As per the relevant provision the Central Government may enter into an agreement with the Central Government of another country outside India or specified country outside India in order to facilitate double taxation relief in matter of income upon which income tax has been paid both under this Act in India as well as the respective Act outside India. The Tribunal after its perusal of the necessary legislations, held that, "*Thus we find in the absence of an express provision, the right of the resident country to tax its residents cannot be taken away under the DTAA. Therefore, the expression "may be taxed" cannot be construed to mean "shall be taxable only in the resident state" unless it is expressly stated.*

Source: Tribunal, Delhi in Natasha Chopra vs. DCIT dated 30th June 2022 vide TS-535-ITAT-2022(DEL)



Forex Fluctuation Loss Allowable on Loan Transaction Between PE and HO

Facts

The assessee company, Cobra Instalaciones- Y-Servicios has its registered office in New Delhi and is a Permanent Establishment of the Spanish company M/s Cobra Instalaciones- Y-Servicios SA which has been incorporated as per the laws of Spain. The Foreign company is engaged in providing services and consultancy in projects, Engineering and Electrical contractors and suppliers. The PE of the foreign company is in existence in India since A.Y. 1995-96 and has been providing the same services since then. For Assessment Year 2016-17, the assessee filed its Return of Income in 2017 declaring a loss of Rs.3,79,65,686/-. As per the audited Balance Sheet for the year ended 31.03.2016, the assessee was deriving income from execution of various projects and the loss as per P&L Account was Rs.15,29,03,617/-.

During the course of assessment, the AO asked the assessee to justify the allowability of foreign exchange loss. In response, the assessee submitted that the project office was engaged in the activity of executing certain infrastructure projects for which funds were required as a part of working capital requirement and the same were provided by its Head Office. The AO did not allow the notional foreign exchange loss on restating the outstanding amount to the head office. The AO took a position that capital remittance to establish and run a business through project office is not loan but capital contribution 'and though it is a liability in the balance sheet of the project office', it cannot be called a debt incurred during the course of business. Based on provisions of Article-7(3) of India-Spain DTAA, the AD held that any notional expenditure/loss toward head office is not allowable as deduction. Accordingly, the AO disallowed the assessee's claim of foreign exchange loss on re-statement of such remittance which is not in the nature of debt. Consequently, the assessee appealed before the CIT(A) who ruled in favor of the assessee.

Ruling

The tribunal ruled in favor of the assessee by upholding the order of the CIT(A). It was observed that the Assessee-Company has been receiving the funds in EURO for the last many years from the Head Office and had been admittedly repaying the amounts to the Head Office in EURO and such claim of assessee-company of foreign exchange fluctuation loss in A.Ys. 2012-2013 and 2013-2014 preceding to assessment year under appeal, had been accepted by the A.O. under section 143(3) of the I.T. Act, 1961. Additionally, Article 7(3) of India-Spain DTAA was not applicable in the relevant case because nothing is paid by the assessee- company to the Head Office on account of loss and no deduction claimed. It was further held that the assessee-company had not violated any terms of Article 7(3) India-Spain DTAA because whatever bar had been provided in this Article are not applicable to the case of the assessee company. The Tribunal and CIT (A) also stated that if the A.O. was of the opinion that assessee- company was not entitled for deduction on account of foreign exchange fluctuation loss, then he should not have accepted the similar claim of assessee-company in preceding assessment years and should have refunded the amount of tax paid on the foreign exchange capital gain shown in subsequent assessment year.

Source: Tribunal, Delhi in DCIT Circle 1(2)(1) vs. Cobra Instalaciones-Y-Servicios SA dated 12th July 2022 vide ITA No.7173/Del/2019.

Incidental benefit from services not equivalent to making available of technology; Deletes Rs.121 Cr. addition

Facts

The assessee is a company incorporated in, and fiscally domiciled in, the Republic of Singapore. The assessee is entitled to the benefits of the India Singapore Double Taxation Avoidance Agreement. During the relevant previous year, the assessee received Rs 121,94,85,623, from its Indian associated enterprise by the name of Dimensions Data India Pvt Ltd, for rendering certain business support services, and recovered certain expenses said to be on the cost-to-cost basis.

