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August 2022

Communiqué

International Tax

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USD 4.95 Mn Paid by ONGC to University of Texas, USA, for Research, Not Taxable as FTS or Royalty Under India-US DTAA

USD 4.95 Mn Paid by ONGC to University of Texas, USA, for Research, Not Taxable as FTS or Royalty Under India-US DTAA

Facts

The assessee was a Central Public Sector Undertaking and had entered into an agreement with the University of Texas at Austin, USA to carry out research activity in collaboration with the assessee for the development of suitable chemical Enhanced Oil Recovery (EOR) formulations for its 5 reservoirs. As per agreement, the assessee agreed to pay to the University of Texas a sum of USD 4.95 million in aggregate for the services to be availed. The assessee in view of the fact that the aforementioned University was a tax resident of USA and did not have a permanent establishment in India. An application for an order under section 195(2) of the Act was sent to the ITO Int. Tax, to determine the proportion of sums chargeable to tax on which tax was to be deducted.The ITO Int. Tax observed that the payments to be made to University of Texas at Austin, USA were in the nature of royalties/fees for technical services. Consequently, the AO directed the assessee to deduct the TDS @ 10% (excluding education cess /surcharge) on gross payments to be made to the University.

Aggrieved, the assessee filed an appeal before the Ld. CIT-A. The assessee before the Ld. CIT-A submitted that the payments made to the University did not attract section 195 of the Act.

However, the CIT-A upheld the order of the ITO Int. tax. Consequently, the assessee approached the Tribunal.

Ruling

The Tribunal ruled in favor of the assessee by relying upon section 9 of the Act as well as Article 12 of the DTAA. It observed that under the Act if the consideration paid for rendering technical services constitutes income by way of fees for technical services, it is taxable. However, it was noted that Article 12 of the India USA Treaty also defines fees for technical services. The Tribunal then went on to compare the definitions of the term royalty and fees for technical services under both the Act as well as the DTAA.

The Tribunal held that, *"In view of section 90 of the Act, the definition of fees for technical services contained in the agreement overrides the statutory provisions contained in the Act. In fact, the latest agreement between India and Singapore further clarifies this position, where they have explained the meaning of the word 'make available'…Therefore the clause in Singapore agreement which explicitly makes clear the meaning of the word 'make available', the said clause has to be applied, and to be read into this agreement also. Therefore, it follows that for attracting the liability to pay tax not only the services should be of technical in nature, but it should be made available to the person receiving the technical services. The technology will be considered 'made available' when the person who received service is enabled to apply the technology."*

The Tribunal further held that the **tax is not dependent on the use of the technology by the recipient.** It opined that the recipient after receiving of technology may use or may not use the technology and the same would have no impact on the taxability aspect is concerned. It was noted that just because his business is dependent on the technical service which he receives from the service provider, it does not follow that the assessee is making use of the technology which the service provider utilizes for rendering technical services. The Tribunal held that, *"Therefore, unless the service provider makes available his technical knowledge, experience, skill, know-how or process to the recipient of the technical service, in view of the clauses in the DTAA, the liability to tax is not attracted."*

The Tribunal concluded the matter by noting that in order to ascertain whether the service provider had made available the technical knowledge to assessee as far as tax liability was concerned, it was evident from the articles of the agreement between ONGC and the University and the facts of the case that there was neither any patent nor any copyright used by the assessee against which the royalty was paid nor there was any technical know-how which was made available to the assessee and hence no tax liability in view of Article 12 of the DTAA could be imposed upon assessee.

