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INTERNATIONAL TAX REVIEW

APRIL 2022

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HIGH COURT RULINGS

High Court (HC) quashes notice issued to initiate reassessment proceedings as the notice was time barred and issued without any jurisdiction

Facts

During the year, assessee received a sum from its associated enterprise (AE) i.e., M/s Matec Maschinenbau GmbH (MGM) as interest on the loan extended by the assessee. The assessee reflected the receipt of interest in the income tax return and also filed the Auditor's Certificate in Form No.3CEB disclosing certain details of the transaction. During this year, the assessee purchased 90% of the shares of MMG and this transaction was also reflected in the balance sheet for the relevant year. The AO taxed the interest on the loan extended to MMG by stating that the assessee utilized interest-bearing advances in extending loans to its sister concerns and as such, the aforesaid amount is to be taxed. The matter was adjudicated by Commissioner of Income Tax (Appeals) (CIT(A)) and subsequently by the Tribunal. However, subsequently, a notice was issued to the assessee proposing reassessment. The reasons for reopening, inter alia, included that the loan advanced by the assessee to its AE amounted to an international transaction which was required to be referred to Transfer Pricing Officer (TPO), yet the reference was not made during the original assessment proceedings. The assessee filed its objections to reasons for reassessment and contested against the Sec 147 reassessment notice by referring it as without jurisdiction and barred by limitation i.e., beyond a period of 4 years from the relevant date. Assessee claimed that the interest received for the loan extended to its AE was reflected in the return and was duly disclosed in Auditor's Certificate in Form No. 3CEB. Assessee submitted that the reopening could have been justified if there were reasons to believe that some income chargeable to tax escaped assessment owing to assessee's fault to disclose all the material facts, however, this was not the case as all the documents were made available to the AO. Despite that, revenue emphasized on the reopening citing the reason that Form 3CEB only included the interest amount and not the loan transaction, which fell within the provisions of 92CA and the original assessment was completed without determination of arm's length price (ALP) of the transaction and thus, it was the non-disclosure of the loan transaction that prevented the reference to TPO by AO. Aggrieved by such observations, assessee filed before a writ petition before the HC.

Ruling

Placing reliance on the Apex Court ruling in Rajesh Jhaveri Stock Brokers Pvt (2008(14) SCC 208, HC explained that the present case is covered by the proviso to Sec 147 and hence, the question for consideration was whether revenue can establish the twin conditions therein i.e., whether the AO has reason to believe that income chargeable to tax has escaped assessment and that, such escapement is due to either omission or failure of the assessee to disclose fully or truly all material facts. HC observed that the assessee had undisputedly enclosed Auditor's certificate in Form 3CEB in standard format disclosing nature of transaction, rate of interest, interest computed, and method adopted to determine ALP. Further, the loan transaction with MMG was examined in proceedings u/s 143(2), wherein assessee was called upon to justify

the advance to MMG, pursuant to which AO disallowed interest citing the reason that assessee utilized loan bearing advances to lend loan to its AE.

HC held that all circumstances demonstrated that assessee did not omit or fail to disclose the advance/loan transaction with MMG, therefore, jurisdiction for reassessment could not have been assumed. While referring to the CBDT's Instruction No. 3/2003 that mandated reference to be made to TPO if aggregation of international transactions was more than Rs. 5 crores, HC stated that original order reflected that interest on loan/advances were brought to tax with reference to the value of transaction, therefore no prima facie reason arose to refer the loan transaction to TPO. In view of such observations, HC allowed assessee's writ petition and quashed the notice for reopening of assessment proceedings and order of reference to TPO and order rejecting assessee's objections to AO's jurisdictions.