The assessee did not offer the fees so received from the Indian entity to tax, on the short ground that as the services rendered by the assessee to the Indian entity, does not amount to making available the services so rendered, in terms of Article 12 of the Indo Singapore tax treaty, it cannot be taxed in India. The AO was not satisfied by this claim of the assessee and asked to show cause as to why this income not be taxed as fees for technical services under section 9(1) of the Income Tax Act, 1961, as also under Article 12 of the Indo Singapore tax treaty. The assessee provided submissions to support the claim that as long as the provisions of the Indo Singapore tax treaty are more favorable to the assessee, the provisions of the Income Tax Act cannot be invoked at all, and that, in terms of the requirements of Article 12(4) of the Indo Singapore tax treaty, the fees for technical services can only be taxed in the source jurisdiction only when, inter alia, these services „make available technical knowledge, experience, skill, know-how or process.

However, the AO found no merit in these submissions and proceeded to frame the order, and brought to tax the receipts of Rs 121,14,85,623 as fees for technical services under article 12(4) of the Indo Singapore tax treaty. The Aggrieved assessee in response approached the Tribunal for relief.

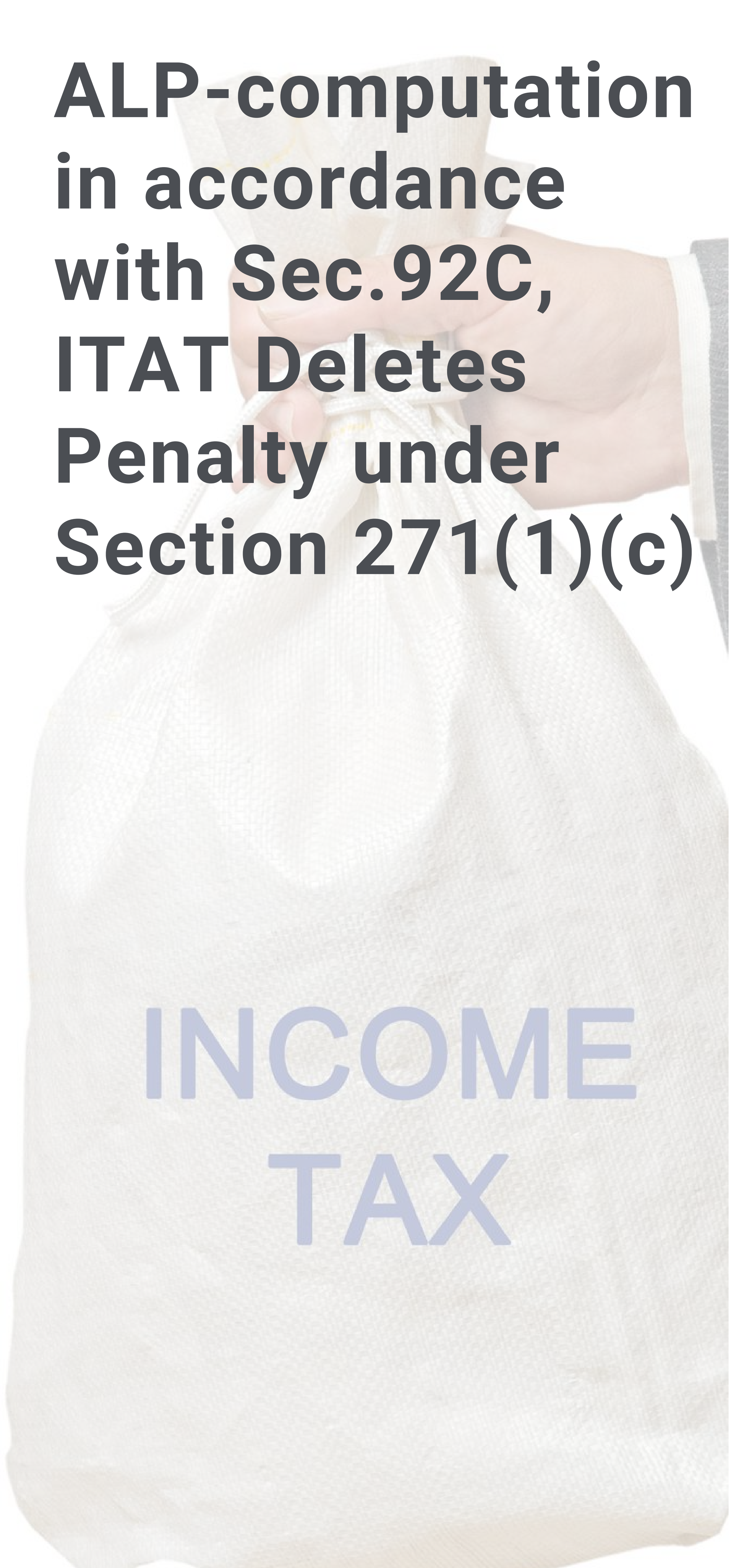
Ruling

The Tribunal decreed in favor of the assessee. The tribunal relied on the case of Shell Global International Solutions BV vs. ITO (2015) 64 in in order to support its contentions. It held that "*unless the recipient of the services, by virtue of rendition of services by the assessee, is enabled to provide the same services without recourse to the service provider, the services cannot be said to have made available the recipient of services. A mere incidental advantage to the recipient of service is not enough.*"

The Tribunal observed that technology would be considered "made available" when the person who acquired the service is enabled to apply the technology. It held that the clause in the Indo-Singapore tax treaty could not be invoked on the facts of the present case- as no case is even made out by the revenue that as a result of rendition of these services to the Indian entity, there is any transfer of skill or technology. The Tribunal further noted that, "Once the taxability fails in terms of the treaty provisions, there is no occasion to refer to the provisions of the Income Tax Act, 1961, as in terms of Section 90(2), "where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom Such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee".

Source: Tribunal, Mumbai in NTT Asia Pacific Holding Pte. Ltd vs. ACIT dated 4th July 2022 vide ITA No. 1212/Mum/2021

ALP-computation in accordance with Sec.92C, ITAT Deletes Penalty under Section 271(1)(c)



Facts

The assessee was engaged in business of call center and IT enabled services. For the year under consideration, assessee filed its return of income on 31/10/2005 declaring total income at Rs. Nil. In respect of international transaction pertaining to ‘Provision of Contact Centre Services’, the assessee provided eC RM services, using voice, web chat and email to the customers of SITEL Corp, USA and SITEL UK Ltd. (i.e., its AEs), as it was not capable of directly marketing its services. For benchmarking this transaction, the assessee adopted the Transactional Net Margin Method (‘TNMM’) The assessee earned an adjusted net cost plus mark–up of 12.83%, as against the net cost-plus mark–up earned by the broadly comparable independent companies at 9.95%. Accordingly, it was claimed that the international transaction of ‘Provision of Contact Centre Services’ is at arm’s length price (‘ALP’).

