Recent Judicial Decisions in International Tax

Ca. Siddharth Banwat
MasterCard Asia Pacific Pte. Ltd.
Production Resource Group
Ab Holdings, Mauritius – II
FRS Hotel Group (Lux) S.a.r.l.
Nokia Networks OY
Google India Pvt. Ltd.
Skaps Industries India Pvt. Ltd.
Burt Hill Design Pvt. Ltd.
Cairn Holdings UK Ltd.
Tata Industries Ltd.
Johnson Matthey Public Ltd.
Elitecore Technologies Pvt. Ltd.
GE Energy Parts Inc.
ABB FZ-LLC
MASTERCARD ASIA PACIFIC PTE. LTD. (AAR)(2018)
BACKGROUND FACTS

Singapore

MasterCard Asia Pacific

Service as per MLAs

Processing Fee payment

India

Customers (Various Banks)
Taxpayer Co.’s (MasterCard’s) Revenue Stream:

- Transaction processing fees (related to authorization, clearing and settlement of transactions);
- Fees for setting up and maintaining a processing network; and
- Miscellaneous revenue from ancillary services.
**BACKGROUND FACTS**

**Taxpayer Co.**

1. Was a Regional Headquarter.
2. Provided transaction processing and payment related services.
3. Owned – Singapore processing center.
**BACKGROUND FACTS**

**Taxpayer Co.**

4. Owned – Subsidiary in India.

5. That Subsidiary owned and maintained the MIPs placed at the premises of the customers in India.
The customers (banks) were provided with an MIP.

An MIP was connected to MasterCard's network and processing centers.
An MIP was about the size of a standard personal computer and was placed at the customers' premises in India.

The taxpayer company’s Indian subsidiary owned and maintained the MIPs placed at the premises of the Indian customers.
Bank of Merchants

Electronic processing of payments
(MasterCard Worldwide Network)

Bank of Issuer
Steps involved in processing the payment:

1. Initial level verification and validation of a transaction.

BACKGROUND FACTS

Steps involved in processing the payment:

3 Clearing and settlement of the transactions.

2. MIP ownership, VAT/GST payment, relevance for disposal test.

3. Transmission towers, etc. owned by third party – MasterCard’s PE?
Could use of Internet/ network in India give rise to Fixed place PE?

Could presence of the subsidiary make a difference?

Could closure of LO and setting-up of Subsidiary give rise to PE?
Could subsidiary be regarded as ‘virtual projection’ of erstwhile PE?

Could ownership of a software give rise to a PE?

Could activities of Bank of India cause MasterCard’s PE in India?
ISSUES FOR DISCUSSION

10 Preparatory and auxiliary activities issue.

11 Functionality Test issue.

12 Service PE issue.
Issues for Discussion

13 Royalties issue.

14 Tax Avoidance issue.
PRODUCTION RESOURCE GROUP (AAR)(2018)
• PRG is a company Registered in Belgium.

• PRG is in business of providing technical equipment and services for events including lighting, sound, video and LED technologies.

• It entered into a Service Agreement dated 09.07.2010 with the Organizing Committee of the Commonwealth Games, Delhi, (OCCG), for a term commencing on 9 July 2010 and expiring on 30 October 2010, to provide, on a turnkey basis, lighting and searchlight services during the opening and closing ceremonies of the Commonwealth Games Delhi, 2010 (CG 2010).

• In terms of the agreement, PRG rendered the services for two days, namely 3 October 2010, at the opening ceremony, and on 14 October 2010 at the closing ceremony. Its employees and equipment were in India for a period of only 66 days for preparatory, installation and dismantling of equipment from 2.8.2010 to 24.10.2010.
CLAIMS OF PRG

• The consideration for the aforesaid services was not taxable as Fees for Technical Services (FTS), in the absence of the services being ‘continuously rendered’, as against a one-off project.

• The services were also claimed to be standardized in nature, and hence, not taxable as FTS.

• Based on the Most Favored Nation (MFN) clause in the India-Belgium Double Taxation Avoidance Agreement (DTAA), the requirement of ‘make available’, appearing in the India-Portugal DTAA, was sought to be imported. In the absence of services being made available, it was claimed that the services would not be taxable in India.

• The consideration was also not taxable as business profits, in the absence of a Permanent Establishment (PE) in India. It was submitted that the conditions of place of business, power of disposition, permanence, location, business activity and business connection, were not cumulatively satisfied, for the existence of a PE.
PRG was provided with a ‘lockable’ space for storing its tools and equipment, inside the stadium. The very existence of a ‘lockable’ space implies access to and control over the space, to the existence of others. Based on the nature of business, it was held that this place was not merely for storage, but for carrying out the business itself.

The fact that the space was within the stadium, i.e. where the revenue generating activity would take place, itself was a factor in establishing a PE.

Coupled with the space, the lighting facilities created and erected by PRG, were also held to be a part of the ‘place of business’.

The contention of a transient presence was rejected on the basis that the establishment need not be permanent, and the context of the business would be relevant.

An analogy was drawn to the Supreme Court decision in Formula One World Championship Limited (2017) 80 taxman.com 347, to state that the permanence was for as much time as the business required.
AAR Ruling/ Findings

- The contention of PRG that services were provided only for 2 days, was rejected on the basis that this was a turnkey project, covering the entire duration of the Commonwealth Games and more.

Other factors that were considered by the AAR while upholding the existence of a PE

- The fact that some of the activities were sub-contracted - the AAR held that PRG would need an Indian address/ office, to do so.

- The very fact that some of the key technical and other manpower were employed onsite, was held to be an extension of the foreign enterprise on Indian soil.

- Insurance on the project, obtained by PRG, was also held to be an indicative factor, on the basis that no insurance company would insure any equipment, structures against any risk of fire, damage or theft unless the place was safe and in exclusive custody and at the disposal of the customer i.e. PRG in this case.

- The clause in the agreement requiring mandatory licensing was held to be indicative of a place being at the disposal of PRG.
AAR Ruling/Findings

- Based on the above, the AAR concluded that each of the criteria for establishment of a PE - place of business, power of disposition, permanence, location, business activity and business connection, were cumulatively satisfied.

- On the aforesaid basis, the AAR also held the income to be taxable under section 9(1)(i) of the Act, stating that ‘business connection’ is much wider in import, than a PE.

- Separately, the AAR rejected the tax department’s contention that the payment was in the nature of royalty, on the basis that consideration received by PRG was for a final product and not for the know-how, technical expertise, etc.

- The AAR also rejected the stand of both PRG and the tax department that the consideration was not in the nature of FTS. On the basis that there was clear human element involved, highly skilled technical personnel rendered the services and the services were non-standard, the AAR held that the consideration was indeed in the nature of FTS.

- However, the AAR further held that such FTS was not made available, and hence, the consideration would not be taxable as FTS under India-Belgium DTAA.
In light of the above findings, the AAR concluded that the consideration was connected with the PE in India, and hence, was chargeable to tax in India, as business profits, both under the Act and under India-Belgium DTAA.
AB HOLDINGS, MAURITIUS - II (AAR)(2017)
Facts of the Case

- AB Holdings, Mauritius-II (AB Holdings) is a Mauritian Company holding a valid Tax Residency Certificate (TRC) and a Category 1 Global Business License.

- AB Holdings was engaged in investment activities in 'S' sector in India and other Asian markets and it was managed by its Board of Directors (BOD) consisting of 3 directors, out of which two directors were tax residents of Mauritius (working for a financial services firm).

- In line with its business purpose, AB Holdings invested in AB International India Private Limited (AB International) and companies in Philippines and Indonesia which are engaged in 'S' business. The BOD duly backed these investment decisions in their meetings.

- Under a group reorganisation, AB holdings transferred shares of AB International and other Asian companies to a newly incorporated Singaporean company, AB Singapore vide, a Share Purchase Agreement (SPA) dated 25 November 2008. This was done solely for business and commercial reasons of obtaining operational and cost benefits.
C' Group USA, are the ultimate holding company and Mr. 'S', MD of 'C' partners LP is director in majority of the group companies.

The Applicant is a paper company incorporated in Mauritius by the 'C' Group USA, whose main business is to buy different businesses, sell them at appropriate value and time.

As part of its business strategy, the Applicant company was formed in Mauritius whereas its control and management are located in the US.

The Applicant company has no address of its own except that of the management company M/s IM Mauritius, with functions consisting of filing of returns of income, filing of audited accounts, financial service etc.

The Applicant has no assets or employees of its own in Mauritius, and all its activities are done by the Management company. Its expenses consisted only of legal and professional fees.

Two out of the three directors of the company are employees of the management company, and Mr. 'S', managing partner of 'C' Group is the key director of the company.
Revenue Contention

• As per the passport details of Mr. 'S', managing partner of 'C' Group who is the key director of the company his passport details he was not present in Mauritius when key decisions were said to have been taken by the Board. Therefore, he was mainly operating from the US, where the control and management are located.

• The transaction under consideration amounts to tax avoidance and is structured in such a way that increases the value of shares of the Applicant company as a result of appreciation in value of Indian assets, and it is neither taxed in India nor in Singapore, when the shares are finally sold.

• The transactions give an impression of a colourable/artificial device that is employed for the purpose of avoiding tax. The annual returns which are submitted shows that, the Applicant does not have any business activity other than holding the shares. The holding company as part of C Group is involved in business of middle market buyouts.
AAR Ruling

“The entity is a paper company”
• AAR observed that AB holdings are not a 'fly by night operator". AB Holding had a valid tax residency certificate and also a Category 1 Global Business License.

“The transactions give an impression of a colourable/artificial device”
• The transfer of shares from AB Holdings to AB Singapore was done as a part of the business reorganisation which shows long-term business and commercial purpose. Also, the investment was held for a long-term duration which shows that these were not short-term transactions undertaken to avoid tax.

• Simply on the basis of Holding company's involvement in the decision making, the Revenue can neither question the validity of the existence of AB Holdings nor the investments undertaken by it unless its involvement renders AB Holdings a mere puppet.

“Non –presence of directors”
• With regards to the physical location of the directors of the taxpayer, the AAR noted that the AB Holdings, as well as the Holding company, had a common director who had made multiple trips to and from Mauritius including the period wherein important decisions of AB Holdings were taken. It was also noted that with technological advancements in communication, it was unrealistic to expect all the directors to be physically present at every meeting(s).
“Directors had no role in the decision-making process”

- As regards other directors who were financial services consultant catering to more than 400 companies, AAR held that such directors had sufficient qualifications so as to engage in meaningful discussions in respect of the taxpayer's business. Thus, the Revenue merely assumed that other Directors had no role in the decision-making process.