Source: Tribunal, Ahmedabad in Oil and Natural Gas Corporation Ltd. vs. ITO dated 3rd August 2022, vide ITA Nos. 1881-1882/AHD/2019

ITAT Quashes Revisionary Order

ITAT Quashes Revisionary Order: Holds that No Prejudice Caused to Revenue on DAPE's Taxability Where Department Agent Remunerated at ALP

Facts

The Assessee Company was a non-resident company incorporated under the laws of Malaysia and was engaged in the supply of supplies Aluminum formwork which finds application in the construction of buildings. The Group had a wholly owned subsidiary in India in the name and style of MFE Formwork Technology India P Ltd ('MFE-India') having its registered office at Mumbai, Andheri. The assessee had been a tax resident of Malaysia in terms of Article 4 of the DTAA entered into between India and Malaysia and had executed a Marketing Service Agreement ('MSA') with MFE-India. As per the MSA, MFE-India was required to promote and market the products of the Assessee Company within India and educate the prospective customers about the benefits of the products offered by the Assessee Company. Furthermore, vide a technical support service agreement between MFE-Malaysia and MFE-India, the latter is required to provide support in terms of the formwork supplied by MFE Malaysia to its customers in India; such support being in the nature of supervisory support that would be required by the customer as regards the formwork supplied.

The said company qualified as a dependent agent of the assessee in terms of Para 5 of Article 5 of the DTAA between India and Malaysia. Thus, for the year under consideration, the assessee had a Permanent Establishment ('PE') in India in terms of Article 5 of the DTAA between India and Malaysia. The assessee had filed the Return of Income for such PE.

During the course of assessment, the AR was asked to submit the Computation of Income for the Return of Income filed by the assessee for the year under consideration wherein it was found that the assessee had computed profit attributable to the activity of PE in India from sales made in India and had computed the same by attributing 24% of Gross Profits based on FAR Analysis.

The AO accepted such computation made by assessee, however the matter was revised on the ground that *"no enquiry had been conducted with regard to how attribution of 24% gross profit was arrived at"*, it was also viewed that, *"the Assessing Officer has simply accepted the Function Asset Risk Analysis [FAR analysis] submitted by the assessee company disregarding several other factors, which demonstrate lower than Arm's Length Profit are attributed to Indian operations"*.

Consequently, the Commissioner rejected such analysis of the assessee and conducted his own due to which the profit attributable to tax came to a 35% instead of the prior 24% and asked the AO to pass a consequential order in line with such findings. Aggrieved, the assessee appealed before the Tribunal.

Ruling

The Tribunal ruled in favor of the assessee. At the very outset the Tribunal noted that the form of PE was a dependent agent permanent establishment (DAPE) and that the assessee had complied with and duly paid the arm's length remuneration for the services rendered by the agent constituting the DAPE. The Tribunal noted that the assessee followed a dual taxpayer approach and relied upon **Set Satellite Singapore Pte Ltd. v. DCIT (2008) 307 ITR 205 Bom.** And observed that, *"so far as profit attribution of a DAPE is concerned, the prevailing legal position is that as long as an agent is paid an arm's length remuneration for the services rendered, nothing survives for taxation in the hands of the dependent agency permanent establishment."*

The Tribunal arrived at the issue that whether an order could be considered to be prejudicial to the interest of the revenue even when the income so determined is on the basis of the correct legal position of the single taxpayer approach, moreover so which had the approval of the Hon'ble jurisdictional High Court. The Tribunal analyzed section 263 of the Act that allows the Commissioner may modify or cancel the assessment passed by the AO, if he considers such order by AO to be erroneous in so far as it is prejudicial to the interests of the revenue. The Tribunal relied on case of **Malabar Industrial Co Ltd Vs CIT [(2000) 243 ITR 83 (SC)]**, wherein it was held that, "*A bare reading of this provision makes it clear that the pre-requisite to exercise of jurisdiction by the Commissioner Suo motu under it, is that the order of the ITO is erroneous insofar as it is prejudicial to the interests of*

the revenue. The Tribunal held that the Commissioner had lost sight of the difference between tax attribution to a PE and a DAPE. Furthermore, the Commissioner had considered such profit attribution in both such cases was pari materia, a proposition that has been specifically rejected by the Indian judiciary time and again. As such the Commissioner had erred by not examining the arm's length price determination in the context of the dependent agent.