The AO made reference to Transfer Pricing Officer (‘TPO’) for determination of ALP of the aforesaid international transaction. The assessee was also asked to explain as to why the idle capacity adjustment should not be allowed to be added to its operating profit. In response, the assessee, made relevant submissions showing that the assessee’s profitability for the year ended 31/03/2005 was adversely impacted due to significant reduction in revenue from one of its key customers falling from 77% to a mere 7% in the relevant year.

The TPO did not agree with the submissions of the assessee. By applying the arm’s length margin, the TPO, proposed an upward adjustment of Rs. 8,54,35,703 in respect of international transaction of ‘Provision of Contact Centre Services’ AO computed the total income of the assessee at Rs. 6,42,38,970. Subsequently, in quantum appeal, against the order passed under section 143 (3) of the Act, the learned CIT(A) restricted the transfer pricing adjustment to Rs. 1,56,78,265. Accordingly, under section 271(1)(c) of the Act, the AO levied penalty of Rs 57,37,070. Upon appeal, the CIT(A) allowed the appeal filed by the assessee and directed deletion of penalty levied by the Assessing Officer under section 271(1)(c) of the Act, subsequent to which the matter now lies before the tribunal.

Ruling

The Tribunal ruled in favor of the assessee by upholding the order of the CIT (A). It perused explanation 7 to section 271(1)(c) and observed that, “*The Explanation further provides an exception, where no penalty will be imposed pursuant to aforesaid addition, if assessee proves to the satisfaction of the authority that the price charged or paid in such a transaction was computed in accordance with provisions contained in section 92C and such price was computed as per the manner prescribed under that section in good faith and due diligence.*” The Tribunal then went on to analyze the meaning of the words good faith and due diligence by relying on the case DCIT v/s RBS Equities India Ltd., [2011] 133 ITD 77 (Mum.), wherein it was held, “*As to the scope of connotations of expression in good faith appearing in Explanation 7, we find guidance from section 3(22) of General Clauses Act which states that "a thing shall be deemed to be done in 'good faith' where it is in fact done honesty, whether it is done negligently or not. A thing done in good faith is a thing done honestly, and, therefore, it is not even necessary whether in doing that thing the assessee has been negligent or not... as long as no dishonesty is found in the conduct of the assessee and as long as he has done what a reasonable man would have done in his circumstances, to ensure that the ALP was determined in accordance with the scheme of section 92C, deeming fiction under Explanation 7 cannot be invoked.*” Additionally, the tribunal also held that this case was not one where the transfer pricing documents had been rejected by the TPO. In light of its findings, the tribunal held that the assessee had computed the ALP with respect to international transactions with due diligence and in good faith.