- Concerning office/place of management/staff, the AAR noted that the Mauritian tax authorities had verified the place of business of the applicant at the address given by the taxpayer.

- The AAR also observed that the taxpayer is an investment company which does not require huge offices and staff unlike manufacturing or a trading concern which requires day to day dealings with various stakeholders.

- In light of the facts above, AAR held that AB Holdings fulfils all the criterion laid out for being a legal and beneficial owner of the shares. Accordingly, AB Holding was eligible to avail the capital gains exemption according to Article 13 of the treaty and hence such gains would not be liable to tax in India.
FRS HOTEL GROUP (LUX) S.A.R.L. (AAR)(2018)
• The applicant is a company within the FRHI Group incorporated under the laws of and Duchy of Luxembourg.

• The applicant provides services in connection with hotel management and including all services that are necessary for hotel operation, such as establishing hotel standards & policies, sales and marketing, centralised reservations, purchasing and certain other services as per the operational requirements of the hotel owners to meet the hotel brand requirements.

• (BAHDL) engaged the applicant to provide certain services in different phases of hotel development and operation so that the hotel property, i.e., Swissotel Kolkata can be developed and operated as per international standards.
The applicant agreed to provide the following services:

- **GRS** to facilitate reservation / booking of rooms, banquets, etc. in Indian hotel property;

- Centralised Services: miscellaneous support services as required by the Indian hotel owner at its option, including but not limited to global sales & marketing, finance support, human resources support, operations support, and technology support;

- Corporate Design & Construction services for providing advisory services in connection with any capital improvements proposed by the Indian hotel owner in relation to the hotel property, including refurbishing, maintenance, repairs or, etc.; and
Facts of the Case

- Purchasing services: Assistance in purchases of goods, supplies, and services as required by the Indian hotel owner in relation to the operation of the Indian hotel commensurate with the brand of the hotel.
ISSUES BEFORE AAR

- Whether AAR can rule on PE?

- Whether the payments received by the applicant from the Indian hotel for provision of global reservation services are chargeable to tax in India as FTS or royalty under the provisions of section 9(1)(vi) / 9(1)(vii) of the Act read with provisions of Article 12 of the tax treaty?
AAR Ruling

Whether AAR can rule on PE?

- The reference was made to Rule 12 of the Authority for Advance Rulings (Procedure) Rules 1996 (the Rule). The Rule is self-explanatory and explicit, and it does indicate that the AAR has not only the power but the duty to look at 'all aspects of the questions set forth which would enable it to pronounce a ruling 'on the substance of the questions posed for its consideration'.

- If the contention of the applicant is accepted, and for a certain stream of income, a ruling is given without having any regard to other business operations, the whole exercise of approaching the AAR and getting conclusive orders will be rendered futile.

- The five agreements which form part of the record cannot be viewed on a standalone basis. The activity of the applicant is an integrated one, and it cannot be split into one or the other. On a perusal of the terms of the agreement, it emerges that the different agreements are a part of the wholesome arrangement.
Whether PE Exists?

- it is now well-settled law that a fixed place PE arises on the fulfillment of the following conditions:
  - Existence of a fixed place.
  - The fixed place being at the disposal of the non-resident.
  - The non-resident is carrying on its business (wholly or partly) through such fixed place.

There is no doubt that the Indian hotel, Swissotel Kolkata is a fixed place. Upon a careful analysis of the terms of the various agreements, it was observed that the hotel is entirely at the disposal of the applicant.

Once the hotel is constructed, its operation and management rest with the applicant including right from the employment of the hotel staff (including the managerial personnel)

Some of the core functions of the operation of the hotel such as sales and marketing, reservation, etc. have also been outsourced to the applicant.
AAR Ruling

- The applicant has further undertaken to advise the hotel with all the critical aspects of the hotel operation such as training of staff, preparing of the budget, carrying out capital improvements, etc.

- Dealing with the third test for the existence of a PE, i.e. to determine whether the applicant has carried on its business (partially or wholly) through the fixed place being the Indian hotel, the AAR observed that the applicant has, in substance, taken over all the important functions in relation to the operation and management of the Indian hotel

- It is, therefore, apparent that the applicant has taken over the operation and management of the Indian hotel by entering into different agreements and has earned income through all of such agreements. Therefore, the Indian hotel, Swissotel Kolkata, satisfies all the three tests and does constitute a fixed place PE of the applicant with respect to these incomes

- Since in the present case, it has been held that the income of the applicant is attributable to the fixed place PE in India, the question whether it can be characterised as royalty or fees for technical services becomes wholly academic.
NOKIA NETWORKS OY (DELHI - ITAT)(2018)
FACTS OF THE CASE

- The Assessee is a resident of Finland and sold GSM equipment manufactured by it to Indian telecom operators, on a principal-to-principal basis.

- During the year 1994, the taxpayer had established a Liaison Office (LO). Subsequently, on 23 May 1995, a wholly owned subsidiary was incorporated.

- During the period when LO was in operation, the GSM equipment were sold to Indian operators from outside India on principle to principle basis under independent buyer-seller arrangements as well certain contracts for installation was also entered into.
Subsequent to the incorporation of subsidiary in May 1995, Nokia India Private Limited (NIPL) was either assigned the installation contracts by the Assessee or entered into independent contracts with the customers for installation. NIPL also entered into technical support agreements with customers. NIPL’s income from these activities was taxed in India.
Assessee’s Contention

For the offshore supply of equipment, the taxpayer did not file return of income in India for Assessment Years (AYs) 1997-98. The taxpayer claimed that it does not have a PE in India, and therefore, income was not taxable in India. Further, it does not have any business connection in India as it had supplied goods to Indian telecom operators on principle to principle basis, no income could be taxed in India.

AO’s Order

The Assessing Officer (AO) was of the view that NIPL constituted a PE of the Assessee and attributed an additional 30 percent of the profit from the equipment to NIPL. The AO also concluded that 30% of the equipment price pertained to supply of software and sought to tax it as royalty in the hands of the Assessee. On appeal, the ITAT held that NIPL being a virtual projection would form a PE, and attributed to NIPL 20 percent of the Assessee’s profits from the sale of equipment to Indian customers.
Dealing with the appeal against the ITAT order, the High Court partially ruled in favour of the Assessee holding that software was embedded in the equipment and payment for it could not be taxed as royalty.

The High Court noted certain factual errors leading to its own disagreement with the ITAT on PE and remitted the question back to the ITAT.
FIXED PLACE PE

• As the Treaty did not have a Services PE clause, the majority of members concluded that the presence of employees of the Assessee was not relevant and they needed to examine whether the NIPL constituted a fixed place PE or a Dependent Agency PE (DAPE) of the Assessee.

• The ITAT relied heavily on the Supreme Court ruling in the case of Formula One, for applying the tests for fixed place PE determination. They thought it to be of paramount importance whether NIPL was at the disposal of the Assessee for conducting the latter’s own business activities.

• The ITAT perused several contracts and examined the activities undertaken by the Assessee, especially signing of contracts, network planning, and negotiations of offshore contracts in India, to determine whether these constituted ‘business activities’ of the Assessee and whether they were carried out from a fixed place, at its disposal.

• The ITAT held that the provision of telephone, fax and conveyance services provided by NIPL to the employees of the Assessee did not make the NIPL offices at the disposal of the Assessee. Therefore, no Fixed Place PE was formed.
Preparatory or Auxiliary Exemption: DAPE and Independent Agent

- The ITAT held that signing, network planning and negotiation would fall under preparatory and auxiliary activities.

- ITAT also examined the DAPE provisions under Article 5(5) of the Treaty and concluded that NIPL had neither negotiated, nor concluded any contract on behalf of the Assessee.

- ITAT noted that NIPL did not assist in the delivery of goods, it bore its own entrepreneurial risk and acted as an independent party carrying out its own activities for which it was remunerated on an arm’s length basis. Thus, NIPL was not a DAPE.
Virtual Projection Test / Alter Ego Test

- On this issue, the majority of members held a view that the concept of ‘virtual projection’ flows from the concept of PE itself. Therefore, if NIPL does not fall within the parameters of PE under Article 5, virtual PE cannot exist in a vacuum and independent of the other parameters.

- The ITAT discussed business connection (BC) for the sake of completeness, noting that if there is no PE under the DTAA, then even if there was a BC, it would not impact the taxability of the Assessee in India.
THE DISSenting JUDGEMENT

• A third member dissented from the majority’s view and held that NIPL would constitute a PE even if it were not a DAPE under Article 5(5) of the Treaty.

• He justified this by relying on the test of virtual projection. Referring to the term ‘alter ego’ and placing reliance on other international commentators, he opined that when a subsidiary company’s survival for carrying on its business activities is entirely connected with and dependent on the business of its parent, then the subsidiary is merely an alter ego, or virtual projection, of its parent. Consequently, it must be treated as a PE of the non-resident parent.

• In his view, when the work of a foreign enterprise is carried out by a separate legal entity in the source jurisdiction, there is no question of the foreign enterprise using a place of business in the source jurisdiction or having a place at its disposal.

• A separate legal entity having a fixed place of business at its disposal for performing actions in furtherance of the business interests of the foreign enterprise is sufficient and concluded that NIPL was a PE of the Assessee in India.
GOOGLE INDIA PRIVATE LIMITED (BENGALURU ITAT)(2018)
Facts of the Case

Provision of IT and ITES service to Google Ireland in return for consideration.

Back Office and Support Service

Quality control functions for adwords program across the globe.

- Payment of approx USD 225 million between 2006-12 to Google Ireland for purchase of Ad Space.
- Marketing and distribution of purchased ad space to Indian advertisers.
- Separate ad space sale contractors with advertisers.
- Pre and post sale services.
- Training advertisers on use of adwords.
FACTS OF THE CASE

Google India is a wholly owned subsidiary of Google International LLC. Google India provided the following services to its affiliate entity, Google Ireland:

1. Information technology (“IT”) services and information technology enabled services (“ITeS”) under a services agreement dated April 1, 2004 (“Services Agreement”).

2. Google India also functions as a non-exclusive authorized distributor of Google Ireland’s AdWords program in India under an agreement dated December 12, 2005 (the “Distribution Agreement”). In addition to its marketing and distribution services provided to Google Ireland, under the Distribution Agreement, Google was also required to provide pre-sale and post-sale / customer support services to the advertisers.

