CNK & Associates LLP
Chartered Accountants

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Transfer Pricing and International Taxation

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TRANSFER PRICING

Letters of comfort/ support issued to banks on behalf of subsidiaries and disclosed as contingent liability in the financial statements would constitute an international transaction within the meaning of section 92B

Asian Paints Ltd. vs. ACIT (160 taxmann.com 214) (Mumbai - Trib.)
In favor of Revenue

Facts

The assessee had issued non-contractual letters of comfort/support to banks on behalf of its subsidiary associated enterprises **(AEs)**, who had availed loans from banks outside India. The loans were granted by the banks to the AEs against the security of debts/ receivables by the AEs. The assessee argued that it has no financial obligation whatsoever, while granting the letter of comfort and no cost was incurred by the assessee for the same. The assessee further argued that the letter of comfort does not keep the assessee financially or legally obligated to bear the costs of repayment of loans to the banks, in case the subsidiaries defaults in repayment and thus, cannot be said to be covered within the scope of transfer pricing provisions, which requires determination of arm's length price (ALP).

Held

The assessee in its financial statement has not only considered the corporate guarantees issued as its contingent liability but has also considered the letters of comfort/support as contingent liability. Once the letters of comfort/ support were admitted as liability by the assessee itself, thus have a bearing on the assets, it would constitute an international transaction within the meaning of section 92B of the Act.

INTERNATIONAL TAXATION

Subscription fees received by a USA based company for providing access to data base pertaining to legal and law related information was not taxable in India as fees for technical services (FTS)

CIT vs. Relx Inc. (160 taxmann.com 109) (Delhi HC)
In favour of Assessee

Facts

The assessee, a tax resident of USA, was engaged in the business of maintaining online database pertaining to legal and law related information, titled 'Lexis Nexis'. It had received subscription fee from Indian subscriber for the use of the said database. The assessee filed its return of income by treating subscription fees received as business income, not taxable in India, in absence of permanent establishment **(PE)**. The AO held that the said income would be taxable in India as FTS as per section 9(1)(vii) of the Act as well as fee for included services **(FIS)** as per Article 12(4) of the India USA Tax Treaty.

Held

The assessee providing access to the database cannot be considered to be providing any managerial, technical or consultancy service to a subscriber. The mere access granted to a subscriber to the legal data base would clearly not fall within the ambit of section 9(1)(vii) of the Act as well as, as per Article 12 of the India USA Tax Treaty. For subscription fees to be taxed as 'royalty', the payments should be a consideration for the use of or the right to use any copyright or literary, artistic or scientific work as defined by Article 12(3) of the Tax Treaty. Granting access to the database would clearly not amount to a transfer of a right to use a copyright. Neither the subscription agreement nor the advantages accorded to a subscriber can possibly be considered in law to be a transfer of a copyright. The Supreme Court in Engineering Analysis Centre for Excellence vs. CIT (125 taxmann.com 42) has clearly drawn the distinction

between the transfer of a copyright as distinct from a mere right to use copyrighted material. Accordingly, mere granting access to the legal data base would not be taxable as 'Royalty' or FTS/FIS as per the Act as well as India USA Tax Treaty.

FTS received by a Mauritius company would not be taxable in India, in absence of specific clause as per India Mauritius Tax Treaty. Article 12A inserted w.e.f. 1st April 2017 cannot be applied for earlier years

Diamond Manufacturing Management and Consultancy Ltd. Mauritius vs. ACIT (161 taxmann.com 77) (Visakhapatnam - Trib.) (In favour of Assessee)

Facts

The assessee was a tax resident of Mauritius. It had entered into a technical collaboration with its AEs in India for providing technical, process, marketing and sales assistance services outside India and received FTS. The AO invoked section 9(1)(vii) read with section 115(A)(1)(b) of the Act and concluded that the FTS were chargeable to tax in India.

Held

In absence of any specific clause in the India Mauritius Tax Treaty, FTS received by Mauritius Company can only be taxed as per Article 7 dealing with business profits. Since the assessee does not have any PE in India, these business profits cannot be taxed in India. Article 12A was inserted in the India Mauritius Tax Treaty with effect from 1st April 2017, where clause taxing FTS was inserted. The said Article 12A cannot be applied for earlier years.

Separate Notification issued in respect of India Spain Tax Treaty - Notification S.O. 1484(E) [NO. 33/2024/F.NO. 503/2/1986-FTD-I]

Brief Background

India has entered into various Tax Treaties with different countries to achieve various objectives that aim to foster economic cooperation, prevent double taxation, promote cross-border trade and investment, and prevent tax evasion. Tax Treaty becomes effective once it is notified in the official gazette.

India has entered into Tax Treaties with various Organisation for Economic Co-operation and Development **(OECD)** countries illustratively, Netherlands, France, Switzerland, Sweden, Spain, Hungary which have a Most Favored Nation **(MFN)** clause. MFN clause in the Tax Treaty provides that if after signature/entry into force of the Tax Treaty with the first country, India enters into a Tax Treaty at a later date with another OECD countries providing for a beneficial rate of tax or restrictive scope for taxation of particular income viz. dividend, interest, royalty, etc. a similar benefit should be accorded to the first country.

