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International Tax and Transfer Pricing

Judicial Decisions

Rupee Denominated NCDs of Indian companies were considered as Rupee Denominated Bonds, eligible for concessional tax rate of 5% as per section 194LD

Heidelberg Cement AG vs. ACIT (143 taxmann.com 79) (Delhi – Tribunal) (In favour of: Assessee)

Facts

The assessee, a foreign company had invested in rupee denominated non-convertible debentures ('NCDs') of Indian companies. The assessee had earned interest income of Rs. 47.70 crores from the said NCDs. The assessee offered the said interest income to Income Tax @ 5% in accordance with section 194LD r.w.s. 115A(1)(a)(iiab) of the Act.

The AO took a view that section 115 A(1)(a)(iiab) read with section194LD is applicable only in case of interest' from rupee denominated bonds of Indian company or a Government security whereas the assessee has earned interest from Rupee Denominated NCDs.

Before the DRP, the assessee had placed reliance on a letter issued by the PCCIT, International Tax, New Delhi to CCIT/CIT of various International Tax jurisdiction (including CIT having jurisdiction over the assessee) stating that in the absence of specific definition of bonds in the Act, the term 'bonds' used in section 194LD should be considered as including Rupee Denominated NCDs and accordingly, the concessional rate of 5% should be allowed provided other conditions mentioned in section 194LD of the Act are satisfied.

The Delhi Tribunal relied on the decision of Delhi High Court in the case of DIT vs. Shree Visheshwar Nath Memorial Public Ch. Trust (194 Taxman 280), which had held as under:

- The word 'Debenture' is nowhere defined under the Act. However, the Companies Act, 1956 specifically defines this term and as per the definition provided in section 2(12) of the said statute, 'Bond' is covered under the expression 'Debenture'. In the absence of any definition of 'Debenture' in the Act, reliance could be placed upon the definition given in

section 2(12) and also the common parlance in which this term is understood.

- As per the new Gem dictionary, the term 'debenture' includes the bond of a company or a corporation.

The Delhi High Court had examined section 11(5) of the Act which uses the term 'Bonds' and 'Debenture' differently in the section and therefore, it had reached the conclusion that debenture does not include bonds. The Delhi High Court further held that specific provision is made, in respect of investment in particular kinds of bonds. That would not mean that while dealing with the investment in 'Debenture', a restrictive meaning would be given to the term 'Debenture', more particularly when this term is not defined under the Act. It is a trite principle of interpretation that in the absence of any definition given to a particular term in a statute, the meaning which has to be given to the said term, is the meaning which is understood in common parlance.

Held

Rupee Denominated NCDs were considered as 'Bonds' eligible for concessional tax rate as per section 194LD, even where section 194LD does not specifically grant exemption to debentures.

Most Favoured Nation (MFN) Clause in Protocol Integral to Tax Treaty, effective even without specific notification

DCIT vs. Converteam Group (TS-779-ITAT-2022) (Delhi Trib.) (In favour of: Assessee)

Relevant facts

The assessee company was a tax resident of France. The assessee was engaged in the electrification business. The assessee received charges for the management support services amounting to Rs 5.57 crores from the Indian companies. The said management charges were treated as non-taxable in India by the assessee claiming it to be in accordance with Article 13 of the India-France Tax Treaty read with protocol to the Tax Treaty that prescribes the MFN clause which restricts the scope of taxation of fees for technical services (FTS) under the Tax Treaty. The assessee claimed benefit of the provisions of Article 13 of India-UK Tax Treaty read with Article 13 of India-France Tax Treaty.

The AO further observed that the protocol could not be treated as forming part of the Tax Treaty itself unless there is a notification issued by the Government to incorporate the less restrictive provisions of the other treaty available. The AO treated the management support services of Rs.5.57 crores received on account of intermediary services taxable as FTS.

The main contention of the Income Tax department was that protocol *ipso facto* cannot be given effect to in absence of the notification. The said stand has been supported CBDT Circular No.3/2022 dated 3 February 2022.

Held

The Protocol to a Tax Treaty is an indispensable part of a Tax Treaty with the same binding force as the main clauses of the Tax Treaty. There is no need of a separate notification for enforcing the provisions of the protocol. MFN clause of the Protocol to India-France Tax Treaty forms an integral part of the Tax Treaty.