Google AdWords is an online advertising service developed by Google, where advertisers pay to display brief advertising copy, product listings, and video content within the Google ad network to web users. The program uses the keywords to place advertisements on pages where Google thinks they might be most relevant. Advertisers pay when users divert their browsing to click on an advertisement. AdWords enables an advertiser to change and monitor the performance of an advertisement and to adjust the content of the advertisement.
PROCEEDINGS BEFORE LOWER AUTHORITIES

• During assessment proceedings relating to financial years 2006-07 to 2011-12, the assessing officer (“AO”) noticed that in its books, Google India had credited an aggregate sum of around INR 1457 crores (approx. USD 225 million, at today’s exchange rates) to the account of Google Ireland without withholding taxes.

• Google India explained that these amounts were payments for purchase of AdWords Space under the Distribution Agreement and would be characterized as business income in Google Ireland’s hands. In the absence of a permanent establishment of Google Ireland in India, such income would not be liable to tax in India under the Income Tax Act, 1961 (“ITA”) read with the India-Ireland Tax Treaty (“Ireland Treaty”).

• However, the AO treated the payments as royalties on which tax should have been withheld by Google India. Aggrieved, Google India appealed to the Commissioner of Income Tax (Appeals) (“CIT(A)”). The CIT(A) upheld the order of the AO. Aggrieved, Google India preferred another appeal to the Tribunal.

Issue for consideration before ITAT
• Whether the amounts credited in Google India’s books to Google Ireland’s account constituted business income or royalties for use of software, trademarks and other intellectual property rights?
TAX AUTHORITIES ARGUMENT

• Google India’s marketing and distribution functions involved the sale of certain rights in the AdWords Program, for which Google India required a license to use the AdWords Program. The distribution rights granted to Google India under the Distribution Agreement were therefore in effect a license to use Google Ireland’s intellectual property i.e., inter alia the copyright in the underlying software code of the AdWords Program.

• The Tax Authorities concluded that the license of Google Ireland’s intellectual property to Google India under the Services Agreement was actually for the purpose of providing the post-sale services under the Distribution Agreement, and therefore the payments made to Google Ireland constituted royalties.

• The non-disclosure agreement (“NDA”) and a confidentiality clause forming part of the Distribution Agreement clearly demonstrated that the payments to Google Ireland were for information, knowhow and skills imparted to Google India.

• Google India has been permitted to use Google Ireland’s trademarks and brand features in order to market and distribute the AdWords Program

• The grant of distribution rights involves transfer of rights in ‘similar property’ (Explanation 2 to Section 9(1)(vi) of the ITA). The grant of distribution rights also involves the transfer of right to use Google Ireland’s industrial, commercial and scientific equipment i.e., the servers on which on which the AdWords Program runs.
The grant of distribution rights also involves transfer of right in processes, including Google Ireland’s databases software tools etc., without which it would not be able to perform its marketing and distribution functions.
ASSESSSEE’S ARGUMENT

• The distribution rights granted to Google India under the Distribution Agreement did not involve a license to use Google Ireland’s intellectual property.

• The Services Agreement and the Distribution Agreement should not be read in a conjoint manner. Google India submitted that the limited license it receives to Google Ireland’s intellectual property under the Services Agreement is only for enabling the provision of quality control and IT/ITeS services for which it receives a separate consideration. Google argued that these services provided by Google India are to ensure that ads placed by advertisers globally confirm with Google’s editorial guidelines and the local laws of the country from where the ad originates. These services are not linked in any manner to its AdWords Program distribution function. Its AdWords division and the ITeS division operate separately and there is no overlap of any activities and responsibilities between the two divisions.

• Its role under the Distribution Agreement is limited to:
  • purchasing online ad space in the AdWords Program from Google Ireland for resale to advertisers in India.
  • performing marketing related activities in order to promote the sale of ad space to advertisers in India.
  • providing assistance and training, where required, to Indian advertisers to familiarize them with the features and tools of the AdWords Program.
ASSEESSEEE’S ARGUMENT

• No information, know-how and skills were imparted to Google Ireland. The Tax Authorities alleged this on the basis of the NDA and confidentiality clause which is intended only to protect confidentiality of the information, if any, which either party gathers during the course of the business. Such clauses are generic to most agreements and cannot per se establish that there is a right to use Google Ireland’s intellectual property.

• The right to use the Google trademarks and brand features granted to Google India were merely to enable Google India to distribute the ad space in India, and were incidental to the main purpose of the distribution agreement which was the sale of ad space. Google India submitted that the mere use of brand name for procuring ad contracts would not amount to use of trademark.

• The distribution rights are commercial rights and cannot be rights in ‘similar property’ for the purposes of Section 9(1)(vi). In any case, the definition of royalty under the Ireland Treaty does not contain the words ‘similar property’.

• Google India has no right to use Google Ireland’s equipment or servers. The operation, control and maintenance of the servers, located outside India, solely rests with Google Ireland

• Google India does not have access to or control over any back-end processes such as databases, software tools etc., under the Distribution Agreement
ASSESSEE’S ARGUMENT

• Google India neither receives any right nor access to the AdWords Program under the Distribution Agreement and does not use it in any manner whatsoever. The payment to Google Ireland is merely towards purchase of the ad space for resale without access to any underlying computer program.

• Accordingly, Google India argued that the payment to Google Ireland is for purchase of ad space which is in the nature of business income. In the absence of a permanent establishment of Google Ireland in India, such income would not be taxable under the ITA read with the Ireland Treaty.
Whether the amounts credited in Google India’s books to Google Ireland’s account constituted business income or royalties for use of software, trademarks and other intellectual property rights.

Whether distribution rights amount to license of intellectual property?

• Based on information regarding the AdWords Platform provided by the Google India, information available on Google’s website and in books available in the public domain, the Tribunal concluded that the Distribution Agreement was not merely an agreement to sell ad space but rather is an agreement to provide services to facilitate the display and publication of an advertisement to targeted customers with the help of technology.

• The Tribunal was of the view that the AdWords Program gives an advertiser a variety of tools to enable it to maximize attention, engagement, delivery and conversion of its advertisements. The tools are provided using Google’s intellectual property, software and database (including data on numerous individual web-users and their name, age, gender, location, phone number, IP address, habits, preferences, online behavior, search history etc.) with Google India acting as a gateway.
RULING

• The Tribunal was of the view that the use of customer data for providing services under the Service Agreement was also utilized for marketing and distribution functions under the Distribution Agreement. It concluded that the use of customer data and confidential information should be regarded as the use of Google Ireland’s intellectual property by Google India.

• The Tribunal concluded that it is through use of Google’s intellectual property that the AdWords tools for performing various activities are made available to Google India and the advertisers. Therefore, payments made to Google Ireland for use of its intellectual property would therefore clearly fall within the ambit of "Royalty".

Google Ireland’s IP not incidental to the activities of Google India:
• Under the Distribution Agreement, Google India was permitted to use Google trademarks and other distinctive brand features of Google Ireland. The Tribunal concluded that such use was essential and pivotal for Google India to market and distribute the AdWords Program. The Tribunal distinguished the rulings in Sheraton and Formula One and held that the brand features were used as marketing tool for promoting and advertising the ad space, which is the main activity of Google India and therefore would not be incidental to Google India’s business.
RULING

• The Tribunal did not place reliance on the reports of the OECD Technical Advisory Group (“TAG”) and the CBDT’s High Powered Committee (“HPC”) which had concluded that payments arising from advertisements would constitute business income.

• The Tribunal distinguished the reports on the ground that the fact patterns dealt with therein were vastly different from the facts in the present case. In the present case Google India has been provided access to the IPR, Google brand features, secret process embedded in AdWords Program as tool of the trade for generation of income.

• On the same basis, the Tribunal also distinguished this case from earlier Tribunal rulings in Right Florist and Pinstorm Technologies and Yahoo where courts had held that payments made to a foreign company for banner advertisement hosting services would not constitute royalties.
Whether the Services Agreement and the Distribution Agreement should be read together?

- The Tribunal held that under the Distribution Agreement, Google India was solely responsible for providing all customer support services to the advertisers through use of Google Ireland’s data and intellectual property. While Google India could afford to provide these services to the advertisers under the Services Agreement (under which Google India received a license to Google’s data and intellectual property), but services were instead rendered under the Distribution Agreement.

- In the Tribunal’s view, without Google India exercising its rights under the Services Agreement, it could not discharge its obligation under the Distribution Agreement. Thus, the Tribunal concluded the services rendered under Services Agreement cannot be divorced with the activities undertaken by Google India under the Distribution Agreement. The bifurcation of agreements was only a design / structure prepared by Google India to avoid the payment of taxes.
SKAPS INDUSTRIES INDIA PRIVATE LIMITED (AHMEDABAD ITAT)(2018)
• During relevant AYs 2013-14 and 2014-15, assessee-company paid installation/commissioning charges to a US entity without deducting TDS on the ground that absent ‘make available, payment doesn’t constitute Fees for Included Services under Article 12 of India-US DTAA;

• Assessing Officer held that the assessee was taxable in India in respect of the fees for technical services under section 9(1)(vii) read with Section 115A, and the applicable tax rate under section 115A at 10% being lesser than the tax rate at 15% envisaged by the Indo US tax treaty would apply to the assessee.
Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. Quite to the contrary, there was one new issue which was taken up, for the first time, by the CIT(A) with respect to tax residency certificate requirement under section 90(4); that, in the absence of a tax residency certificate having been furnished by the Teems Electric Inc USA (TEI) and in view of the specific provisions of Section 90(4), the TEI cannot be granted protection of Indo US tax treaty;
RULING

- Ahmedabad ITAT rules that mere non-furnishing of Tax Residency Certificate (‘TRC’) cannot *per se* be treated as a trigger to disentitle the treaty benefits;

- Rejects Revenue’s stand that in view of specific provision contained u/s. 90(4), treaty benefits were not available to US entity in absence of a TRC;

- ITAT clarifies that Sec. 90(4), in the absence of a non-obstante clause, cannot be construed as a limitation to the treaty superiority u/s. 90(2) over domestic law, further clarifies that “It can only be pressed into service as a provision beneficial to the assessee.”;

- Highlights that GAAR provision u/s. 90(2A), which starts with a non-obstante clause, is the only rider to the treaty override provision set out in Sec. 90(2);

- Further cites Punjab and Haryana HC ruling in Serco BPO P. Ltd. which had judicially approved the use of Sec. 90(4) in favour of the assessee, however, explains that in present case it is only confronted with an open issue of Sec 90(4) being treated as a limitation to the treaty superiority contemplated u/s. 90(2), for which there are no binding judicial precedents;
RULING