Decision of Supreme Court in case of Nestle SA

The Supreme Court in the above decision held that a notification under section 90(1) is necessary and a mandatory condition for a court, authority, or tribunal to give effect to a Tax Treaty, or any protocol changing its terms or conditions, which alters the existing provisions of law. In absence of separate notification under section 90, the beneficial tax treatment granted by another OECD country would not automatically apply to the Tax Treaty with First Country. In such an event, the terms of the earlier Tax Treaty require to be amended through a separate notification under section 90.

Separate Notification issued in respect of India Spain Tax Treaty

As per the Protocol to the India Spain Tax Treaty, where India limits its taxation at source on royalties or

FTS to a rate lower or a scope more restricted than the rate or scope provided for in this Tax Treaty, the same rate or restricted scope as provided for in the Tax Treaty with other OECD Country shall also apply to India Spain Tax Treaty. The Supreme Court in case of Nestle SA had held that it is mandatory for the CBDT to issue separate notification to amend India Spain Tax Treaty.

As per existing India Spain Tax Treaty, royalties relating to the payments for the use of, or the right to use, industrial, commercial or scientific equipment was taxed at 10% of the gross amount, whereas other royalties or FTS was taxable at 20%.

The CBDT has issued separate notification dated 19th March 2024 amending Article 13 of the India Spain Tax Treaty, affecting the taxation of royalties and FTSs. In view of the said Notification, all royalties and FTS would get taxed at 10% of gross amount as per India Germany Tax Treaty.

CNK Comments

The above notification is effective from AY 2024-25. However, the Protocol to India Spain Tax Treaty states that the same is applicable from the date on which the later Tax Treaty was signed. Accordingly, whether lower rate of tax of 10% would be applicable from the date on which India Germany Tax Treaty was signed or with effect from AY 2024-25 is still in question. India Spain Tax Treaty did not require any separate notification to give effect to the protocol in the Tax Treaty. However, in view of the Supreme Court decision, the CBDT has issued separate notification for amending India Spain Tax Treaty. Similar notifications need to be issued by the CBDT for amending other Tax Treaties with MFN clause.

Protocol amending India Mauritius Tax Treaty – Principal Purpose Test inserted in India Mauritius Tax Treaty

India and Mauritius had signed Tax Treaty on 24th August 1982. As per the said Tax Treaty, any capital gains earned by a resident of one contracting state from sale of shares in another country was only taxable in the country of which the alienator was a resident.

The said Tax Treaty was last amended in May 2016 whereby the right to tax capital gains arising from sale or transfer of shares acquired after 1st April 2017 was allowed to the country in which the company whose shares were transferred was a resident. With the amendment in May 2016, shares acquired until 31st March 2017 was not taxable in India, shares acquired and sold between 1st April 2017 and 31st March 2019 would attract capital gains tax at a 50% discount on the domestic tax rate, whereas shares acquired after 1st April 2017 and sold after 1st April 2019, will attract tax at the full domestic rates.

On 7th March 2024, India has signed another protocol amending the Tax Treaty with Mauritius to plug treaty abuse for tax evasion or avoidance. The amended Tax Treaty has included what is called the Principal Purpose Test **(PPT)**, which essentially lays out the condition that the tax benefits under the treaty will not be applicable, if it is established that obtaining that duty benefit was the principal purpose of any transaction or arrangement. The earlier protocol of May 2016 included Article 27A Limitation of Benefits which applied only to capital gains. The March 2024 protocol has inserted a new Article 27B after Article 27A that applies to any type of income and is not restricted to capital gains.

The PPT will deny treaty benefits, such as the lower rate of withholding tax on interest royalties and dividends, where it is established that obtaining that treaty benefit is one of the principal purposes for the party engaged in the transaction.

Mauritius had signed the Multilateral Convention to implement the Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting **(MLI)** on 5th July 2017. However, the MLI only applies to tax treaties that are Covered Tax Agreements **(CTA)**. Treaty between India and Mauritius was not listed as a CTA until the above amendment.

The new protocol to the India Mauritius Tax Treaty is therefore designed to raise it to the status of a CTA under the MLI.

By adhering to the new protocol, treaty benefits can be denied if the business arrangement is done purely for the purpose of avoidance of tax. An abuse of these provisions can result into denial of benefits. The amendment does not clarify whether or not past investments will be grandfathered, albeit, the PPT provision has been introduced as a non-obstante clause of the treaty. It is possible to interpret that the Protocol shall prevail over other provisions of the treaty, including the grandfathering provision.

CNK Comments

*The CBDT has stated that the Protocol pertaining to the amendment is yet to be ratified and notified under section 90 of the Act and until this Protocol comes into force, any queries or concerns regarding the amendments will be addressed as and when necessary. The CBDT Circular No. 789 had clarified that Tax Residency Certificate **(TRC)** by Mauritian authorities will constitute sufficient evidence of residence to claim benefits of Tax Treaty. With PPT provision now introduced in the India Mauritius Tax Treaty, Indian tax authorities are likely to look beyond TRC and will deny the benefit of India Mauritius Tax Treaty if it is reasonable to conclude, that obtaining the treaty benefits was one of the principal purposes of any arrangement or transaction.*

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