Source: HC in Bharat Fritz Werner Ltd. vs DCIT/PCIT dated April 13, 2022 vide writ petition no. 57135/2018

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ITAT RULINGS

Sub-contracting charges paid by assessee to its subsidiary are taxable as FTS under amended definition of Section 9(vii) as well as Article 12 of India China DTAA

Facts

The assessee, an Indian company, engaged in the business of development and export of computer software and related services, sub-contracted certain overseas work in China to Infosys Technologies (China) Co. Ltd. (Infosys China) and during the year made payments for the aforesaid function to Infosys China. Said payments were made without deduction of tax at source. The assessee's contention was that the payments were not chargeable to tax under the Act or under the relevant Double Taxation Avoidance Agreement (DTAA). However, the revenue authorities held the assessee to be an `assessee in default' for

not deducting tax at source u/s 195 of the Income Tax Act ('Act') and stated that the payments made to Infosys China are liable for tax deduction u/s 9(1)(vii) of the Act as fees for technical services (FTS) under the domestic law as well under the relevant DTAA respectively. Aggrieved by such observations, the assessee preferred an appeal before the Tribunal.

Ruling

The Tribunal held that the issue of whether tax deduction at source u/s 195 of the Act on the payment made by the assessee comes within the purview of section 9(1)(vii) is squarely covered by the order of Mumbai Tribunal in Ashapura Minichem Limited v. ADIT (2010) 40 SOT 220 (Mum.), wherein it was had held that in view of the retrospective amendment to section 9, by the Finance Act, 2010 and substitution of Explanation to the said section, it is no longer necessary that, in order to invite taxability u/s 9(1)(vii) of the I.T. Act, the services must be rendered in Indian Tax jurisdiction. The judgement negated the observations made in the case of judgment of the Apex Court in Ishikawajima Harima Heavy Industries Ltd. v. DCIT reported in (2007) 288 ITR 408 (SC) wherein it was stated that rendering of services and utilization in Indian tax jurisdiction was a must for the purpose of taxability u/s 9(1)(vii) of the Act. Further, as regards Assessee's submission that the payment was covered by exception under Section 9(1)(vii)(b), Tribunal clarified that for the purpose of taxation, the Assessee is different from its subsidiary in China,

and categorically stated that "merely because the clients of the assessee are outside India does not mean that the assessee is carrying on business outside India. In addition, Tribunal also pointed that the assessee claimed benefit of Section 10A/ 10B for the export of software from the specified units from India, hence, it was not open to the assessee to contend that no services were rendered or utilized in India.

Further, Tribunal also rejected assessee's submission of non-taxability in India due to treaty benefits under India-China DTAA by placing reliance on the observations made by Mumbai Tribunal in Ashapura Minichem Limited (supra), wherein it was held that the deeming fiction under Article 12(6) of India-China DTAA will have application and royalty or fees for technical services shall deem to arise in a contracting State where the payer is situated. In other words, it was held that irrespective of the situs of technical services having been rendered, according to India-China DTAA, the fees for technical services will be deemed to have been accrued in the tax jurisdiction in which the person making the payment is located.

Relying on the above, the Tribunal concluded such payments to have arisen in India. On assessee's alternate submission that partial payment for subcontracting were paid before enactment of Finance Act, 2010 thus, the assessee cannot be made liable for the tax liability on the said payment under Section 201(1) and 201(1A). Therefore, Tribunal relied on coordinate bench ruling in assessee's own case wherein under identical facts, the matter was restored to the AO and directed to take a decision in accordance with law after affording a reasonable opportunity of being heard to the Assessee.

In view of the above, Tribunal concluded that subcontracting charges paid by Assessee to Infosys China constitutes FTS under Section 9(1)(vii) and DTAA and thus liable for withholding of tax under Section 195. Having said that, alternate claim of the assessee for partial payment before enactment of Finance Act, 2010 was restored to the file of AO for further consideration.

