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Inside this edition...

ITAT Deletes Penalty Under Section 271(1)(c): Base Erosion and Separate Approach to Profit Attribution not Adequate Reason — 01

ITAT Rules Royalty to be Paid by Sony India: No Merit Found in the TP Adjustments Made by the TPO — 02

Distributive Fee paid by Google India Not Royalty Under India-Ireland DTAA: ITAT Follows SC Ruling in Engineering Analysis — 03

Tribunal holds UK Law Firm Eligible to Claim Benefit Under India-UK Treaty, Follows the Ratio in Linklaters Ruling — 04

Tested Party to Be One That is Least Complex in Nature: ITAT affirms CIT(A) Order Foreign AE Qualifies as Tested Party — 05

Base Erosion and Separate Approach to Profit Attribution not Adequate Reason

Facts

The assessee is a company incorporated as a tax resident of Netherlands and was taxable on gross basis at the rate of 10% under Article 12 of the India Netherlands Tax Treaty in India. During the previous year under consideration, the assessee rendered certain services to two of its Associated Enterprises (AE), Hazira LNG Private Limited (HLPL) and Hazira Port Private Limited (HPPL) respectively. With respect to such services, the assessee invoiced HLPL and HPPL at certain weighted average hourly rates, which are subject to tax at the rate of 10% of gross basis in the hands of the assessee as per Article 12 of the treaty. The assessee benchmarked such receipts using Comparable Uncontrolled Price (CUP) method. Additionally filed submissions before the AO/TPO who after consideration proposed the following adjustments in the draft assessment order: Rs. 8,53, o3, 582 as TP adjustment in relation to services rendered to HLPL and HPPL and Rs. 49,28, 754 as reimbursement of expenses.

Additionally, the AO also initiated proceedings under section 271 (1)(c) of the Act with respect to such adjustments. Aggrieved, the assessee appealed before the ITAT Ahmedabad against the final assessment order which relying upon the judgement of the ITAT Kolkata in the case of M/s. Instrumentarium Corporation vs. ADIT ITA No. 1549/Kol/2009, wherein the issue of base issue against instrumentalism was decided, dismissed the appeal of the assessee. Subsequently, the AO passed an order under section 271(1)(c) of the Act levying penalty of Rs. 89,90,233. On appeal the CIT(A) upheld this order of the AO. Consequently, the assessee approached the Tribunal for relief.

Ruling

The tribunal ruled in favor of the assessee. It observed that the Revenue made adjustments based on the ruling in the case of Instrumentarium Corporation, with regards to the issue of base erosion for charging lower weighted average rate as compared to third parties. The tribunal held that the issue of base erosion is debatable issue in nature and it cannot be a factor on which penalty is imposed upon the assessee. Similarly, the tribunal further held that the matter of treating the reimbursement of expenditure as fees for technical services is another such debatable issue and that no penalty should have been levied on the basis of the same. Additionally, it was noted that the assessee had made full appropriate disclosure of relevant facts and materials during the course of assessment proceedings and through Form 3CEB. The tribunal further held that a mere difference of opinion with respect to the method or approach adopted for profit attribution cannot qualify to be the footing to impose a penalty, “Only because there was a difference of opinion between the approach adopted by the Assessee and the Ld. Assessing Officer for determining the profits attributable to the PO, this would itself not a sufficient to impose penalty u/s 271(1)(c) of the Act.”

Accordingly, the tribunal deleted the penalty under section 271(1)(c).

Source: Tribunal Ahmedabad in Shell Global Solutions International B.V. vs. DCIT, Intl. Taxation, A'bad vide ITA 1389/Ahd/2019 dated 13th October 2022.

ITAT Deletes Penalty Under Section 271(1)(c)

No Merit Found in the TP Adjustments Made by the TPO

Facts

The assessee is a full-fledged distributor of Sony's electronics products in India and is primarily engaged in import and distribution of Sony products, mainly comprised of audio/visual entertainment products in the Indian market. During the year, the assessee had also entered into international transactions relating to providing of advisory services to the AE. In order to benchmark the international transaction in the nature of imported goods and other aggregated transactions, TNMM was considered as the most appropriate method and the ratio of operating profit to operating sales was considered as the PLI.

During the course of assessment proceedings, the assessee had paid royalty amounting to Rs. 166,989,634. A show cause notice was issued to the assessee with regards to the same. The assesses was to make submissions so that examination could take place to ascertain the arm's length nature of royalty payment. The assessee had to furnish information with respect to the following:

- The nature and complete description of tire intangible transferred or licensed to the taxpayer in respect of whom royalty is paid is to be examined.
- The length of arm's length principle would be to see whether the royalty paid by the taxpayer fur die intangible reflect the same charges for the intangible that would have been, or would reasonably be expected to be, levied between independent parties dealing at arm's length for comparable intangible under comparable circumstances.
- Royalty payments are to be treated at arm's length only when it is proved substantially by the taxpayer that such intangibles were actually received and further proving that such received intangibles have benefited it.

