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International Tax and Transfer Pricing –Judicial Decisions

International Tax – Judicial Decisions

In Brief

In cases of secondment agreement where Indian company for all practical purpose is an employer of the secondee, reimbursement of expenses incurred by foreign company will not attract provision of withholding tax as the same is not in the nature of "fees for technical services"

Abbey Business Services India Pvt Ltd [TS-655-HC-2020(KAR)] (In favour of assessee)

Facts

The assessee, an Indian company and a subsidiary of foreign company ANTICO Ltd. ANTICO Ltd., was a group company of Abbey National Plc, UK (ANP). During the year under consideration, ANP entered into secondment agreement with assessee to facilitate the outsourcing agreement between ANP and a third-party service provider (MSource) in India. Accordingly, ANP sent some executives to India and salary was paid to them by ANP. Assessee made certain payments to ANP; part of which was salary reimbursement on which Indian tax was deducted and balance pertained to hotel and travelling expense on which tax was not withheld (reimbursement). Subsequently, the assessee filed an application with the assessing officer (AO) under section 195(2) of the Income-tax Act, 1961(the Act), to seek authorization for payments to non-residents without deduction of tax. The AO held that the application under section 195 was filed much after the date of credit of the sums to the accounts of ANP and considered the application as non est (non-existent) and disposed of the same without adjudicating the claim of the assessee on merits.

The assessee, thus filed a petition under section 264 of the Act before Director of Income-tax who rejected the petition preferred by the assessee.

Subsequently, the AO heard the assessee and found that assessee had deducted tax only on part amount and did not deduct the tax on the balance amount. The AO in his order held that as per the secondment agreement, the seconded employees of ANP were highly skilled and ANP had agreed to provide training to some of the employees of third party/MSource. Accordingly, the entire payment was in nature of "fees for technical services" (FTS) under the Act and the India-UK tax treaty, on which tax should have been withheld. Resultantly, the AO treated assessee as "assessee in default" for non-withholding of tax on payments made to ANP.

Aggrieved by the order passed by AO, assessee filed an appeal before Commissioner of Income-tax Appeals [CIT(A)]. However, CIT(A) dismissed the appeal.

Thus, assessee approached the Bangalore Tribunal. The tribunal relying on various decisions (including earlier decision in assessee's own case) held that:

- Assessee established that payment made to ANP is not taxable in India.
- There was no obligation on the part of the assessee to deduct the tax at source on the payments made to ANP and therefore, the assessee cannot be treated as 'assessee in default' under section 201(1) of the Act.

Aggrieved by the order passed by the tribunal, the revenue authorities approached Karnataka High Court.

Held

On perusal of the relevant clauses of the agreement and the nature of services provided by the assessee under the agreement, it was evident that the assessee had entered into a secondment agreement for securing services to assist assessee in its business.

Secondment agreement constitutes an independent contract of services in respect of employment with assessee. The seconded employees had to work at such place as the assessee may instruct and the secondee had to function under the control, direction and supervision of the assessee and in accordance with the policies, rules and guidelines applicable to the employees of the assessee.

The employees in their capacity as employees of the assessee had to control and supervise the activities of Third party/MSource. Therefore, the assessee for all practical purposes was to be treated as employer of the seconded employees.

There was no obligation in law for deduction of tax at source on payments made for reimbursement of costs incurred by a non-resident enterprise and therefore, the amount paid by the assessee was not liable to withholding tax. Similar view has been taken by High Court of Delhi in HCL Info System Ltd[1] in respect of salaries paid to foreign technicians on behalf of the assessee.

High Court also distinguished ruling of Delhi High Court in case of M/s Centrica India Offshore Pvt. Ltd.[2] citing that the said decision is factually not applicable to the present case.

[1] 274 ITR 261 (Delhi)
[2] W.P.(C) No. 6807/2012 dated 25-4-2014

In Brief

Offshore supply by Swedish Co. under a consortium with its Indian AE is not taxable in India, in absence of place of business (Permanent Establishment) at disposal in office of Indian AE

Bombardier Transportation Sweden AB [TS-552-ITAT-2020(DEL)] (In favour of assessee)

Facts

Assessee, a company incorporated in and tax resident of Sweden was engaged in the business of manufacturing of train control and signalling systems for mass transit system. During the year under consideration, assessee entered into an agreement with Delhi Metropolitan Railway Corp. (DMRC) and consortium agreement with its Indian AE (BTIN). The assessee also rendered intermediaries' services like marketing, sales, business development, project management, customer services etc. to BTIN and received fees for it. Assessee relying on the beneficial provisions of Article 12 and protocol 7 of the India – Sweden tax treaty contended that the income from rendering intermediary services is not taxable in India as FTS.