Source: Bangalore ITAT in Infosys Limited vs DCIT, International Tax, Circle 1(1) dated April 11, 2022 vide IT(IT)A No.4/Bang/2014, IT(IT)A No.1182/Bang/2014

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Assessee eligible for exemption under Article 8 of DTAA between India and USA owing to baggage screening services rendered under IATP pool

Facts

Assessee, a US tax resident is engaged in operating airlines in international traffic for carriage of passengers and goods and in providing services incidental to such operation. In addition, the assessee also earned income from other airlines in India by providing baggage screening services and engineering and aircraft handling services. During the assessment proceedings, AO alleged that the income from providing baggage screening services to other airlines to be taxable as business profits under Article 7 of the DTAA between India and USA since assessee had a PE in India and AO contended that the assessee was not covered Article 8(1) read with Article 8(2) of the DTAA on the basis that the said activity was not directly connected with the operation of aircraft. The assessee contended that in terms of Article 8 of the DTAA between India and USA, profits derived by assessee from operation of aircraft in international traffic can be taxed only in the USA. Further, the assessee stated that the amount received from other airlines for providing baggage screening services and

engineering and aircraft handling services, being incidental to operation of aircraft in international traffic is not taxable in India. However, the AO held such services to be taxable in India. Aggrieved by the observations of the AO, assessee preferred an appeal before CIT(A), however CIT(A) confirmed the additions made by AO. Subsequently, assessee filed an appeal before the Tribunal.

Ruling

Tribunal observed that in addition to transportation of passengers, goods and livestock, for the purposes of the expression 'profits from operation of ships or aircraft in international traffic', the article covers even: (a) sale of tickets, (b) other activities directly connected with such transportation and (c) the rental of ships or aircraft incidental to any activity directly connected with such transportation. However, the assessee's case did not fall under (a) or (c) and for applicability of (b), in addition to transportation of passengers, mail, livestock or goods by sea or air, any other activity has to be considered with reference to such transportation as aiding or supporting it and incidental thereto. Tribunal held that the profit derived by the assessee from baggage screening services and aircraft handling services provided to other airlines is in no way connected to assessee's activity of transportation of passengers, mail, livestock, or goods etc. by air in its own aircrafts. Tribunal further explained that even if the assessee did not provide such services, in no manner, the assessee's activity of transportation of passenger, mail, goods, livestock etc. were affected. Further, Tribunal also highlighted that the assessee itself had stated that when not required for its own use, for optimum use of the equipment and manpower deployed at IGI airport, the services are provided to other airlines, evidencing that provision or non-provision of these services would not affect assessee's air transportation activity. Thus, Tribunal concluded that income from baggage screening services and aircraft handling services provided to other airlines did not fall within the ambit of 'other activity directly connected to such transport' as provided under Article 8(2)(b) of India-USA DTAA and thus not covered under Article 8(1).

However, Tribunal considered assessee's alternate claim that it would be covered under Article 8(4) which extends benefit provided under Article 8(1) to profits from participation in pool, joint business or international operating agency. Tribunal observed that the assessee became a member of (International Airlines Technical Pool (IATP) in Nov 1967, which is universally recognized as the largest pool of airlines know to aviation industry and several other airlines such as Turkish Airlines, Romanian Air Transport, etc.

Further, the assessee had submitted documentary evidence indicating services received by assessee and provided by it to other airlines through IATP. Therefore, placing reliance on the judgement of Delhi High Court in DIT vs. KLM Royal Dutch Airlines 392 ITR 218, it was held that once the assessee derives profit from participating in a pool on reciprocal basis, in terms of Article 8(4), such profit can only be taxed in the country of residence of the enterprise, in the present case USA.

Tribunal concluded that the profit derived from providing baggage screening services and aircraft handling services to other airlines as a participant of IATP pool would be covered under Article 8(1) read with Article 8(4) of India–USA DTAA.