Source:Tribunal, Mumbai in Dy. CIT vs. M/s Sitel India Limited dated 19th July 2022 vide ITA No. 2595/Mum/2014

AMP-spend not international transaction given Revenue's failure to establish presence of agreement; Follows precedent

Facts

The assessee, Ferrero India Private Limited, was a subsidiary of Ferrero International S.A., Luxembourg, which is the holding company of the Ferrero Group. The Company was engaged in distribution of finished goods in the Indian market. In this regard, the Company purchases finished goods, i.e., chocolates and confectionery from Associated Enterprises ('AEs') for distribution to agents who subsequently sell to retailers and the final consumers. During the year under consideration, the assessee filed its return of income declaring the total loss of Rs. 562,721,541/-. The return was processed for scrutiny and after due notice, the AO referred the case of the assessee to the ACIT, Transfer Pricing Officer - 1 (2) (TPO) for determination of arm's length price of international transactions entered into by the Assessee with its Associated Enterprises ("AEs"). The assessee adopted Resale Price Method (AMP) for benchmarking the major international transactions of purchase of finished goods. As per the assessee, the transactions entered into with its AEs were at arm's length price from an Indian Transfer Pricing perspective. The TPO applied bright line test for the difference in ratio of AMP expenses incurred by the Assessee (18.14%) vis-a vis the comparable companies (13.79%) and further added a mark-up of 18.25% on excess AMP expenditure incurred by the Assessee. the TPO determined the arm's length price of the above AMP expenditure as Rs. 9,82,82,571/- and made the transfer pricing adjustment. The AO in the assessment order passed under section 143(3) added the amount of transfer pricing adjustment to the assessee's total income determining the total loss of the assessee at Rs. 46,44,38,9701- as against the returned loss ofRs.56,27,21,541/-. The AO has also proposed to initiate penalty proceedings under section 271 (1) (c) of the Act. The AO passed the assessment order under section 143(3) of the Act. Aggrieved by the assessment order passed by the AO, the Assessee has filed the appeal before the CIT(A) who favored the assessee. Consequently, the aggrieved revenue approached the Tribunal.

Ruling

Upon perusing the fats of the case, the Tribunal reached a conclusion favorable to the assessee. It was observed that the revenue had been unable to establish the existence of any agreement between the assessee and the foreign AE for incurring advertisement and marketing expenses for the benefit of such foreign AE. Nor could any interference be drawn as to the existence of international transaction on mere incurring excess expenditure on those items as compared to expenditure incurred by comparables as chosen by the T.P.O. Additionally, the Revenue failed to demonstrate the presence of any machinery provision to compute Arm's Length Price nor could demonstrate existence of any agreement between the assessee and its AE that the expenses on AMP was incurred for enhancing the brand value of the AE. It was noted that merely because on account of expenditure incurred by the assessee the third party also benefits thereby, the expenditure cannot be disallowed In light of these observations, the tribunal held, "We are of the considered view in this case, there does not exist any international transaction and therefore, the question of determination of ALP of such transaction does not arise. Furthermore, as we have examined from the case-law cited above, the onus is on the Revenue for establishing that there is an international transaction has not been discharged in this case. Consequently, the relief provided by the learned CIT(A) to the assessee is sustained and furthermore since there is no international transaction at all, the question of determining ALP does not exist."

Source: Tribunal, Pune in Dy. CIT vs. Ferrero India Pvt. Ltd. Dated 6th July 2022 vide ITA. No. 07/pun/2021.

