CNK
& ASSOCIATES LLP
CHARTERED ACCOUNTANTS

Quarterly Insights, April 2022

International Tax and Transfer Pricing – Judicial Decisions

International Tax

Payment to e-commerce operator for subscription-based website access was treated as being in the nature of fees for technical services and was held to be subject to TDS under section 195, even where Equalization levy was paid

Google Asia Pacific Pte Ltd [TS – 57 – HC - 2022 (Del)]
(in favor of assessee)

Facts/Background:

The assessee, a company based in Singapore was providing cloud services in India. The assessee was providing subscription based interactive website access for online data analytic to Indian customer under the Google Cloud Services Reseller Agreement ('the Agreement'). The assessee was of the view that services rendered by it would be subject to equalization levy at 2%. The assessee approached the Income Tax Department for a certificate allowing an Indian company to make payment to it, without deduction of tax at source. The Income Tax Department was of the view that cloud services rendered would be taxable as fees for technical/ included services and therefore, issued certificate under section 195(2) of the Act directing the Indian company to deduct tax at source at 10% on gross amount.

The assessee filed Writ Petition before the High Court seeking a direction to permit the Indian company to make payment without deduction of tax at source for FY 2021-22.

Held:

The payment to be received by the assessee would be taxable as fees for technical/ included services as per the Act/ Tax Treaty between India and Singapore. The High Court observed that maximum tax liability of the assessee would be 10% as per the Tax Treaty. As the assessee had already paid 2% equalization levy, the High Court directed the Indian company to deduct tax at source at 8% on gross amount paid.

CNK Comments:

Any amount received by e-commerce operator from e-commerce supplier or services is subject to equalization levy of 2%. Section 10(50) of the Act was amended, wherein it was clarified that equalization levy would not be applicable, where income is chargeable to tax as royalty or fees for

technical services. The remitter of fees should therefore first examine as to whether payment to be made to a non-resident is royalty or fees for technical services before considering exemption under section 10(50). Even where non-resident contends that fees to be received by it is subject to equalization levy, where the nature of payment is royalty or fees for technical services, the payer would still have obligation to deduct TDS.

Requirement of Furnishing Form 67 for claim of Foreign Tax Credit (FTC) is only a directory requirement

Ms. Brinda RamaKrishna [TS-1059-ITAT-2021(Bang.)]
(in favor of assessee)

Facts/Background:
The assessee, an individual was resident and ordinarily resident of India in AY 2018-19. The assessee had earned salary income for services rendered in Australia, which was also subject to income tax in India. The Assessee filed her tax return claiming FTC for taxes paid in Australia without filing Form 67. The said Form was filed much later after due date to file tax return had expired.

The Centralised Processing Centre ('CPC') Bangalore processed the tax return without granting credit of FTC. The assessee filed a rectification application before the AO, which was rejected by the AO. In the rectification order, the AO observed that the assessee has failed to furnish Form 67 on or before the due date of furnishing the return of income, which is mandatory requirement as per Rule 128(9) of the Rules.

Held:
Rule 128(9) of the Rules does not provide for disallowance of FTC in case of delay in filing Form No.67. Tax Treaty overrides the provisions of the Act, which allows the assessee to claim FTC where income is taxed in more than one country. Placing a requirement in the Rules, whereby FTC would not be allowed where Form 67 is not filed on or before the due date to file tax return, is contrary to what is permissible as the Act read with Tax Treaty provisions. Accordingly, filing of Form No.67 is a directory requirement and no disallowance of FTC is permissible even where Form 67 is not filed or filed belatedly.

Separate Notification is not required for availing benefit of "Most Favoured Nation" clause. The CBDT Circular would not be applicable from retrospective date

GRI Renewable Industries S.L [TS-79-ITAT-2022(PUN)]
(in favor of assessee)

Facts/Background:
The assessee was a tax resident of Spain. The assessee was engaged in the business of providing technical support, financial support & advice, legal support, commercial support etc. and SAP software and implementation of process model. The assessee, in their tax return, offered the above income earned in India as 'fees for technical services and 'royalties' respectively. The assessee claimed that 'royalties' and 'fees for technical services' were taxable @10% instead of 20% as provided in the Tax Treaty by relying on the Protocol to the Tax Treaty having Most Favoured Nation ('MFN') clause read with Article 12 of the India Portugal Tax Treaty.

The AO held that to import MFN clause from another Tax Treaty, having lower rate of tax or narrower scope of definition of certain clause, it is necessary that such importing of MFN clause must be separately notified. In the absence of any notification of the MFN clause from the Portuguese Tax Treaty, the benefit of the relevant Article of the India Portugal Tax Treaty was not available to the assessee. The AO accordingly applied the tax rate of 10% plus applicable surcharge and education cess as per section 115A of the Act. As the domestic rate was more beneficial as compared to the Treaty rate of 20%.

The Tax Treaty between India and Spain was notified in 1995. The Protocol unfolds that if under any convention between India and a third State which is a Member of the OECD, entered into force after 1 January 1990, where India limits its taxation for 'royalties' or 'fees for technical

services' "to a rate lower" or "scope more restricted" than the rate or scope as set out in the Tax Treaty, such beneficial rate or scope shall also apply to India Spain Tax Treaty.

India had entered into Tax Treaty with Portugal vide Notification dated 16 June 2000. Article 12 of the Tax Treaty with Portugal, which is an OECD member country and fulfils all other conditions as prescribed in the Protocol, provides that the 'royalties' and 'fees for technical services' shall be taxed at 10% of the gross amount.