• ITAT opines that an eligible assessee cannot be declined the treaty protection u/s. 90(2) on the ground that the said assessee is not able to furnish a valid TRC; However, ITAT rules that even if Sec. 90(4) is inapplicable, there has to be reasonable evidence about entitlement of treaty benefits to the US entity, holds that the onus is on assessee to give sufficient and reasonable evidence of satisfying the requirements of Article 4 (Residence) so as to be entitled for treaty protection;

• ITAT remarks that “These requirements are far more onerous than furnishing of TRC, the latter would have been a much simpler a course of action.”; With respect to Form W9 (which is used in the context of domestic tax withholding requirements in the United States) submitted by assessee, ITAT refers to the information contained in US IRS website, and observes that “it is merely a declaration so as to provide inputs to the tax-deductor for fulfilling reporting obligations to the US IRS. It has no relevance in the present context.”; Since at no stage assessee was asked to submit evidences in support of the residential status, ITAT remands matter back to CIT(A) on the fundamental aspect of treaty entitlement and also on other issues for fresh adjudication.
FORMULA ONE WORLD CHAMPIONSHIP LIMITED
(SUPREME COURT)(2017)
Factual Matrix

FIA – (Federation International de l’Automobile – NPO – 1904 – Paris, France – Apex Body1

FOAM – Formula One Asset Management Co Ltd (CRH) 24.04.2001 Transfer of Commercial Rights 01.01.2011 Transfer of Commercial Rights for 100 Years


Revenue from these activities go to respective companies, BP2, AS, FOAM

Beta Prema 2 – Circuit Rights, media and title sponsorship rights
Allsports – Paddock Rights
TV Feed – FOAM
**Facts and Background**

**FOWC – Formula One World Championship Ltd**

- Company registered and Resident of UK
- Federation Internationale de l’Automobile (FIA), the international motor sports events regulating authority ‘FIA’, assigned commercial rights in Favour of Formula One Asset Management Limited ‘FOAM’ on 24.04.2001 and on the same date these rights were transferred to Formula One World Championship FOWC
  - By another agreement, FOAM licensed all the rights to FOWC for 100 year w.e.f 01.01.2011.
  - Therefore, FOWC becomes the Commercial Rights Holder (CRH) for the F1 Championships
  - All the teams participating in the championship enter into a contract known as “Concorde Agreement” with FOWC & FIA undertaking to participate in the all the races during the season.

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**Jaypee Sports**

- Paid USD 40 Mn for acquiring hosting rights
- Right to host racing Event

**Buddh International Circuit**
Facts and Background

- Promoter of event in India - Jaypee Sports International Ltd (Jaypee)

- F1 event is hosted, promoted and staged by a Promoter with whom FOWC as a CRH enters into contract and nominated for FIA for inclusion in its F-1 calendar

- Jaypee – FOWC – Agreement dated 13.09.2011 known as “Race Promotion Contract (RPC)” for grant of right to host, stage and promote F-1 Grand Prix of India event for a consideration of USD 40 Mn.

- Jaypee – FOWC enter into another agreement – Artwork License Agreement (ALA) for use of certain marks and IP belonging to FOWC for USD 1 Mn

- Prior to 2011 agreement another RPC dated 25.10.2007 was in place with Jaypee.

- In terms of RPC 2011- races held in India in 2011, 2012, and 2013
The assessee and Jaypee both approached the AAR and sought advance ruling on the following questions:

1. Whether the payment of consideration receivable by FOWC outside India in terms of RPC from Jaypee was or was not royalty as defined in article 13 of Indo-UK DTAA?

2. Whether FOWC was justified in its position that it did not have a permanent establishment (PE) in India in terms of article 5 of the DTAA?

3. Whether any part of the consideration received or receivable from Jaypee by assessee outside India was subject to tax at source under section 195 of the Indian Income Tax Act?

The AAR, Held:
• **amounts paid were 'royalty'**.
• **Secondly, assessee had no fixed place of business, was not doing any business activity in India and had not authorized any organization or entity to conclude contracts on their behalf and, therefore, had no PE in India.**
• Jaypee, FOWC & Revenue file writ petitions before DHC

• Jaypee /FOWC argue payments under RPC / ALA are not taxable as Royalty nor does it have a PE in India in terms of Art 5 of DTAA

• DHC reverses AAR decision on both counts.

• Holds that payment FOWC is not Royalty. Further has a PE in India.

• Consideration received is not Royalty is not disputed by Revenue.

• **Therefore, the issue before SC : Whether FOWC has a PE in India?**
ARGUMENTS BY JAYPEE AND FOWC

• In order to constitute a PE, two conditions were necessary to be satisfied – (i) there should have been a particular fixed place which was at the disposal of FOWC; and (ii) from the said fixed place, FOWC should have been conducting its business activity. It was argued that both the conditions were absent in the present case.

• It was FIA which had control over the manner in which the F1 Championship was to be conducted. Further, it was Jaypee which was responsible for conducting the races and had complete control of the event. All obligations for conduct of the F1 Championship were to be discharged by Jaypee as the organiser.

• The entire expenditure for construction of the track had been borne by Jaypee, for which it had hired its own engineers, architects etc. The circuit was owned by Jaypee and control thereof vested with Jaypee alone. The track was utilized by Jaypee not only for the F1 Championship but for organizing several other events as well on a regular basis, all year round. Right from construction of the track to conclusion of the events, all acts and obligations were to be performed by Jaypee, with no role of FOWC.
ARGUMENTS BY JAYPEE AND FOWC

• According to the 2011 RPC, FOWC as the commercial rights holder of the F1 Championship had simply granted Jaypee permission to host the event since it was FOWC which had the exclusive right to propose the F1 Championship calendar. FOWC’s role was primarily that of advising, assisting and consulting with the Jaypee (Promoter) in relation to the event.

• Jaypee was required to construct the circuit in a form and manner as approved by both FOWC and FIA only in order to ensure that the track met all requirements of the FIA regulations. Other than that, all rights to stage, host and promote the event vested exclusively with Jaypee. Thus, the circuit was not under the physical control or at the disposal of FOWC.

• The business of FOWC was not to organize F1 races, and therefore the question of its PE in India in the form of the race circuit did not arise.

• The entire F1 Championship event in India was a temporary model for three days in a year only. Even if it was accepted that the FOWC had control over the circuit for those three days, possession of the site for three days in a year could not be termed as PE.
• Relevant Material relied upon:

• Section 9(1)(i) – deemed accrual of income – business connection, dependent agent, independent agent, word “through” in explanation (4), “permanent establishment” in Sec 92F

• Article 5 of DTAA examined in detail and explained clause wise

• Extensively analysis of Commentaries relied upon:
  • Philip Baker
  • Klaus Vogel; and
  • OECD Commentary on MC
SUPREME COURT ON PHILIP BAKER

- Virtual Projection – Visakhapatnam Port – 1983- 144 ITR 146
- Three characteristics of PE – Stability, productivity and dependence
- Examples such as Shed rented for 13 years (Botswana); A writer’s study (US); a stand in a trade fair regularly occupied for 3 weeks in a year (Canada); A temporary restaurant in Dutch flower show for 7 months (Antwerp); An office, workshop and storeroom for maintenance of aircraft (Pak)
- Court decisions :Canada, Switzerland, France, Germany, Belgium Courts :
- Fixed place need not be owned or leased by the FE provided it is at the disposal – having some right to use for the purpose of business and not solely for the purpose of the project undertaken on behalf of the owner.
Supreme Court on Klaus Vogel

- Term Business is vague and little relevance for PE definition.
- Crucial element is Place
- Definition of the expression ‘place’
- Difference between ‘place’ and ‘establishment’. Tangible facility as distinct from soil
- POB only if the person is free to use:
  - A. at any time of his choice;
  - B. for work relating to more than one customer; and
  - C. for his internal administrative and bureaucratic work.
- OECD Commentary – 4 examples of salesman, employee access, road transporter, painter.
SUPREME COURT VERDICT

• The Buddh International Circuit was a fixed place, from where the Indian Grand Prix was conducted including all other activities in relation thereto as set out in various agreements and this undoubtedly constituted an economic and business activity of FOWC.

“whether the circuit was put at the disposal of FOWC”

• To this end, the Court opined that the various agreements executed between FIA, FOWC, Jaypee and FOWC’s affiliates could not be looked at in isolation from one another. A conjoint reading thereof was necessary to bring out the real transaction between the parties and to capture the real essence of FOWC’s role and to determine who had real and dominant control over the event.

• On a perusal of various agreements, the Court observed that by virtue of the Concorde Agreement of 2009, FOWC was authorized to exploit the commercial rights in relation to the “F1 Business” directly or indirectly only through its affiliates, where “F1 Business” was defined to mean exploitation of various rights, including media rights, hospitality rights, title sponsorship etc. Under the 2011 RPC, the right to host, stage and promote the Formula One Grand Prix of India was given by FOWC to Jaypee for a consideration of USD 40 million.
SUPREME COURT VERDICT

• **On the same day, another agreement was signed between Jaypee and three affiliates of FOWC**, whereby Jaypee gave back (i) Circuit rights, mainly media and title sponsorship, to Beta Prema; (ii) Paddock rights to Allsports; and (iii) Rights to services such as generation of television feed, licensing and supervision of other parties at the event travel, transport and data support to FOAM.

• **The aforementioned rights were critical to hosting the Grand Prix in India.** The success of the event depended not only on the track and participation by teams, but was also guaranteed by services aimed at ensuring maximum public viewership such as paddock seating, media advertising, television broadcasting etc, all of which were outsourced to affiliates of FOWC. Revenues generated therefrom solely accrued to FOWC’s associates. **Such an arrangement clearly demonstrated that the entire event had been taken over and controlled by FOWC and its affiliates.**

• **Relying on the commentaries of international tax experts such as Dr Phillip Baker, the Court observed that for ascertaining whether there was a fixed place or not, a PE must have three characteristics – (i) stability; (ii) productivity; and (iii) dependence.** Further, a fixed place of business necessarily connotes existence of a physical location which is at the disposal of the enterprise through which its business is carried on.
**SUPREME COURT VERDICT**

- *It is not necessary that the premises are owned or even rented by the enterprise. It will be sufficient if the premises are put at the disposal of the enterprise.* However, merely giving access to such a place to the enterprise for the purposes of the project would not suffice. The place would be treated as ‘at the disposal’ of the enterprise when the enterprise has the right to use the said place and has control thereupon. In terms of the various provisions of the agreements between Jaypee and FOWC and its affiliates, the Court opined that FOWC did have the place – the Buddh Circuit and related premises – at its disposal and under its control throughout the duration of the race and for a fortnight prior thereto and a week thereafter.