After considering the submissions and agreements, the TPO believed that there were sufficient reasons to reject the contentions of the assessee. Consequently, the TPO benchmarked royalty paid for goods manufactured to MBIL amounting to Rs. 27,943,965 at NIL and payment of royalty of Rs. 100,488,528 paid for goods manufactured by CTTL was bench marked at NIL and upward adjustment of Rs. 146,989,634 was proposed. The assessee appealed before the Dispute Resolution Panel(DRP) who dismissed the appeal and held that the actions of the TPO were justified. Consequently, the matter reached the tribunal.

Ruling

The tribunal ruled in favor of the assessee and noted that it would be assessee who would pay royalty by noting that, *"It is not a case of the Revenue that MBIL and CTTL have also paid royalty to Sony Corp. Therefore, we fail to understand how MBIL and CTTL can be considered as manufacturer by TPO/DRP for the purposes of royalty payment because by no stretch of imagination Sony Corp would allow an unrelated party to manufacture its products on which it has sole copyright/trade mark right/manufacturing/distribution rights."*

It was held that the TPO had grossly erred in supporting his finding on the premise that the assessee had failed to prove that such intangibles were actually received by it and further failed to prove that such received intangibles have benefited it. The tribunal noted that the TPO further erred in justifying his findings by stating that the assessee has not derived any benefit on account of usage of intangible property for which royalty was paid. The tribunal observed that *"It is also not in dispute that the assessee has licensed technology and trade mark from Sony Corp and further licensed them to OEMs and the OEMs manufacture these goods based on technology sub licensed by the assessee and sells them back to the assessee for which the assessee pays royalty at an agreed percentage of net selling price and this payment of royalty by the assessee instead of OEMs is due to commercial necessity and payment of royalty transaction is already bench marked under TNMM."* As such the tribunal held that upon considering the facts in totality, no merit could be found in the TP adjustment in respect of transaction of payment of royalty and accordingly directed the AO to delete the adjustment of Rs. 14,69,89,634. In the matter of TP adjustment made in respect of transaction of provision of Advisory services. The tribunal examined the findings of the DRP in such matter and held that the DRP summarily rejected the contentions/objections of the assessee without giving any detailed findings on facts. As such the tribunal restored this issue back to the DRP and directed it to pas s a speaking order after reconsidering the assessee's contentionsand providing the assessee with an adequate opportunity of being heard.

Source: Tribunal, Delhi in M/s Sony India Pvt. Ltd. vs. National E Assessment Centre vide ITA No. 493/DEL/2021 dated 17th October 2022.

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ITAT Rules Royalty to be Paid by Sony India

ITAT Follows SC Ruling in Engineering Analysis

Facts

The assessee (Google India Private Limited) (GIPL) is a company engaged in the business of providing Information Technology (IT) and Information Technology Enabled Services (ITES) to its group companies. Furthermore, the assessee also acts a as a distributor of Adwords Programme in India. The assessee had entered into AdWords Program Distribution Agreement dated 12.12.2005 with Google Ireland Limited (GIL). As per the agreement, the assessee was appointed as a non-exclusive distributor of AdWords programme to the advertisers in India and distribution fees were paid by the assessee to Google Ireland as:

For AY 2009-10 Rs. 1,66,58,00,103; for AY 2010-2011 Rs. 1,85,68,92,343; for AY 2011-12 Rs. 3,72,01,00,047 and for AY 2012-13 Rs. 5,70,74,19,173. The AO initiated proceedings under section 201(1) and 201(1A) of the Act in respect of the above payments made by the assessee to Google Ireland Limited, since no tax was deducted at source under section 195 of the Act. The show cause notice was issued to the assessee proposing to treat the above payments as royalty under the Act and the DTAA. The assessee contended against such proposal, however the AO rejected the contentions of the assessee and passed the order. Aggrieved, the assessee filed an appeal before the first appellate authority. The CIT (A) ruled against the assessee by dismissing all appeals. Consequently, the assessee approached the tribunal for relief.

Ruling

The tribunal ruled in favor of the assessee. It held that payment made to Google Ireland under the AdWords Programme could not be considered to be royalty under the India Ireland DTAA. Relying on the case of Engineering Analysis Centre of Excellence (P)Ltd vs. CIT it opined that the definition of the term 'royalty' in Article 12(3) of the India Ireland DTAA overrides the definition of royalty as per Explanation 2 o f section 9(1)(vi). As the one under the agreement is more beneficial it shall be the one considered. As such the tribunal noted that the distribution fee could not been classified as royalty and also noted that no rights as per section 14 (a)/(b) and section 30 of *the Copyright Act 1957 have been transferred by Google Irelandto the assessee. It was further held that on the basis of Engineering Analysis that a mere use of or right to use a computer programme without any transfer of underlying copyright will not satisfy the definition of royalty under the DTAA.*

Source: : Tribunal, Bangalore in M/s. Google India Private Limited vs. The Deputy Commissioner of Income Tax (international taxation) vide IT(TP)A No. 1513/Bang/ 2013 dated 19th October 2022.