Held:

The Protocol was signed by both the governments on 8 February 1993. The opening part of the Protocol was duly signed by the competent authorities of both the countries on the same date on which the main Agreement was signed. Accordingly, the Protocol was to be treated as "an integral part of the Convention". Once the Agreement between India and Spain was notified on 21 April 1995, the Protocol, which is an integral part of the Agreement also got automatically notified along with the Agreement. In such a scenario, it was difficult to comprehend the need for any separate notification for the import of the MFN clause.

The Tribunal took note of the recent CBDT Circular dated 3 February 2022 wherein the CBDT has expressed its view of importing of MFN Clause into various Tax Treaties entered by India. One of the view that was expressed in the CBDT Circular was issuing of a separate notification for importing the MFN clause in the Tax Treaty. It was held that a CBDT Circular cannot operate retrospectively, to the transactions taking place in any period anterior to its issuance. The requirement of a separate notification for implementing the MFN clause, as per the said Circular, cannot be invoked for the year under consideration, which is much prior to the CBDT circular of the year 2022.

Transfer Pricing

Combined PLI earned from transactions with AE and non-AE more than PLI of comparables companies, by itself would make International transactions at Arm's length price ('ALP')

Neilsoft (P.) Ltd. [136 taxmann.com 66]
(in favor of assessee)

Facts/Background:

The assessee, an Indian Company was engaged in providing engineering services. The assessee rendered engineering design services amounting to Rs. 25.49 crore to its United States associated enterprise ('AE'). It also provided similar services in domestic market as well as other AEs in Europe with revenue at Rs. 13.30 crore and Rs. 49.00 crore, respectively. The assessee also undertook trading activity with revenue of Rs. 21.10 crore. Though accounts were maintained in a consolidated manner, the assessee, for the purposes of benchmarking, worked out the profit level indicator ('PLI') separately from services rendered to AE, Non- AE and from its trading activities.

The TPO observed that the assessee had considered the internal transactional net margin method (TNMM) with 13.44% PLI from non-AE transactions of rendering services as compared to international transaction of rendering services to AEs at 18.04%. The TPO observed that the assessee had not maintained separate segmental accounts and the consolidated accounts were used for showing the above profit margins from three different segments.

Held:

The assessee rendered similar services both to the AEs and non- AEs. As against this combined margin from services, the mean margin of the comparables taken by the AO in the order giving effect to the DRP's directions, is 13.13%. The assessee's combined margin is also better than that of the comparables, which makes the international transaction at ALP.

CNK Comments:

Based on this judgment, one can take a stand that there is no requirement of providing separate segmental breakup between the AE and non-AE. If the combined PLI is greater than the margin of the comparables, then the transactions entered with AE can be said to be at ALP.

Pledge of shares with the Bank to facilitate loan to the AE akin to corporate guarantee services and needs benchmarking at ALP

Virgo Valves & Controls Ltd [TS-167-ITAT-2022(Mum)-TP]
(in favor of Revenue)

Facts/Background:

The assessee had pledged certain shares with the bank as a collateral security for loan taken by its AE. The assessee contented that pledging of shares does not amount to issue of corporate guarantee.

The TPO treated the said pledge of shares as international transaction and computed the value of international transaction at 2.5% of book value of pledged shares. The definition of "international transaction" contained in the explanation to section 92B is inclusive and not exhaustive. Guarantee has specifically been included as international transaction. In case of guarantee, the assessee facilitates its AE to take loan from any bank for which it stands as a guarantor. For such guarantee given, it assumes risk. But for this guarantee given by it, the bank would not have given loan to the AE. Similarly, where the assessee pledges its securities to any bank and on that basis, loan is availed by the AE, the same would amount to international transaction. In a third-party situation, no entity will assume this risk of pledging its assets, which can be confiscated by the lender on default by the AE, unless it is compensated for the same.

Held:

The definition of "transaction" in section 92F(v) includes an arrangement, understanding or action in concert; (whether or not such arrangement, understanding or action in concert, is formal or in writing; or whether or not such arrangement, understanding or action in concert is intended to be enforced by legal proceedings). Pledging of shares for the benefit of an AE is, therefore, an international transaction and akin to corporate guarantee.

KEY TAKE AWAY

- Payment to e-commerce operator for subscription-based website access was treated as being in the nature of fees for technical services and was held to be subject to TDS under section 195, even where Equalization levy was paid.
- Requirement of furnishing Form 67 for claim of FTC is only a directory requirement.
- Separate Notification is not required for availing benefit of "Most Favoured Nation" clause. The CBDT Circular would not be applicable from retrospective date.
- Combined PLI earned from transactions with AE and non-AE more than PLI of comparables companies, by itself would make International Transactions at ALP.
- Pledge of shares with the bank to facilitate loan to the AE akin to corporate guarantee services and needs benchmarking at ALP.

www.cnkindia.com

CNK
& ASSOCIATES LLP

MUMBAI

3rd Floor, Mistry Bhavan, Dinshaw Vachha Road,
Churchgate, Mumbai. 400 020, India.
Tel: +91 22 6623 0600

501/502, Narain Chambers, M.G. Road,
Vile Parle (East), Mumbai 400 057, India.
Tel: +91 22 6250 7600

Bengaluru: +91 80 2535 1353
Chennai: +91 44 3557 6647
Vadodara: +91 265 234 3483
Ahmedabad: +91 79 2630 6530
Gandhinagar: +91 79 2630 6530
Delhi: +91 11 2735 7350
Dubai: +971 4 3559533
Sharjah: +971 4 3559544