- The SC rejected the argument that the duration for which the circuit and the associated infrastructure at the disposal of FOWC was too short. The fact was that the race was to be held for only three days in a year, i.e. the business was to be conducted only for three days. *Since for all the three days the entire control was with FOWC, this duration was sufficient to constitute fixed place PE.* Concurring with the views of the Delhi High Court, the SC held that notwithstanding that the event was held for limited days in a year, FOWC had unbridled access through its personnel to the circuit for the entire duration of the event, and for two weeks prior thereto and a week thereafter.
SUPREME COURT VERDICT

• The Court also opined that the mere construction of the track by Jaypee at its expense was of no consequence. Ownership of the track or use thereof for hosting other events was also immaterial. The argument that FOWC’s role came to an end with granting permission to host the event was categorically rejected by the Court. It was held that conduct of the F1 Championship and control over the track during that period unequivocally reflected omnipresence of FOWC and its affiliates. FOWC’s stamp over the event was loud and clear.

• The Court observed that even the physical control of the circuit was with FOWC and its affiliates from the inception, i.e. right from inclusion of the event in the F1 calendar till the conclusion of the event. The Buddh International Circuit was under the control and at the disposal of FOWC through which it conducted its business as the commercial rights holder of the F1 Championship.

• In conclusion, the Court held that the PE test as laid down by the Andhra Pradesh High Court in the case of CIT v Visakhapatnam Port Trust2 stood fully satisfied.

The Buddh International Circuit was a fixed place where the commercial / economic activity of conducting the F1 Championship was carried out, and was a virtual projection of the foreign enterprise, i.e. FOWC on Indian soil. The circuit bore all three characteristics of a PE, i.e. stability, productivity and dependence.
E-FUNDS IT SOLUTIONS INC (SUPREME COURT)(2017)
FACTS OF THE CASE

- USA
  - eFunds Corporation
  - 100%

- NETHERLANDS
  - IDLX Corporation
  - 100%
  - IDLX International BV
  - 100%
  - IDLX Holding BV
  - 100%

- INDIA
  - eFunds International India Private Ltd
  - 100%

- eFunds IT Solutions Group Inc
  - 100%
FACTS OF THE CASE

- E-Funds Corporation ("E-Funds US") is a company incorporated in the United States of America and part of a group which is engaged in the business of electronic payments, ATM management service, decision support & risk management and similar professional services.

- E-Funds US and its group company, E-Funds IT Solutions Group Inc ("E-Funds IT US") entered into contracts with their clients in the US, for the provision of Information Technology Enabled Services ("ITES"). These contracts were assigned or sub-contracted to e-Funds International India Private Limited ("E-Funds India"), an indirect subsidiary of E-Funds US in India, for execution.

- Under the terms of the agreements between E-Funds India and the two US entities, E-Funds India provided support services to E-Funds US and E-Funds IT US, which in turn enabled them to render services to their clients.

- The Assessing Officer ("AO"), relying upon the Functions, Assets and Risks Analysis ("FAR Analysis") performed in relation to E-Funds US and E-Funds India, observed that:
  - E-Funds US allowed E-Funds India to use its technology and infrastructure for provision of IT enabled services for free;
  - E-Funds US even undertook marketing activities for E-Funds India and the latter did not bear any significant risks in the overall services;
In light of this, the AO concluded that:

- E-Funds India was a fixed place PE of E-Funds US and E-Funds IT US in India since the US entities had a fixed place in India through which they were carrying on their own business.

- Thus, the income attributable to E-Funds US and E-Funds IT US, which was not included in the income earned by E-Funds India, was to be taxed in India.

- This view was upheld by the Commissioner of Income Tax (Appeals) ("CIT(A)") who concluded that in addition to a fixed place PE, there also existed a service PE and an agency PE. On appeal, the findings of CIT(A) in relation to the existence of fixed place PE and a service PE were affirmed by the Income Tax Appellate Tribunal ("Tribunal"). The Tribunal did not rule on the existence of an agency PE as arguments on that ground had not been furthered by the Income Tax Department ("Revenue"). The findings of all the above authorities were set aside by the Delhi High Court ("High Court"), which ruled that E-Funds India did not constitute a PE of E-Funds US or E-Funds IT US in India.

- Aggrieved by the ruling of the High Court, the Revenue preferred an appeal before the Supreme Court.
SUPREME COURT RULING

Issues under consideration

• Whether E-Funds India constituted a fixed place PE of E-Funds US and E-Funds IT US in India, under the India – US Tax Treaty?

• Whether employees seconded by E-Funds US to E-Funds India constituted a service PE of E-Funds US in India, under the India – US Tax Treaty?

• Whether E-Funds India constituted an agency PE of E-Funds US and E-Funds IT US in India, under the India – US Tax Treaty?

• Whether admissions made in the course of the Mutual Agreement Procedure under the India – US Tax Treaty could be used to justify the creation of PE?
SC ruling

Determination of Fixed Place PE:

• relied on decision in Formula One World Championship Ltd vs. CIT

• Noted that neither E-Funds US nor E-Funds IT US had a physical premise in India at its disposal nor did they have control over use of E-Funds India’s premises for their business.

• A subsidiary of a foreign parent carrying on business in the source State does not by itself create a PE in the source State.

• it was “fundamentally erroneous” to say that merely by contracting with a 100% subsidiary, a PE would be created. In any event, E-Funds India had only rendered back office support services to both US entities, and as such, it could not be said that the business of either US entity had been carried on through E-Funds India.

• On that basis, the Supreme Court held that the outsourcing of work by E-Funds US and E-Funds IT US to India would not result in the creation of a fixed place PE of E-Funds US or E-Funds IT US in India.
SC ruling

Determination of Service PE

• Article 5(2)(l) of the India – US Tax Treaty provides that a service PE would be constituted in India where a US enterprise furnished services within India through employees or other personnel.

• The Revenue had argued that personnel engaged by E-Funds India for the provision of support services to E-Funds US and E-Funds IT US were de facto working under the control of the US entities, and as such, constituted a service PE of the US entities in India.

• On facts, the Court observed that none of the customers of E-Funds US or E-Funds IT US were located in India, or receiving services in India. As such, the primary requirement that services be furnished “within India” had not been satisfied. On that basis, the Court did not go into the question of control over the personnel engaged by E-Funds India. In any event, E-Funds India merely undertook auxiliary operations that facilitated the provisioning of the main service (i.e. ITES) by E-Funds US and E-Funds IT US abroad. As such it could not be stated that a service PE had been created in India in terms of the India – US Tax Treaty.
Determination of Agency PE
Agency PE could only be constituted in terms of Article 5(4) of the India – US Tax Treaty. Since the tests under Article 5(4) had not been satisfied with respect to E-Funds India, no agency PE could be said to have been constituted.

Mutual Agreement Procedure
• The Revenue contended that the PE issue stood determined owing to certain statements made in the MAP Settlement Agreement to the effect that the US entities had PEs in India. It was argued that these statements should continue to remain applicable to the E-Funds Group as there had been no subsequent change in the factual position of the Group.

• On this point, the High Court had concluded that MAP proceedings had been initiated on a without prejudice basis and that the existence of a PE was a question of law that needed to be determined purely on merits. Referring to Paragraph 3.6 of the OECD Manual on MAP Procedure, the Supreme Court observed that it was “very clear” that a MAP Settlement Agreement was time and case specific and could not be considered precedent for subsequent years. Thus, statements made in a MAP Settlement Agreement for a previous year could not be used in determining PE status for a subsequent year.
A.P. MOLLER MAERSK AS (SUPREME COURT)(2017)
FACTS OF THE CASE

Denmark Resident

Centralised IT system

Indian Agent

Assessing Information

Reimbursement
Facts Of The Case

• The taxpayer, a tax resident of Denmark, was engaged in the business of shipping, chartering and related business.

• The taxpayer appointed agents in various countries including India for certain services. For the sake of convenience of all the agents and to avoid unnecessary cost, a centralised IT system (global telecommunication facility) was maintained by the taxpayer, which enabled the agents to access information like tracking of cargo, transportation schedule, customer information, documentation system and several other information. The IT system also comprised of booking and communication software, hardware and a data communications network. The agents reimbursed cost for the said system to the taxpayer on a pro-rate basis.

• The Assessing Officer (‘AO’) held these payments to be taxable as fees for technical services (‘FTS’) under the India-Denmark Tax Treaty (‘Tax Treaty’).

• The Commissioner of Income-tax (Appeals) [‘CIT(A)’] upheld the order of the AO. The Income Tax Appellate Tribunal (‘Tribunal’) decided the issue in favour of the taxpayer following the decisions of the High Court in Skycell Communications Ltd (251 ITR 53) (Madras) and Bharti Cellular Ltd (319 ITR 139) (Delhi).
The Bombay High Court (‘HC’) dismissed the Department’s appeal holding that IT system was an automated software based communication system which did not require taxpayer to render any technical services. It was a cost sharing agreement to conduct the shipping business more efficiently. The HC specifically observed that there is no finding by AO or CIT(A) there is any profit element involved in the payments received by the taxpayer from Indian agents.

The Department, aggrieved by the order of the HC, filed an appeal with the Hon’ble Supreme Court (‘SC’).
• No technical services are provided by the taxpayer to the agents. The payment is in the nature of reimbursement of cost whereby the proportionate share of expenditure incurred on the system and maintenance is borne by all agents.

• The SC reemphasized that neither the AO nor the CIT(A) has stated that there was any profit element embedded in the payments received by the taxpayer.

• Further, the Transfer Pricing Officer had also accepted that the payments were in the nature of reimbursement and was at arm’s length. Once it is found to be in the nature of reimbursement of expenses, it cannot be considered as income chargeable to tax.

• The SC observed that once it is accepted that IT system is an integral part of shipping business and business cannot be conducted without the same, it is only a facility that was allowed to be shared by the agents. Accordingly, the same cannot be treated as technical services.

• The SC has relied on its decision in the case of Kotak Securities Ltd. (383 ITR 1), where it was held that use of facility does not amount to technical services, as technical services denote services catering to special needs of the person using them and not a facility provided to all.
supreme court ruling

- The Department filed additional written submission after the conclusion of the arguments claiming the payments to be in the nature of royalty. However, the SC dismissed the same considering it as a “desperate attempt” of the Department as the claim was not made before the appellate authorities or the High Court and considering the fact that even this issue was not raised in appeal filed before the SC.