A&M expenses not an international transaction; Remits benchmarking analysis on import of raw materials

Facts

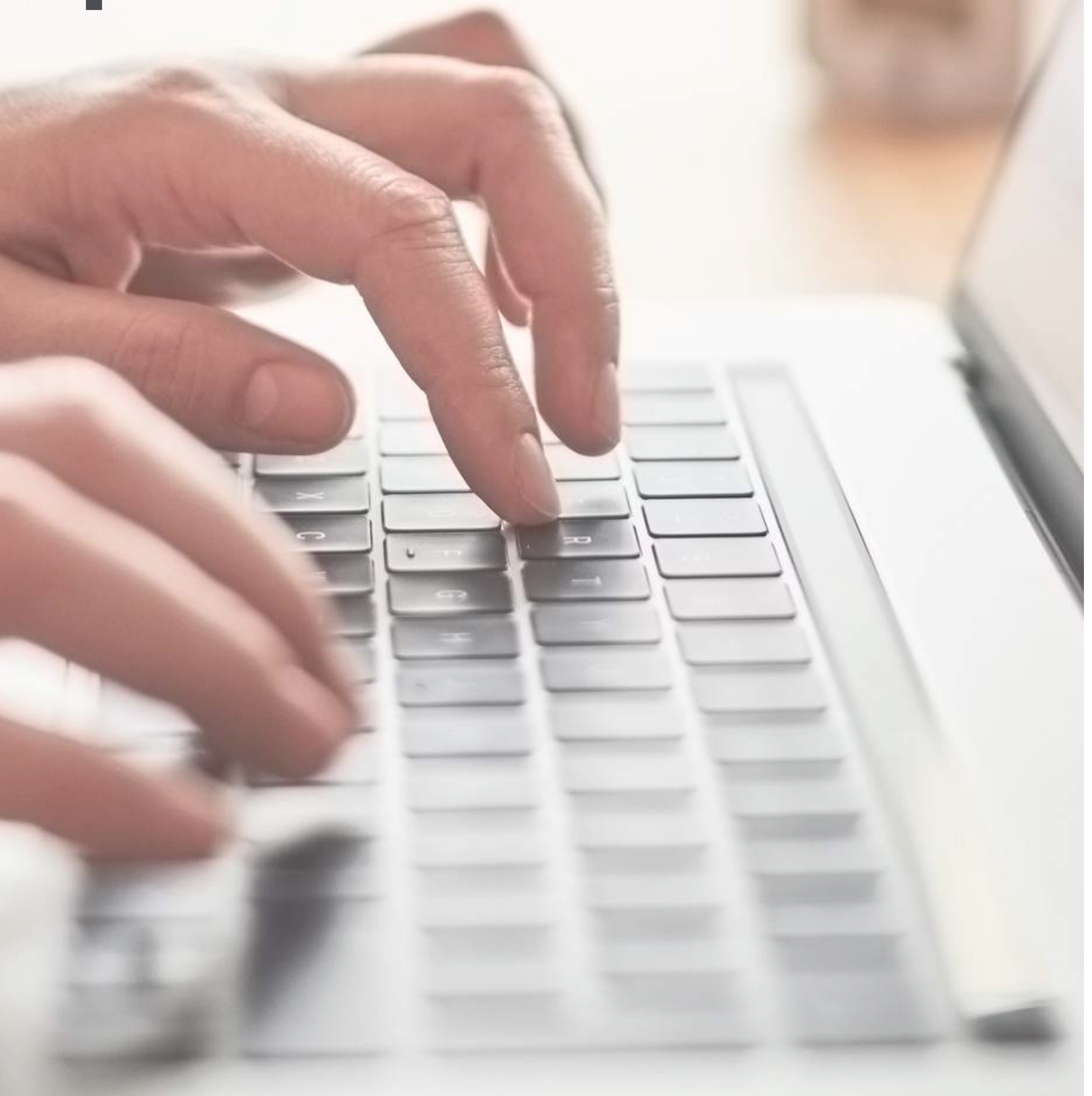
The assessee, a company incorporated under the provisions of the Companies Act, 1956. It is a joint venture between Hindustan Unilever Limited (HUL) and Kimberly Clark Corporation, a USA based company. It was engaged in the business of manufacturing of Infant Care and Feminine Hygiene Care Products. The return of income for the assessment year 2010-11 was filed on 14.10.2010 declaring loss of Rs.2,23,45,387. The appellant company had also reported the following international transactions within the meaning of section 92B of the Act: Purchase of raw materials, spare parts & consumables, Purchase of finished goods, payment of Royalty, Payment of Global License Fees. The AO referred the matter to Transfer Pricing Officer (TPO) u/s 92CA (1) of the Act for the purpose of benchmarking the above international transactions reported by the appellant company in Form No.3CEB. The TPO vide order passed u/s 92CA (3) of the Act suggested the TP adjustments on account of Advertising & Marketing (A&M) expenses of Rs.36,07,83,298/-. While doing so, the TPO computed the expenditure incurred on account of advertisement at Rs.46.82 crores which works out to 0.25% of the sales. The TPO adopted the difference between both to benchmark the international transactions on account of A&M with its foreign AE. Accordingly, the TPO proposed an upward adjustment of Rs.36,07,83,298/- on account of A&M expenditure. As regards to the addition of transfer pricing adjustment in respect of international transaction of import of raw materials of Rs.57,28,75,077/-, the assessee stated that for the qualitative supply of raw materials at lower price, AE of appellant company had entered into an agreement with third party vendors for supply of raw materials for all group entities including the appellant at an agreed price. However, the TPO rejected the assessee's explanations and submissions and proceeded to benchmark the international transaction of import of raw materials by adopting TNMM as most appropriate method at entity level and selected the comparables whose average profit margin was computed at 7.49% as compared to negative margin of (-) 6.68% of the appellant company. On receipt of TPO's order, a draft assessment order u/s 143(3) against assessee was passed, who consequently, chose to file for relief before the Dispute Resolution Panel (DRP). On receipt of the DRP directions, the AO made an addition on account of international transaction of import of raw materials of Rs.36,07,83,298/- without complying with directions of DRP to restrict TP adjustment only to the extent of AE transactions. Hence, the aggrieved assessee appealed before the Tribunal.