Source: Delhi ITAT in United Airlines vs. DCIT/DDIT dated April 12, 2022 vide ITA No. 958/Del/2014

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Payments made by an entity for centralized chain marketing services cannot be considered as royalty/FTS and therefore not liable for TDS u/s 195

Facts

The assessee is engaged in operating a hotel under the name and style

of Hyatt Regency as a franchise of Hyatt International Asia Pacific Limited known as Hyatt. A group company named Hyatt International South West Asia Limited (HISWAL) is engaged in the field of providing marketing, management and operation of hotels work under the brand of Hyatt. The assessee entered into a Strategic Oversight Agreement (SOA) with HISWAL in respect of carrying out hotel and management services with the assessee. As per SOA, there were various other services which are to be provided by other affiliates of Hyatt and one such affiliate of Hyatt was Hyatt Chain Services Ltd., Hongkong (HCSL). HCSL provides centralised services outside India to one worldwide Hyatt Group of Hotels, who work under the supervision and control of Hyatt. HSCL conducted sales and marketing on behalf of all hotels affiliated to the Hyatt chain. The assessee filed an application under section 195(2) of the Act before the AO in respect of payments proposed to be made to HCSL for provision of centralised services i.e., advertisement, sales promotion and computerised reservation to the assessee amongst others. The chain marketing services as stated in the application filed by the assessee included business and sales promotion, advertising, publicity and public relations, reservation system across the globe, conduct marketing surveys and studies to standardize and improve the facilities in the hotels of the affiliates across the world, all other such activities aimed at protecting and promoting the mutual interest of the affiliates as well as to benefit the guests with better services and facilities. The cost of such expenses incurred by HCSL was allocated amongst the participating Hyatt Hotels worldwide on cost basis without having any element of profit.

During assessment proceedings, AO opined that the payment made to HCSL by the assessee was in the nature of royalty/FTS u/s 9(1)(vi)/(vii). Assessee contended that no tax was required to be withheld on the remittance as it was towards the pro rata share of sales and marketing services which were performed outside India and hence no income accrued, arose or received in India. However, AO rejected assessee's submissions, and concluded that the payment to HCSL to be in the nature of royalty / FTS and directed assessee to withhold tax under Section 195. Aggrieved by such findings, AO filed an application before CIT(A). CIT(A) after duly considering the findings of the Ld. AO, detailed submissions made by the assessee before him and relevant clauses of SOA held that tax is not required to be withheld on payments to HSCL. Aggrieved by such findings, revenue filed an appeal before Tribunal against the order of CIT(A).

Ruling

Tribunal clarified that HCSL is a separate independent no profit entity, providing services outside India to various hotels operated by Hyatt across the globe and that costs of such chain marketing services are reimbursed on proportionate basis by the participant hotels one of which is the assessee. Further, Tribunal explained that the payment by assessee to HCSL is in relation to centralised services provided by HCSL outside India and are not made for consideration for any of the items enumerated in Explanation 2 to section 9(1)(vi).

Placing reliance on Delhi HC ruling in Sheraton International (313 ITR 267) and Karnataka HC ruling in ITC Hotels ITA Nos. 477 and 478 of 2009

dated 15.06.2015, wherein the services provided in relation to advertisements, publicity and sales promotion was held to be neither royalty nor FTS under Section 9 and thus, not liable to tax in India, the Tribunal held that the payments made to HSCL by assessee are not in the nature of royalty under the provisions of Section 9(1)(vi) and thus not chargeable to tax and assessee is not required to withhold any tax on such payments. Further, Tribunal also concurred with assessee's alternate argument that the said remittances, being reimbursement of expenses on cost-to-cost basis, cannot be said to be income deemed to accrue or arise to India in the form of royalty or FTS. Further, the revenue's argument that tax is to be withheld based on the findings in the assessment of HISWAL for AY 2009-10, did not hold true in the present facts as assessee and HISWAL are separate legal entities and HISWAL's assessment was completed based on HISWAL having a PE in India. Further, held that the findings in one case cannot blatantly be applied to an altogether different case. In the instant case, there is nothing on record to suggest that HCSL had a PE/ business connection in India and thus in view of above, Tribunal concluded that the aforesaid payments did not qualify as royalty/FTS.

Source: Delhi ITAT in ITO (Int. Taxation) vs. Asian Hotels North Ltd. vide order dated March 15, 2022 vide ITA No. 210/Del/2016

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