Insight
- Characterization of payments for various types of technology related transactions has been a subject matter of controversy in India. The SC in the case of Bharti Cellular Ltd. and Kotak Securities Ltd. (supra) ruled that payments with no human intervention do not fall within the meaning of technical services. This proposition has been reaffirmed by the SC in the present case while holding that the use of a common facility (though technology related) will not tantamount to technical services. Furthermore, this ruling reiterates the position that it is only “income” that is liable to be taxed; mere recoupment or reimbursement of expenses cannot be regarded as “income” chargeable to tax in the hands of the recipient.
- This is a welcome ruling from the SC which reaffirms that standardized services through the use of a facility available to many service recipients at large are unlikely to constitute FTS. The decision also needs consideration while evaluating the tax implications of amounts contributed as reimbursement toward shared services where the contribution does not have an element of income. The decision of the SC is the law of the land and is binding on all the Courts/Appellate Authorities.
JSH (MAURITIUS) LIMITED
(BOMBAY HC)(2017)
FACTS OF THE CASE

Before

JSH Mauritius

TATA Industries Limited, India

After

TATA Sons Limited, India

TATA Industries Limited, India

Share transfer of TIL
FACTS OF THE CASE

- JSH (Mauritius) Limited (Taxpayer), is a company incorporated in Mauritius engaged in the business of investment and financing activities, having no permanent establishment or business presence in India.

- It held a valid Category 1 Global Business Company License (GBL-1) and a Tax Residency Certificate (TRC) issued by Mauritian authorities. The Taxpayer held shares of Tata Industries Limited (TIL), an Indian company, for a period of 13 years and in June 2009, it transferred the TIL shares owned by it to Tata Sons Limited (TSL). The sale proceeds from the TIL shares were re-invested in a group company of TIL.

- The Taxpayer had approached the AAR to ascertain whether it was entitled to beneficial provisions (namely, Article 13(4)) of the Treaty in relation to sale of TIL shares in order to be exempt from paying any capital gains tax in India.

- The AAR ruled in favour of the Taxpayer and observed that it was not a 'shell company' and held that the transaction was not designed to avoid tax. Aggrieved by the decision of the AAR, the Income Tax Department (Revenue) filed the present writ petition before the HC.

- Importantly, the Revenue filed the writ petition after a delay of 8 (eight) months from the date of the AAR's order.
The Revenue put forth the following key contentions to argue that the Taxpayer should be taxed in India in relation to capital gains arising from the sale of TIL shares:

- **The Taxpayer is a 'shell company' and 'fly-by-night' Company:** Contending that the Taxpayer had been incorporated only to take advantage of the Treaty, the Revenue pointed to the original proposal made to the Indian regulator at the time of investment which depicted the name of one Jardine Matheson Bermuda as the investor. Only later was the proposal amended to route the investment through Mauritius.

- **No commercial substance:** The Revenue argued that the Taxpayer had never incurred expenses of wages, salaries of staff, electricity, other charges etc., and its only income and expense (apart from the profits from the sale of shares of TIL) were on account of interest received from or paid to its group entities.

- **Period of holding:** The mere fact that the Taxpayer had held shares of TIL for 13 (thirteen) years was irrelevant according to the Revenue while assessing the Taxpayer's eligibility to avail Treaty benefits.
Beneficial owner of TIL shares: The Revenue contended that Jardine Matheson Bermuda was in fact the beneficial owner of the TIL shares since the Taxpayer had not nominated anyone on the Board of Directors (Board) of TIL and in fact, certain employees of Jardine Matheson Bermuda were appointed as directors on TIL's Board.

AAR's verdict on 'shell company': Arguing that the transaction was a clear case of Treaty abuse, the Revenue stated that the AAR is not empowered to decide cases of tax avoidance. According to the Revenue, the AAR was erroneous in not discussing the basis for concluding that the Taxpayer was not a 'shell company'.
The following key arguments were advanced by the Taxpayer before the HC:

• **Maintainability of Taxpayer's application before the AAR:** The Taxpayer submitted that the Revenue had failed to challenge the initial order of the AAR wherein it had reserved the right to examine the issue of tax avoidance at the final hearing stage as against at the admission stage. Consequently, the ruling had attained finality and maintainability of the Taxpayer's application could not be challenged at this stage before the HC. The Taxpayer argued that the AAR's order is thus final and binding on parties and the Revenue.

• **Bona fide and Residence of the Taxpayer:** The Taxpayer reiterated its long-term investment in TIL, after due approval from the Indian regulator, its valid GBL-1 and TRC granted by Mauritian authorities and income tax returns filed in Mauritius. It argued that it was a Mauritian 'resident' for the purposes of the Treaty and therefore squarely entitled to Treaty benefits.

• **Exemption from Capital Gains Tax in India, Legality of Treaty shopping:** The Taxpayer further substantiated its claim to avail Treaty benefits by placing reliance on the Azadi case (*supra*) and circulars (binding on the Revenue) issued by the Central Board of Direct Taxes. The circulars unequivocally provide that taxation of capital gains arising to a resident of Mauritius would be taxable in Mauritius; and that a TRC would constitute sufficient evidence of residence, respectively.
• Dismissing the Revenue's writ petition, the HC decided in favour of the Taxpayer. The HC held that it would not act as an appellate authority unless the AAR's appreciation of facts and findings were perverse or if the provisions of law were incorrectly construed. The HC concluded that the AAR had considered all relevant aspects of the matter in arriving at a just conclusion and that the Treaty had also been rightly interpreted.

• The HC noted that the long period of holding TIL shares and reinvesting the proceeds in another Indian company suggested the *bona fide* of the Taxpayer. It further held that since the AAR did not rule that the Taxpayer is a 'fly-by-night' company, alleging *prima facie* tax avoidance at a later stage was unwarranted.

• Interestingly, the HC did not rule on the delay of 8 months on the Revenue's part, in filing the writ petition challenging the AAR ruling, *albeit*, the Revenue had argued that "*some time was lost due to administrative exigency."
VODAFONE GROUP PLC UK
(DELHI HC)(2017)
Facts Of The Case

The claim under India-Netherlands BIPA

- Vodafone Group PLC, UK (‘Vodafone’ or the ‘Defendants’) is the parent company of several subsidiaries. On April 17, 2014, Vodafone International Holdings BV (‘VIHBV’), a subsidiary of the Defendants, initiated arbitration proceedings against the Republic of India (‘India’ or the ‘Plaintiff’) under the India-Netherlands BIPA.

- The claim challenged retrospective amendment of Section 195 of the Indian Income Tax Act read with Section 119 of the Indian Finance Act, 2012 by the Indian government, to bring VIHBV under the tax liability net for acquisition of stake in an Indian company. The retrospective amendment was carried out by the Indian Parliament after the Supreme Court of India quashed the tax-demand.
Facts of the Case

The claim under India-United Kingdom BIPA

• During pendency of arbitration proceedings under the India-Netherlands BIPA, the Defendants initiated arbitration against India on January 24, 2017 under the India-United Kingdom BIPA (‘India-UK BIPA’). The Defendants challenged the same actions of the Republic of India under the aforesaid proceedings ie retrospective amendment of Section 195 of the Indian Income Tax Act read with Section 119 of the Indian Finance Act, 2012.

• India filed a suit before the Delhi High Court (the ‘Court’) seeking an anti-arbitration injunction against the Defendants for the initiation of proceedings under the India-UK BIPA.
Vertical chain of entities

• At the outset, the Court recognised that several corporate entities may exist in a vertical chain controlled by a single investor. In the wake of a violative measure by the host State, multiple treaties may procedurally allow the entities in the chain to bring claims against the host State; in effect permitting the controlling investor to bring multiple claims against a host State from several standpoints in the vertical chain.

• The Court acknowledged that this would constitute abuse of legal rights by the investor. The Court relied on the case of Orascom TMT Investments S.à r.l. v People’s Democratic Republic of Algeria (ICSID Case No. ARB/12/35)—Award dated 31 May 2017, wherein it was held that permitting such claims would result in the risk of multiple proceedings, multiple recoveries, conflicting decisions and waste of resources. This would also conflict with promotion of economic development of the host State where claims have been initiated for protection of investment.
Group of companies

The Court sought to take recourse from the group-of-companies doctrine to establish identity of parties in the parallel claims under the BITs. The Court relied on the decision of the English court in the case of DHN Food Distributors Ltd and Ors v London Borough of Tower Hamlets [1976] 3 ALL ER 462, 467 (relied on by the Delhi High Court in Pankaj Aluminium Industries Pvt. Ltd v M/s. Bharat Aluminium Company Ltd (2011) IV AD (Delhi) 212 (not reported by Lexis®Nexis UK)) wherein it was acknowledged that there was a general tendency to ignore separate legal entities of various companies within a group, and to look at the economic entity of the whole group. Relying on the aforesaid doctrine, the Court stated that the Defendants and their subsidiary VIHBV seemed to constitute a single economic entity and form a part of the same group being run, governed and managed by the same set of shareholders.
Identity of cause of action & reliefs

The Court assessed the reliefs sought by the Defendants and VIHBV in their respective claims under the India-Netherlands BIPA and the India-UK BIPA. The Court acknowledged that the relief sought was starkly identical i.e. the parties sought declaration of a breach of BIT by India on account of retrospective amendment to the Indian Income Tax Act read with the Indian Finance Act, 2012. The Court held that there was not only duplication of parties and issues, but also the identity of relief in the parallel proceedings.

Anti-(treaty) arbitration injunctions

*The Court relied on the of landmark judgment Modi Entertainment Networks v WSG Cricket Pte Ltd (2003) 4 SCC 341, enunciating principles for grant of anti-suit injunctions.* It held that an injunction can be passed by a court of natural jurisdiction i.e. India in the instant case, to restrain a party from initiating proceedings in a foreign forum, albeit being forum of choice and exclusive jurisdiction, if the said forum is oppressive or vexatious. The Court also stated that India is the natural forum for litigation of the Defendants’ claim against the Plaintiff.
Abuse of process

The Court held that in the wake of the economic identity of parties, identical causes of action being the retrospective amendment of legislation by India and identity of relief prayed for in the parallel proceedings under the India-Netherlands BIPA and the India-UK BIPA, the Court held a prima facie view that initiation of independent proceedings under the two BITs constituted abuse of process of law at the hands of the Defendants, both on account of the Defendants’ themselves and through their subsidiaries. The Court considered it inequitable and unjust to permit the Defendants from continuing the arbitration under the India-UK BIT.
PRACTICAL IMPLICATIONS

- Anti-arbitration injunctions (more so investment treaty arbitrations) go a long way in damaging a pro-arbitration and an international business-friendly reputation that India is striving to painstakingly build. Nevertheless, the principle on which the judgment is delivered is sound and has been gaining popularity the world over. Initiation of multiple proceedings under different BITs by entities forming part of the same group of companies, raising virtually identical complaints would amount to abuse of process of law.