However, AO held that the intermediary services were taxable in India as FTS. Aggrieved, assessee filed objection with Dispute Resolution Panel (DRP). DRP examined clauses from the agreement with DMRC as well as consortium agreement between the assessee and BTIN and observed that the assessee has permanent establishment (PE) in India in the form of BTIN. Having held that BTIN is the PE of the assessee in India, the DRP attributed the income earned by the assessee from offshore supply of goods and equipment to the PE on gross basis.

Held

- The undisputed fact was that the supplies made under the agreement were offshore supplies. The Hon'ble Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd.[3] had categorically held that only such part of the income attributable to the operations carried out in India can be taxed in India.
- The assessee did not have any place of business in India and all business activities with respect to offshore supplies were carried outside India. The equipment supply was manufactured at overseas manufacturing facility of the assessee and sale of equipment has occurred outside India and payment was also received by the assessee outside India.
- The entire findings of the DRP were based on erroneous appreciation of wrong facts and on perusal of incorrect facts. In fact, the DRP relied on an incorrect contract of another group company instead of the contract between DMRC and the Consortium.
- Accordingly, based on such erroneous appreciation of wrong facts, the DRP held that BTIN was the PE of the assessee in India without

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Rate of Dividend Distribution Tax (DDT) on dividend declared by Indian company can be restricted to tax rate on dividends provided under the tax treaty

appreciating the true facts that the assessee has no place at disposal in India in the office of BTIN from where the assessee could have conducted its business in India.

- Accordingly, the Tribunal directed the AO to delete the addition of income attributable to PE.

[3]158 Taxman 259

Giesecke & Devrient [India] Pvt Ltd [TS-522-ITAT-2020(del)] (In favour of assessee)

Facts

The assessee, an Indian company is a wholly owned subsidiary of a German Company. During the year, the assessee declared and paid dividend to German Company and discharged the DDT liability as per the rates prescribed under the Act (i.e., 15%).

During the course of appeal proceedings before the Delhi Tribunal on issues of transfer pricing, expense disallowance etc., the assessee raised an additional ground of appeal i.e. dividend declared by the assessee company pertaining to its German parent, should be governed by the provisions of India-Germany tax treaty. Accordingly, assessee company contended that the rate of DDT should be restricted to 10% (as per tax treaty) and excess DDT paid (over and above 10%) should be refunded.

Held

Delhi Tribunal allowed the additional ground of appeal relying on the decision of Delhi High Court in case of Maruti Suzuki India Ltd.[4] wherein the High Court accepted the additional issue on similar lines.

Delhi Tribunal, based on the following reasoning, decided the issue in favour of assessee:

- As per the memorandums provided by the Government during introduction / amendments to provisions of DDT, it was observed that levy of DDT was merely for administrative conveniences.
- Though the liability of collection and payment DDT is on company, its incidence is on the shareholders/ recipient.
- DDT is a tax and levy of any tax is subject to provisions of an applicable tax treaty.
- The India-Germany tax treaty and its provisions of limiting tax on dividends at 10% were introduced prior to introduction of DDT. It has been consistently held by judicial authorities that unilateral

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No merit in Assessing officer questioning availment of services and benefit derived from services availed from associated enterprise from common pool, when evidence had been filed by assessee

amendment in Indian tax law cannot be used to deny tax benefits under a tax treaty which was signed / negotiated earlier on a different understanding.

- Since Indian tax law permits application of tax treaty provisions, if more beneficial to taxpayer, the rate of DDT should be restricted to 10% (as per tax treaty) on dividend payable to a German Company.

[4] WP(C) 1324/2019

Transfer Pricing – Judicial Decisions

Danisco India Private Limited (ITA No.2846/Del/2016)
(In favour of assessee)

Facts

The assessee was engaged in manufacturing and marketing of food and non-food ingredients. It was a closely held company; the majority shares being held by Danisco A/s Denmark.

It entered into various international transactions with its associated enterprises (AE). The case was referred to transfer pricing officer (TPO) for determination of arm's length price (ALP). The Intra Group services (IGS) transaction was benchmarked using transactional net margin method (TNMM), wherein the assessee was the tested party.

The TPO raised queries in respect of IGS.

The assessee explained to the TPO that:

- It had paid service fees under the head "management services" which were reimbursed on cost to cost basis.
- Services availed were on account of corporate support, sales & marketing, and technical assistance & support. Documentary evidence were filed in respect of them which included debit notes and the cost sharing agreement.
- All the costs incurred with respect to providing common services (shared costs) were accumulated in a cost pool and were allocated to various Danisco entities on the basis of sales.
- There was no merit in shifting profits to Denmark as the tax rates in Denmark were as high as 25% and the assessee was also paying service tax in India under reverse charge mechanism.