Distributive Fee paid by Google India Not Royalty Under India-Ireland DTAA

Tribunal holds UK Law Firm Eligible to Claim Benefit Under India-UK Treaty, Follows the Ratio in Linklaters Ruling

Facts

The assessee is a UK based Limited Liability Partnership (LLP) with a majority of its partners being tax residents of the UK. During the previous year under consideration, the assessee provided legal services to its clients in and outside India relating to activities carried out by such clients in India. In his assessment, the Assessing Officer (AO) opined that the assessee was not eligible to claim benefit under the India-UK DTAA. He noted that an entity needed to be a 'resident of a contracting state' within the meaning of Article 4.1 of the aforementioned DTAA to avail the benefit under it. The AO held that the assessee was not a resident of UK. He noted that in UK an LLP is not taxable in its capacity as an LLP, it is the partners of the partnership who are taxable. The SO held that under Article 4.1 of the DTAA only an entity capable of being taxed can be a resident under it and evidently the assessee was excluded from such criteria. The CIT (A) upheld the order of the AO. Consequently, the assessee approached the tribunal for relief.

Ruling

The tribunal ruled in favor of the assessee. It noted that the same issue had been adjudged in the case of Linklaters LLP (2010) 40 SOT 51 (Mum) wherein the tribunal had held that the assessee is entitled to the benefit of the India-UK DTAA on the portion of its income from Indian engagements, which had been taxed in the UK in the hands of its UK tax resident partners. Additionally, the tribunal agreed with the cases relied on by the Ld. Counsel for the assessee. In these cases, DDIT vs. AP Moller 67 SOT 147; P&O Nedlloyd Ltd & Ors. Vs. ADIT-IT 369 ITR 282; Maersk Line UK Ltd vs. DDIT 68 taxmann.com 173 and TD Securities (20 I 0 TCC 186), it was observed and held that the eligibility of a fiscally transparent partnership to avail the tax treaty benefits is affirmed on the basis that the income of the partnership firm has been taxed in the hands of its partners.

In the light of the above, the tribunal held, *"Thus, we note that the above case laws as well as ITAT Mumbai Bench decision in the case of* Linklaters LLP (supra) has opined that benefit of Article 4.1 is to be granted to the assessee in identical facts

Source:Tribunal Delhi in Herbert Smith Freehills LLP vs. ACIT Circle 2(1)(1), International Taxation Vide ITA No. 3993/Del/2017 dated 20th October 2022.

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Tribunal holds UK Law Firm Eligible to Claim Benefit Under India-UK Treaty

ITAT affirms CIT(A) Order Foreign AE Qualifies as Tested Party

Facts

The assessee is a company engaged in the business of providing revenue cycle management services focusing on US healthcare segment. Assessee furnished the return of income declaring total loss of Rs. 12,91,71,248. The assessee had entered the international transaction of availing of marketing sale support and customer relationship services amounting to Rs. 2,18,98,411 and also provision of revenue cycle management services earned of Rs. 12, 34, 01,474. The assessee benchmarked this transaction separately, adopted the Transactional Net Margin Method (TNMM) as the most appropriate method selecting the wholly owned subsidiary in US as tested party. The assessee updated the Profit Level Indicator (PLI) as a comparable company by taking single year data for F.Y. 2010-11 and determined arithmetic mean at 10.13%. During TP audit the margin comparable were taken for one year having the arithmetic mean of 10.74%. The TPO rejected the foreign Associated Enterprises as a tested party and directed the assessee to show the benchmarking comparability analysis considering the assessee as a tested party. The TPO also wanted to club the two services together for benchmarking analysis. As such the TPO selected 6 comparable takin PLI of OP/TC whose margin was 21.17% whereas margin of assessee was (-) 35.47% and made an adjustment of Rs. 7,78,08,046. Based on the same, an assessment order was passed under section 143(3) determining the total income of assessee at a loss of Rs. 5,13,63, 202 against the return loss of Rs. 12,91,71,248.
Consequently, the assessee appealed before the CIT (A), who directed the TPO to take the foreign Associated Enterprise as the tested party as it was a least risk and simpler entity. Aggrieved, the Revenue approached the tribunal for relief.

Ruling

The tribunal ruled in favor of the assessee. It opined that the OECD guideline states that choice of tested party should be constant with the functional analysis of the transaction. It noted that usually, the tested party is one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparable can be found and additionally, often, it would be the party that is least complex. Furthermore, it was found that the UN transfer pricing guidelines as well as the Indian jurisprudence are also based on similar principles. The Tribunal stated that,
“Therefore, the principle emerges that it is better if a tested party is taken whose functions are less complex in nature, does not own any intangible generally and the results which can be verified by using reliable data base.”
As such the tribunal held that in the current case, the foreign Associated Enterprise has the least complex functions and had satisfied all the criteria in order to qualify as a tested party. It noted that the TPO had merely rejected such enterprise as it was located in a different geographical location. The tribunal affirmed the order of the CIT(A).

Source: Tribunal, Mumbai in Dy. Commissioner of Income Tax Central Circle 3(2)(1) vs. M/s. Inventurus Knowledge Solutions Private Limited vide ITA No. 2403/Mum/2018 dated 21st October 2022

ITAT affirms CIT(A) Order Foreign AE Qualifies as Tested Party

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