- One does wonder whether it would have been more prudent to allow the arbitral tribunal to determine its own jurisdiction, in light of this very objection raised by India in the arbitration proceedings. After all, even in the instant case, the Court does note that it was an investment treaty award in Orascom v Algeria which had laid down that initiation of multiple proceedings under different BITs, such as in the present circumstances, would tantamount to abuse of process of law.

- Considering this remains an ex-parte interim order, it will be interesting to follow how this case develops if and when the Vodafone entities enter appearance and set out their formal defence.
MARKS & SPENCER RELIANCE INDIA PRIVATE LIMITED
(BOMBAY HC)(2017)
Facts Of The Case

Marks & Spencer Plc (M&S)

Reimbursement of salary for seconded employees

Seconded Personnel to carry out functions in area of management, setting up business

Reliance Retail Limited

JV

Marks & Spencer Reliance India Pvt. Ltd.
Facts Of The Case

- The assessee Marks & Spencer Reliance India Pvt. Ltd. is a joint venture between Marks & Spencer Plc (M&S) and Reliance Retail Ltd.

- The assessee entered into an agreement with M&S

- M&S provided personnel to carry out functions in the area of management, setting up business, property selection, retail operation, product and merchandise selection, setting up merchandise team.

- A sum of Rs. 4.83 crore was paid by the assessee to M&S without deduction of tax at source u/s 195.

- The AO held that the sum was chargeable to tax as FTS and passed an order u/s 201 treating the assessee as assessee in default.
The ITAT held that the payment was not FTS since technology was not ‘made available’ by payee to the assessee.

Moreover, the payment was a reimbursement of expenses in absence of profit element. This was confirmed by the JV agreement.

The ITAT remarked that merely providing employees or assistance in business did not constitute make available of services of technical/consultancy nature.

Hence, payment was not taxable as FTS under DTAA.
• HC noted that ITAT was right in concluding that payment was towards salary expenditure as a part of service agreement and joint venture between the two companies.

• It was a clear case of deputing officials/employees for promotion of business of the assessee which is an Indian arm of M&S.

• Since the said payment to employees is already subject to tax in India, there is no question of treating the assessee in default for non-deduction of tax at source.
MARTRADE GULF LOGISTICS FZCo-UAE (RAJKOT ITAT)(2017)
**FACTS OF THE CASE**

- Assessee is a Shipping Company registered in UAE.
- Assessee is engaged in business of operations of ships in India.
- The Share Capital of the company is held by German entities / residents.
- The Directors of the company are of different nationalities – Indian, German and Portugese.
The A/o denied benefit of India-UAE DTAA to assessee shipping company by invoking article 29 of the DTAA, grounds:

- Effective control and management of the assessee was situated out of UAE. Therefore, it was not Resident of UAE in terms of Art 4(1)(b) and 4(4) of the DTAA. Hence, it could not access the India-UAE DTAA.

- The assessee was not subjected to tax in UAE, thus, it could not be treated as tax resident of UAE; Further, directors and shareholders were non-UAE nationals and also the AGM of the Company was held outside UAE; and

- The assessee was hit by article 29 of the Indo-UAE Tax Treaty (LOB Clause). Art 29 limits the benefits of DTAA if main purpose or one of the main purposes of creation of such entity is to obtain India-UAE DTAA which would not have been otherwise available.
Art 4 (1) & (4) of India-UAE DTAA:

Prior to amendment by Protocol Date 26.03.2007

(1) "any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature"

(4) Where by reason of the provisions of paragraph (1), a person other than an individual is a resident of both contracting states, then it shall be deemed to be a resident of the state in which its place of effective management is situated.

Subsequent to amendment by Protocol Date 26.03.2007

(1) in the case of the United Arab Emirates: an individual who is present in the UAE for a period or periods totaling in the aggregate at least 183 days in the calendar year concerned, and a company which is incorporated in the UAE and which is managed and controlled wholly in UAE.

(4) no change (except numbering)
Article 29 of India-UAE DTAA:

- "An entity which is a resident of a Contracting State shall not be entitled to the benefits of this Agreement if the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits of this Agreement that would not be otherwise available. The cases of legal entities not having bonafide business activities shall be covered by this article."
1. On the entitlement to DTAA on account of ‘subject to tax’:

- Reliance is placed on
  - Green Emirates Shipping – 100 ITD 203 MUM
  - UOI V Azadi Bachao Andolan – 263 ITR 706 SC

- The Assessee is incorporated and hence, had locality related attachments to be a resident of UAE

- Since Assessee is not Resident of India & UAE- Art 4(4) has no relevance.

- That the wordings of amended Art 4(1) – in case of UAE – no longer requires individuals / company to be ‘liable to tax’ in UAE. Requirement of actual liability tax consciously removed from definition of ‘resident of contracting state’
2. On POEM and Art 29:

- Reliance Placed on MUR Shipping DMC Co 155 ITD 1079 (Rajkot)

- LOB Article – 29 introduced by Protocol dated 26.03.2007 to ensure that provisions of Art 4(1) not abused by incorporating SPV in UAE to seek undue benefits of India-UAE DTAA

- Further, Art 29 is subject to rider that the case of legal entities not having bonafide business purpose shall be covered by this article.

- LOB only when an entity is created as a part of maneuvering, wholly or mainly, to obtain the tax benefits of India-UAE DTAA which “would be otherwise not available “

- Therefore, the AO has to be demonstrate that if the company was not formed in UAE, it would not be entitled to such benefits.

- All the shareholders are German entities. India-Germany has similar treaty protection. Therefore, whether the company was formed in UAE or Germany, it would not make material difference so far as non-taxability of income in India is concerned. Thus, requirement of invoking Art 29 not fulfilled.
3. As regards Management:

- The Assessee is incorporated in UAE,

- Nationality of directors is not relevant,

- Place of Holding AGM and nationality of Shareholders is not important. Place of Holding AGM is governed by law of the country where the company is incorporated. Shareholder do not have a say or direct interference in the management of the company.

- Board Meetings and important decisions are taken at Dubai, Senior staff including MD is Resident of Dubai and has Permanent Residential status.

- The assessee has a valid Incorporation certificate, Trading license, Valid TRC, MOA/ AOA. Disclaimer by UAE Govt is not material.
BURT HILL DESIGN PRIVATE LIMITED
(AHMEDABAD ITAT)(2017)
Burt Hill Design Private Limited (‘BHDPL’), is subsidiary of BH Inc USA (BHI), provides ITES.

BHI has seconded some employees and they are at disposal and control of BHDPL.

BHDPL makes payroll payments after doing TDS u/s 192 and remits money to BHI as reimbursements without any further TDS.

AO holds that the presence BDI employees trigger Service PE and in absence of details of expenditure of PE, entire income is business income ‘BI’ liable to tax @ 40 %.

On appeal, CIT(A) holds the payments to be FTS and not BI.
1. The existence of service PE, is academic as whatever is the aggregate of receipts said to be attributable to the PE, is exactly the same as aggregate of expenditure attributable to the PE.

2. It is not the revenue's case that any other receipts of the Burt Hill Inc USA, other than the receipts on account of reimbursements for salaries, or any other income could be attributed to the so called Service PE.

3. Further, when the payments are in the nature of the reimbursements, and, particularly when even the income embedded in these payments has already been brought to tax in India in the hands of ultimate beneficiaries - i.e. the seconded employees, there cannot be any tax withholding obligations under section 195.

4. As for the payments being in nature of the FTS. The stand of the AO equally frivolous. It has not been shown as to how any technical knowledge, skills, knowhow or processes etc are "made available" by these services inasmuch as these services can be performed by the assessee without any recourse to the service provider. Unless this condition, under make available clause under article 12(4)(b), is satisfied the fees for technical services cannot be brought to tax in India in the hands of entities fiscally domiciled in United States.
If the income is taxable under the head salaries, there is no TDS obligation u/s 195.

There is no service PE as what is paid to BHI is paid over to employees seconded to BHDPL.
CAIRN UK HOLDINGS LIMITED (DELHI ITAT)(2017)
As part of the internal reorganization, Cairn UK Holdings Limited ‘CUHL’ (“the Appellant/Assessee”) was incorporated on 26 June 2006. Thereafter, a Share Exchange Agreement dated 30 June 2006 was entered into between cairn Energy Limited PLC ‘CPLC’ and CUHL, whereby the entire issued share capital of nine wholly owned subsidiaries of CPLC were exchanged with the CUHL. In consideration for the aforesaid, CUHL issued 22,14,44,034 shares of GBP 1 each to CPLC. Consequently, CUHL became a wholly owned subsidiary of CPLC.
Facts of the Case

Cairn CIHL was incorporated in Jersey (UK) on 2 August 2006. Thereafter, a Share Exchange Agreement dated 07 August 2006 was entered into between the CUHL and CIHL whereby the CUHL exchanged all the shares of the Subsidiaries with CIHL. As a consideration for the aforesaid exchange of shares, CIHL issued 22,14,44,034 shares of GBP 1 each at par to CUHL. Consequently, CUHL became the wholly owned subsidiary of CIHL.
As a final part of internal reorganization, CIL was incorporated in India on 21 August 2006 as a WOS of CUHL. In accordance with Indian regulatory provisions, equity was injected into CIL by CUHL. Vide subscription and share purchase agreement the entire share capital of CIHL was transferred from CUHL to CIL; the consideration for this transfer was settled partly in cash and partly as shares in CIL. For this purpose, initially funds were infused in CIL on various dates by CUHL and from these funds, on the same day; CIL purchased some part of the share capital of CIHL from CUHL. As a result, CIL acquired 100 percent stake in CIHL from the Appellant.
• It was these 251,224,744 shares of CIHL which when sold to CIL resulted in total consideration of Rs. 26,681.87 crores received in the hands of CUHL.

• With regard to the above transaction. Assessing Officer ("AO"), alleged the gains arising from the sale of shares of CIHL by the CUHL to CIL are short term capital gains and hence chargeable to tax in India at the rate of 40 percent.
TAXPAYER’S CONTENTION

• The Indirect Transfer Provisions are bad in law and ultra vires the Right to Equality enshrined in the Constitution of India, and the Taxpayer should be assessed as per Section 9 of the ITA as it stood before the enactment of the Indirect Transfer Provisions by way of the Finance Act, 2012.