The Tribunal concluded by proclaiming that, "*The order being prejudicial to the interest of the revenue, inasmuch as the payment to the dependent agent not being at an arm's length,* ***is a sine qua non for holding that the order is prejudicial to the interest of the revenue. This exercise has clearly not been done on the facts of this case. For this short reason alone, we must set aside the impugned revision order."***

Source: Tribunal, Mumbai in MFE Formwork Technology Sdn Bhd vs. DCIT [International Tax Circle 3(2)(1) dated 30th August 2022 vide ITA No./890/Mum/2022

Commission Received is Not Fees for Technical Services

Commission Received is Not Fees for Technical Services: Services Rendered Not in the Nature of Managerial, Technical or Consultancy

Facts

The assessee was a company incorporated as per German laws and is a tax resident of Germany. It was engaged in the business of publishing of books and journals in the field of research, education and professional business. In January, 2013 the assessee entered into a Commissionaire Agreement with SIPL by which the assessee was appointed as a non-exclusive sales representative on a global basis to promote, grant and distribute products of SIPL.

During the scrutiny assessment, the AO was of the opinion that the entire receipt claimed as commission income was royalty taxable under section 9(1)(vi) of the Act and the DTAA with Germany and as such treated the same as royalty at the rate of 10% under India Germany DTAA.

The CIT upon appeal considered the same to be FTS. Aggrieved, the assesse approached the Tribunal for relief.

Ruling

The Tribunal ruled in favor of the assessee. It conducted an in-depth analysis of past judicial pronouncements to understand the nature of consultancy and technical services. The Tribunal relied on cases such as **Panalfa Autoelektrik Ltd. 227 Taxman 351, Hero Motorcorp Ltd 394 ITR 403, Farida Leather Company 238 Taxmann.com473, Endemol south Africa [Proprietary] Ltd. 67 ITR (T) 520** to substantiate its ruling. In light of such cases, the Tribunal observed that managerial services necessitate the component of management of the business of the service recipient in a substantial manner. A mere provision of support services cannot be regarded as managerial services and hiring an outside party for provision of support in respect of the operational aspects of a business does qualify as managerial services. The Tribunal also referred to the Commentary to the UN Model Convention for guidance with regards to managerial services.

It further noted that as per the aforementioned judicial precedents, it was maintained that as no patents, invention, model, design or secret formula were transferred or permitted to use and the services rendered were not managerial, technical or consultancy services, the commission payment towards them did not get subsumed under the category of fees of technical services.

The Tribunal further observed that the assessee had received commission which was simply export commission/sales commission and in order to construe any payment as FTS, such payment should have been regarded as a consideration for the rendering of any managerial services. However, here the services provided by the assessee were in respect of customer and sale support. As such it set aside the impugned order passed by the CIT.

Source: Tribunal, Delhi in M/s. Springer Verlag GmbH vs. DCIT [International Taxation Circle- 3(1)(2)] dated 23rd August 2022 vide ITA No. 3826/Del/2019 (A.Y. 2015-16)

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ITAT Deletes Section 40(a)(i) Disallowance

ITAT Deletes Section 40(a)(i) Disallowance: United India Insurance Not Liable to Deduct Tax at Source under Section 195 On Premium Ceded to NR Reinsurers

Facts

The assessee was a public sector general insurance company (fully owned by Government of India) carrying on general insurance business in India. The assessee is governed by the Insurance Act, 1938 and the Insurance Regulatory and Development Authority (IRDA) Act, 1999. As a part of its business strategy, the assessee had taken reinsurance cover with nonresident reinsurer (NRRI) over and above the specific percentage of reinsurance business to be taken with General Insurance Corporation of India in terms of IRDAI regulations. The assessee has ceded reinsurance premium to non-resident reinsurer without deduction of tax at source under section 195 of the Income Tax Act, 1961.