The TPO however rejected the assessee's explanation and proceeded to benchmark the IGS transaction using comparable uncontrolled price

method (CUP). The TPO determined the ALP as NIL (resulting in upward addition to taxable income), based on the following observations:

- Details/documentary evidence of the shared cost pool and the allocation of the costs on the basis of the allocation were not filed
- No cost benefit analysis had been undertaken by the assessee
- Assessee had incurred cost for legal and professional charges and at the same time also availed corporate tax advice and legal service which indicated duplication of work as it has not been specified how the services rendered were different.
- Payment made on account of management services had to be separately analyzed to see whether the transaction was at ALP or not
- There was failure on part of assessee to substantiate that services were actually been rendered to it and benefit had been derived by it on the basis of documentary evidence,
- An independent enterprise would not have paid any third party without ascertaining a cost base and corroborating facts.
- No function, asset and risk (FAR) analysis had been conducted of the IGS to justify the functions performed by the AE for these payments

Aggrieved by the actions of the TPO, the assessee approached Commissioner of income-tax appeals [CIT(A)], who upheld the action of the TPO.

The assessee approached Income tax appellate tribunal (ITAT)

Held

The ITAT quashed the order of the CIT(A) and provided relief to assessee by holding that:

- The Assessing Officer/TPO cannot sit in judgment over the manner in which business have to be carried on by the businessman or as to what benefits are derived by the assessee from availment of such services. The domain of the TPO is limited to check whether services have been availed.
- The basis of the disallowance was that no services had been actually rendered which contradicts the aspect of argument of TPO and CIT(A), that there was duplication of services or the same were shareholder services/activities.
- The assessee had filed extensive evidence with regard to availment of services. The analysis done by the TPO of the nature of services and

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Management services intangible in nature, difficult to provide concrete evidence of rendition

benefits arising to the assessee on availing such services was beyond the scope of transfer pricing provisions.

- The Tribunal relied on the decision of the Pune Tribunal in case of Emerson Climate Technologies (India) Ltd[5] where on similar facts wherein it was held that the approach of TPO in applying CUP to determine the ALP of IGS was inappropriate as the TPO has failed to identify the comparison of controlled transactions with comparable uncontrolled transactions. Determination of the ALP on the basis of need and a benefit of services to the assessee is not CUP method and was not permissible in law.

[5] [2018] 90 taxmann.com 125 (Pune-Trib.)

Henkel Chembond Surface Technologies Limited [TS-673-ITAT-2020(Mum)-TP]
(In favour of assessee)

Facts

Assessee was engaged in business of manufacturing/trading of chemicals and was a joint venture between Henkel AG & Co. KGaA, Germany (51%) and Chembond Chemicals Ltd., India (49%). It received regional management services from Henkel Germany (AE) in the nature of assistance in decision making and adoption of best policies and practices, resulting in better market position and increased turnover.

The case was referred to TPO and the ALP of the regional management service was assessed at Rs. NIL on the premise that assessee failed to provide documentary evidence in support of services received.

Aggrieved, assessee filed an application before Dispute Resolution Panel (DRP), which was rejected by the DRP.

The assessee appealed to ITAT and submitted/contended:

- that the issue pertaining to sufficiency of the documentary evidence in support of the regional management services received by the assessee from its AE was under the jurisdiction of the AO and not the TPO; and
- that the TPO by determining the ALP of the regional management services at Rs. NIL without following any one of the prescribed methods contemplated in law had clearly exceeded his jurisdiction.

Held

The ITAT observed the following:

- The assessee had placed on record documentary evidence in the nature of

– (i) copy of agreement between assessee and AE, (ii) details of management charges, (iii) copies of debit notes raised on the assessee by AE, (iv) information pertaining to visits by overseas employees, (v) cost benefit analysis and backup documents substantiating benefits received, and (vi) E-mail correspondence between assessee and AE, which constituted substantial evidence of rendering of services

- Cost benefit analysis of regional management cost (RMC) pertaining to a range of regional services rendered by the AE within the group, viz.(i) regional planning and guiding services; (ii) regional marketing services; (iii) regional supply and chain operational support services; and (iv) regional safety, health and environment support compliance services were also filed by the assessee before the lower authorities, therein explaining the benefits derived by the assessee from the services rendered by the AE. This was done to drive home the claim of having received the aforesaid services along with benefit derived therefrom.
- The claim of the assessee was correct that since the regional management services received from its AE were intangible in nature, therefore, evidence in support of availing of such services and the benefit received therefrom can only be demonstrated by narrations, descriptions and documentary evidence.
- The department's contention pertaining to insufficient documentation was incorrect. The material placed on record by assessee sufficiently demonstrated that assessee benefitted from the services rendered by AE on the basis of its experienced personnel who were possessed of rich experience in understanding the practical aspects of the nature of business of the assessee along with its service requirement. Lastly, relying on various decisions, it was held that the TPO should not have benchmarked the international transactions of the assessee at NIL or in an adhoc manner without following any one of the prescribed methods.

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