CNK Comments

The above decision would be helpful in case of Tax Treaty with MFN clause, where the applicability of another favourable Tax Treaty is automatic. Where the Tax Treaty specifically provides for further negotiation to adopt less restrictive provisions of the other Tax Treaty, like Tax Treaty between India and Swiss Confederation, the above decision may not be directly applicable.

The financial data pertaining to internal segmentation are more reliable and accurate, as compared to financial data of external comparable companies. it would therefore be appropriate to apply internal benchmarking analysis over external benchmarking analysis

Bertelsmann Marketing Services (P.) Ltd. vs. ACIT (145 taxmann.com 379) (Delhi Trib.) (In favour of: Assessee)

Relevant facts

The assessee was engaged in the business of IT enabled services ('ITES'). The Company was also operating and managing the activities of Business Process Outsourcing (BPO) centres, call centres and providing warehousing facility service to various customers. The assessee adopted internal Transactional Net Margin Method (TNMM) to benchmark transaction of ITES. The TPO rejected internal TNMM on the ground that the assessee had failed to distinguish the ITES rendered by it to the associated enterprise **(AEs)** and BPO services rendered to non-AE. The TPO also observed that the functions of AEs and non-AEs are not the same and, therefore, adopted external TNMM to benchmark the transaction of ITES.

The Delhi Tribunal relied on another decision of Delhi Tribunal in case of Majorel India (P.) Ltd. vs. ACIT (134 taxmann.com 148), wherein the Tribunal allowed the claim of assessee i.e., to adopt internal TNMM for bench marking provisions of ITES. While processes carried out for the AE and non-AE may differ, the fundamental functions performed by the assessee under each of these processes are the same and fall under the category of ITES Industry. These aspects were never disputed by the TPO at any stage. The TPO simply stated that the nature of services performed in AE segment are totally different from nature of services in non-AE segment. But how the services are fundamentally different has not been demonstrated by the TPO.

The Tribunal relied on the "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" which highlight the preference of internal comparables over external comparables (Para 3.27 and 2.58 of OECD guidelines) and the United Nations Practical Manual on Transfer Pricing for Developing Countries, released in 2013 (UN manual) which also provides that TNMM is less dependent on product comparability because net margins are less influenced by differences in products and functions, as compared to other methods like comparable uncontrolled price (CUP).

Held

The TPO was directed to use internal TNMM for benchmarking the transactions to internal segmentation are more reliable and accurate, as compared to financial data of external comparable companies.

Circulars

Requirement of mandatory furnishing of electronic version of Form 10F as per Notification No. 3/2022 dated 16 July 2022 has been postponed for certain non-resident taxpayers till 31 March 2023

Circular F. No. DGIT(S)-ADG(S)-3/e-Filing Notification/Forms/2022/9227 dated 12 December 2022

The Finance Act, 2012 inserted section 90(4) to provide that a non-resident shall not be entitled to the Tax Treaty benefits unless such non-resident obtains a Tax Residency Certificate (TRC) from the Government of the country of which he is a resident. Section 90(5), inserted by the Finance Act, 2013, along with Rule 21AB of the Rules provides for furnishing a self-declaration in Form 10F in case the TRC, obtained from the Government of a particular country, does not contain certain details.

There was no specified mode of furnishing Form 10F. Notification No. 03/2022 dated 16 July 2022 mandates that Form 10F shall be furnished

electronically. For obtaining electronic version of Form 10F, one is required to create a login id and password on the Income-tax portal, for which obtaining a PAN is mandatory.

This requirement creates a hurdle for non-resident payees, as in certain cases, a non-resident payee is not required to obtain PAN. The CBDT considering the practical challenge being faced by non-resident taxpayers, not having PAN as well as not required to obtain PAN, has postponed the mandatory electronic filing of Form 10F till 31 March 2023. Such non-resident taxpayers can file Form 10F till 31 March 2023 in manual form.

KEY TAKE AWAY

- Rupee Denominated NCDs of Indian companies were considered as Rupee Denominated bonds, eligible for concessional tax rate of 5% as per section 194LD
- MFN Clause in Protocol Integral to Tax Treaty, effective even without specific notification
- Requirement of mandatory furnishing of electronic version of Form 10F as per Notification No. 3/2022 dated 16 July 2022 has been postponed for certain non-resident taxpayers till 31 March 2023
- The financial data pertaining to internal segmentation are more reliable and accurate, as compared to financial data of external comparable companies. it would therefore be appropriate to apply internal benchmarking analysis over external benchmarking analysis

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