During the course of assessment proceedings, the AO on the basis of details filed by the assessee noticed that the assessee had ceded reinsurance premium to non-resident reinsurer without deduction of tax at source under section 195 of the Act and as such, disallowed payments made to NRRI as per section 40(a)(i) of the Act on the ground that reinsurance premium paid to the NRRI would become income of the NRRI and would be considered as accruing and arising in India and therefore chargeable to tax as per section 5(2)(b) of the Act.

The AO further held that the liability cast under section 195(1) of the Act, could be discharged by way of deducting tax, or only by taking recourse to sub-section (2) or subsection (3) of section 195 and not applying to the Assessing Officer. Therefore, the AO opined that income of non-resident reinsurer is taxable in India and consequently, the assessee is liable to deduct TDS as required under section 195 of the Act. Since, the assessee had failed to deduct TDS, the total reinsurance premium ceded to non-resident reinsurer was disallowed as per section 40(a)(i) of the Act.

The assessee preferred an appeal before the CIT-A who upheld the order of the AO. Aggrieved, the assessee approached the Tribunal for relief.

Ruling

The Tribunal adjudged in favor of the assessee. It noted that in order to determine the obligation to deduct tax at source, it is upon the revenue to establish that the income was chargeable to tax in India both as per the Act as well as the DTAA. It was observed that the, *"income of NRRI does not accrue or arise in India, because accrual of income is said to take place in country, where revenue generating functions are carried on."*

The Tribunal relied on the case of **Toshoku Ltd v. CIT (1980) 125 ITR 525 (SC)** wherein, it was held that amounts credited in favor of non-resident, were not at the disposal or control of statutory agent and therefore, cannot be charged to tax on the basis of receipt of income, actual or constructive in the taxable countries and opined that even payment to brokers in India would not tantamount to receipt in India. It further expounded that even assuming that even if payment to Indian brokers was to be treated as received in India, *"one can avail provisions of the DTAA which are more beneficial whereby premium would be taxed in India only in case PE to foreign enterprise is situated in India"*

The Tribunal further scrutinized that in the current relevant case, firstly, the NRRIs did not carry out their business functions in India and secondly, the source of income of NRRI was also outside India, hence the Revenue's observations regarding the taxability of reinsurance premium ceded to NRRI in India was absolutely contrary to the facts as well as the well settled law.

Furthermore, neither the foreign insurers had any fixed place in India nor did they carry on any business operation in India, thus none of the conditions stipulated in Explanation 2 to Section 9(1)(i), defining 'Business Connection' could be established. While reaching its conclusion, the Tribunal rejected the Revenue's stance that the Indian brokers were to be categorized as agents of the NRRI, rather these brokers were simply acting as a facilitator or a communication channel and did not get involved in the negotiation of terms or of finalizing percentage. The same can be easily evidenced through the IRDA regulations and the broker's declaration that bars a broker from concluding contract on behalf of the NRRI.

The Tribunal held that where DTAA's specifically excluded reinsurance premium from the scope of business profits, the same could not be taxed in India and thus Section 195 was inapplicable. In case, there is no specific exclusion of reinsurance premium, said amount can be taxed in India only if foreign reinsurance companies have a PE in India. In the case of the assessee, in the years under consideration, the foreign reinsurers to whom the assessee had remitted the reinsurance premium did not have any fixed place of PE in India. It was also noted that the reinsurance brokers acted in their independent capacity and were not the dependent agency of the assessee as well as the non-resident insurers, thus there could not have been said to constitute business connection for an agency PE for the foreign reinsurers in India.

Source: Tribunal, Chennai in DCIT vs. United India Insurance Co. Ltd. dated 26th August 2022 vide ITA. No. 1693/Chny/2011, 34/Chny/2014

ITAT Directs Denovo Benchmarking for Counter Guarantees

ITAT Directs Denovo Benchmarking for Counter Guarantees

Facts

The assessee was a bank incorporated in Japan with its head office at Tokyo and had branch offices in India at Mumbai and Delhi. The assessee was engaged in the business of banking in India and it earns income from interest, commission, exchange and brokerage transactions as well as foreign exchange transactions. For the assessment year 2010–11, assessee filed its return of income declaring total income of Rs. 38,94,70,202.