Ruling

The Tribunal decreed in favor of the assessee. It held, "we find that the contention of assessee that the third-party vendors are not the AEs of the appellant remained un-adverted. Therefore, the certificate issued by third party vendors whereby, they confirmed that the discount of 10% to 20% had been given to the appellant on the raw materials supplied during the year and confirmed that the price they have charged to the appellant company is lower than the price, it would have charged if the appellant had not purchased under global sourcing arrangement cannot be ignored by holding that these certificates were issued by AEs. As regards to the import of raw materials from AEs, the contention of appellant company that the price charged by the AEs is lower than the prevailing market price remains uncontroverted. The lower authorities have failed to advert to this submission made by the appellant and therefore, we are of the considered opinion that the matter requires remission to the AO / TPO to examine the above benchmarking analysis furnished by the appellant."

Source: Tribunal, Pune in Kimberly Clark Lever Private Ltd vs. ACIT dated 20th July 2022 vide ITA No.507/pun/2015.

AMP-spend not international transaction given Revenue's failure to establish presence of agreement; Follows precedent



Facts

During the assessment proceedings, the AO noticed that apart from other income the appellant during the year earned tax exempt dividend income of INR 3.71 crores arisen on the investments made by the appellant. However, the AO noticed that the own funds of the appellant were not sufficient to meet the investments in question. AO, therefore, applied the provisions of section 14A read with rule 8D of the Income Tax Rules and computed the expenditure relatable to the aforesaid tax-exempt dividend income at INR 10.62 crores. Since the appellant in its computation of income had suo-moto disallowed an amount of INR 2.25 crores on account of expenditure relatable to the tax-exempt dividend income earned by the appellant, the AO, therefore, disallowed the balance amount of INR 8.37 crores and added back the same into the income of the appellant and computed the taxable income accordingly. Being aggrieved by the above order of the AO, the appellant filed appeal before the CIT(A) who while relying upon the decision of the hon'ble Delhi High Court in the case of PCIT versus Moderate Leasing and Capital services Private Limited, held that the disallowance under section 14A cannot exceed the total tax-exempt income earned during the year and accordingly restricted the disallowance to the extent of exempt income earned. Being aggrieved by the above action of the CIT(A), the revenue has come in appeal before us.

Ruling

ITAT in view of the above facts, held that the explanation to section 14A inserted by Finance Act 2022 being clarificatory in nature has retrospective effect and stated that the impugned order of the CIT(A) is therefore not sustainable in the eyes of law and the same is accordingly set aside. ITAT therefore restored the order of the Assessing Officer and allowed the Revenue's appeal.

Source: HC, Delhi in the case of ACIT vs Williamson Financial Services Ltd. vide [2022] 140 taxmann.com 164 (Guwahati) dated July 06, 2022

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