During the year, the head office of the assessee in Japan executed inter-bank indemnities, against which the Indian branch issued guarantees on behalf of the clients of overseas branches. The Indian branch received guarantee commission ranging from 0.10% to 0.50% dependent on loan. For the year under consideration, the Indian branch received Rs. 78.09 lakhs as commission. During the course of transfer pricing assessment proceedings, the assessee was asked to furnish complete details regarding this international transaction, which was duly complied with by the assessee. The assessee was further asked to show cause as to why any fee should not be charged from the associated enterprise at the rate at which it has been charged from the non-associated enterprise. Furthermore, the assessee was asked to benchmark the aforesaid transaction and workout the without prejudice adjustment. Consequently, the assessee submitted that the functions performed by the Indian branch were in the nature of the provision of merely administrative support services.On without prejudice basis, the assessee submitted that the other nationalized banks were charging lower rate of commission on bank guarantee backed by a counter guarantee as compared to the issuance of bank guarantee.

The TPO rejected the submission of the assessee and passed an order under section 92CA(3) of the Act. the rate charged by Bank of Baroda to issue the guarantee as the Comparable Uncontrolled Price ('CUP") was considered and accordingly, an adjustment of Rs. 1,13,17,486 was made by applying guarantee fee of 0.75%. On appeal, the CIT(A) directed the TPO to recompute the commission for guarantee by making an addition of 10% increase in the rate of currently being charged by the assessee to arrive at the arm's length rate.

Consequently, both the Revenue and the assessee approached the Tribunal for relief.

Ruling

The Tribunal ruled in favor of the Revenue. It analyzed the case of **Australia and New Zealand Banking Group Ltd. v. DCIT ITA No. 1106/Mum/2017 (ANZ Bank)** relied upon heavily by the AR. The Tribunal noted that the case could not be applicable in the relevant case as unlike ANZ Bank the assessee in the relevant case had failed to furnish any details in support of the claim that no risk was being borne by the Indian branch. There was no detail/ document with regard to the counter guarantee/indemnity executed by the overseas branch nor had any details regarding whether the aforesaid process of charging and payment by the overseas branch was prior to or post the discharge of bank guarantee in favor of the beneficiary in India, in case of default been submitted by the assessee. Additionally, the Tribunal ascertained that although in Form No. 3 CEB the assessee had claimed to determine the arm's length price of international transaction of issuing bank guarantee against the counter guarantee issued by the associated enterprise by applying CUP method, there were, upon perusal, no details available on record as to how such benchmarking has been carried out by the assessee.

The Tribunal held that, "*The TPO, by considering the rate charged by Bank of Baroda for issuance of guarantee against 100% counter guarantee by reputed international banks, has made the transfer pricing adjustment by considering it to be an appropriate CUP. However, there is no further analysis as to how the said transaction is an appropriate CUP to the transaction undertaken by the assessee's Indian branch considering the FAR in both the transactions and whether any adjustment for differences as per Rule 10B(1)(a) of the Income Tax Rules is possible.* **We find that the learned CIT(A) vide impugned order on an ad hoc basis directed computation of commission for guarantee by making addition of 10% increase in the rate of commission charged by the assessee to arrive at the arm's length rate in view of the above, we deem it appropriate to remand this to**

the file of TPO for de novo benchmarking of impugned international transaction of issuing bank guarantee against counter guarantee issued by the associated enterprise. *The assessee is directed to produce all the documents before the TPO in support of its claim. Further, the TPO shall be at liberty to call for any details or documents for proper benchmarking of the impugned international transaction."*

Source: Tribunal, Mumbai in Mizohu Bank Ltd vs. Dy DIT dated 24th August 2022 vide ITA No. 2711/Mum/2017 and ITA No. 2712/Mum/2017

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