• Since the Double Tax Avoidance Agreement between India and United Kingdom (“Tax Treaty”) was entered into in 1994, the Taxpayer should be taxed as per domestic law provisions as they existed in 1994.

• The tax department has erred in interpreting Section 9 of the ITA as it stood before the enactment of the Indirect Transfer Provisions.

• The facts in the case pertain to an internal reorganisation of the Cairn group without involving any sale or transfer to a third party, did not result in any change in the controlling interest and no tax maybe levied on an internal reorganisation which does not result in any increase in wealth of the group.

• Since the capital gains tax liability on account of the Transaction only arose pursuant to the enactment of the Indirect Transfer Provisions by way of the Finance Act, 2012, no interest should be levied in that regard and the penalty proceedings initiated should be dismissed.
DEPARTMENT’S CONTENTION

• The Indirect Transfer Provisions were only introduced as clarifications for the removal of doubts and the income of the Taxpayer in question was always and is taxable in India.

• Under the Tax Treaty, capital gains is to be taxed in accordance with the domestic laws of each country as per Article 14 therein.

• CUHL being a non-resident, any income accruing or arising to it, whether directly or indirectly, through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India. Since CIHL shares derive substantial value from assets in India, they were situated in India.

• There is no concept of group taxation in India, each assessee is taxed separately and the Transaction was a clear case of sale which resulted in capital gains.

• The tax department also distinguished the impugned case from the Vodafone case on the ground that in the latter, it was a transfer of a foreign share between two non-residents while in the former, it was as transfer from a non-resident to a resident and hence the latter could not be applied.
The ITAT at the outset dismissed the Taxpayer's argument regarding the legal validity of the retrospective amendments brought in by the Indirect Transfer Provisions, taking the view that the ITAT is not the appropriate forum to rule on the constitutional validity of the Indirect Transfer Provisions.

On the Taxpayer’s contention that a ‘static’ approach ought to be employed in interpreting the Tax Treaty so as to tax assessees as per domestic law as it existed in 1994, the ITAT perused the ruling of the Delhi High Court in the case of DIT v. New Skies Satellite BV3 which was relied on by the Taxpayer.

The ITAT observed that acts of Parliament may neither supply or alter the boundaries of a tax treaty, nor supply any redundancy to any part of the tax treaty. The ITAT then drew an analogy and opined that similarly, the provisions of a tax treaty cannot limit the boundaries of domestic tax laws. It therefore endorsed the ambulatory approach / dynamic interpretation of tax treaties whereby the tax treaty will be interpreted in light of current law as it exists.
The ITAT also took the view that the facts in the case at hand did not involve a simple internal reorganisation, since the entire series of transactions culminated in the IPO by way of which the Taxpayer received considerable gains. On perusing the financial statements of the Taxpayer the Court also observed that the Taxpayer had not paid any tax on the capital gains even in UK. Based on this and the view that tax treaties are intended to provide relief from double taxation, the ITAT held that the gains are chargeable to tax in India owing to the Indirect Transfer Provisions.

The interesting part which one needs to read into while dealing with capital gains provisions under Treaty law is the right allocated to both the contracting states to levy capital gains tax as per their domestic laws. The interesting question here is that UK did not consider this transaction as taxable but the ITAT held that the same does not override the right of India to tax these capital gains as per its domestic law.
TATA INDUSTRIES LIMITED (MUMBAI ITAT)(2017)
Facts Of The Case

Tata Industries (Tax Payer) 

Apex Investments 

Idea Cellular

Share Transfer by TATA of Idea to Birla India

Share Transfer by apex of Idea to Birla India
FACTS OF THE CASE

• AT&T Corporation had entered into a JV with Birla Group in 1995 for providing wireless telecommunication services in India. The JV obtained license from Government of India-Department of Telecommunication. AT&T Group made investment in JV through its Mauritius based company namely 'Apex' which in turn was holding shares of another company namely 'IDEA'. Subsequently, the assessee company acquired entire shareholding of 'Apex' as a result of which said company became wholly owned subsidiary of assessee.

• During relevant year, 'Apex' sold shares of 'IDEA' to Birla group. In course of assessment, the Assessing Officer invoked the provisions of section 93 and held that capital gains arising out of sale of shares by 'Apex' had to be taxed in the hands of the assessee. The CIT(A) confirmed the order of the AO and held that transaction had to be taxed as short term capital gains and not as long term capital gains.

• The taxpayer argued that the entire capital gain which arose to Apex upon the transfer of shares of Idea was exempt under Article 13(4) of the India-Mauritius tax treaty (the tax treaty)

Issues under consideration
Whether Anti Avoidance provisions of section 93 of the IT Act apply where assets are transferred from a non resident to a resident?
ITAT Ruling

• Section 93 of the Act is successor of Section 44D of Income-tax Act, 1922. The object of both the sections is clear from the title itself. The preamble of section talks of ‘avoidance of Income-tax by transactions resulting in transfer of income to non-resident’.

• The only and logical conclusion that can be drawn from the above mentioned words is that the object behind the sections is to prevent residents of India from evading the payment of by transferring their assets to non-residents while enjoying the income by adopting questionable methods.

• The language of the section is plain and unambiguous. The purpose of incorporating the provision was to curb the practice of tax avoidance by the resident taxpayers by transferring their assets to non-residents and enjoying the fruits of the assets even after such transfer.

• What matters is the result envisaged by the said section i.e. a non-resident is the transferee of the assets but the taxpayer acquires the power to enjoy the income from those assets. In short, if a resident has power to enjoy the income accruing /arising out of the assets transferred to a non-resident, such resident would be deemed to have received that income and therefore, would be liable to be assessed under the Act.
• Being a deeming provision, Section 93 has to be strictly construed and has to be taken to its logical conclusion. It means that if the situation specified in the section exists, only then it will be applicable.

• One of the basic facts i.e. transfer of property by a resident to a non-resident is not there in the whole transaction. In the instant case, a non-resident company has transferred property i.e. shares to a resident and that resident is an unrelated party. Absence of transfer by resident to a non-resident entity takes the transaction out of the ambit of Section 93 of the Act. Therefore, the tax department wrongly invoked the provisions of Section 93 of the Act.

• *Relying on the decision in the case of Azadi Bachao Andolan,* the Tribunal observed that as far as applicability of tax treaty provision *vis-à-vis* Section 93 of the Act is concerned, the tax treaty would prevail over the Act.
JOHNSON MATTHEY PUBLIC LIMITED COMPANY (DELHI ITAT)(2017)
Facts Of The Case

• The assessee provided guarantees to support credit facilities extended to its subsidiaries in India by banks.

• In its return of income it treated the guarantee fees received from Indian subsidiaries to be in the nature of interest income under Article 12 of India-UK Double Taxation Avoidance Agreement (‘DTAA’) and offered it to tax @ 15%.

• The Assessing Officer (‘AO’) treated the guarantee fees as other income under Article 23 of the India-UK DTAA and taxed it at the rate of 40% (plus surcharge and cess).
ITAT Ruling

- The Tribunal held that the guarantee income accrued in India since loan transaction took place in India.

- Though it was contended that the assessee had entered into the global corporate guarantee agreement with the banker outside India, the Tribunal observed that on that account alone no receipts would accrue to the assessee in the jurisdictions where the loan facility was not availed by the subsidiaries.

- It further observed that it was not the entering of the global corporate agreement outside India that occasioned the assessee to charge the guarantee commission, but it was the act of the subsidiary in availing the loan that accrued the guarantee commission to the assessee.

- Since the loan transaction took place in India, the guarantee fee income accrued in India.

- The ITAT also held that the guarantee fee was not interest income as per Article 12(5) of the India-UK DTAA.
The Tribunal held that the contract of loan was different from the contract of guarantee, and the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" did not include payment of guarantee commission received by the assessee in India.

The assessee was a stranger to the privity of contract of loan between the Indian entity and the banker and hence the guarantee fee was not interest income and if this was considered as interest income then other payments like consultancy charges, expenditure incurred for the purpose of pre-loan documentation and the host of expenditure incurred with third parties and not relatable to the loan transaction proper, will have to be treated as "interest."

Further, the ITAT also held that the assessee was not in the business of giving guarantees and hence the guarantee fee was not business income, and neither was it fees for technical services. The ITAT concluded that in view of Article 23(3) of the India-UK DTAA, in the absence of any specific provision dealing with corporate/bank guarantee recharge, the same was to be taxed in India as per the provisions of the Income-tax Act, 1961 (‘Act’)
ELITECORE TECHNOLOGIES PRIVATE LIMITED
(AHMEDABAD ITAT)(2017)
FACTS OF THE CASE

• The taxpayer, Elitecore Technologies Private Ltd., is a wholly owned subsidiary of a US-based company engaged in the business of software developments and products.

• For the relevant tax year 2012/13, the taxpayer earned foreign incomes in Indonesia, Malaysia and Rwanda, on which taxes were withheld in the respective source countries aggregating to INR 55.61 lakhs. The taxpayer claimed a foreign tax credit (FTC) in respect of the taxes so withheld abroad. However, Revenue granted the tax credit for only INR 3.10 lakhs.

• On appeal, the first appellate authority in India (CIT(A)) confirmed the quantification of eligible tax credit at INR 3.10 lakhs, but allowed an expense deduction u/s 37(1) of the Indian Income-tax Act for the balance amount of INR 52.50 lakhs (i.e. tax withheld abroad at INR 55.61 lakhs minus tax credit allowed of INR 3.10 lakhs).

Issues under consideration

Whether Income Tax deducted outside India can be allowed as expense deduction u/s 37 of the Income Tax Act?
Section 40(a)(ii) of the Act provides that deduction for tax levied on profits & gains of any business or profession shall not be allowed while computing business income. Further, an explanation has been added to section 40(a)(ii) clarifying that such tax would also include any sum eligible for relief of tax of u/s 90/90A or deduction from the Indian income-tax allowable of u/s 91. Revenue had argued that the taxpayer’s case was hit by section 40(a)(ii) bar and hence an expense deduction of u/s 37 cannot be allowed. However, the taxpayer had argued that the restriction placed by u/s 40(a)(ii) refers to only “tax” as defined by u/s 2(43) of the Act which refers to tax chargeable under the provisions of this Act (i.e. Indian IT Act, 1961) and the limitation of u/s 40(a)(ii) does not extend its scope to taxes paid abroad.

Further, the taxpayer submitted that the taxes paid abroad were inherently in the nature of expenses incurred for the purposes of business, and hence should be allowable as business expenditure u/s 37(1).

Upholding Revenue’s stand, the Tribunal opined that if taxes in respect of which FTC of u/s 90 or 91 are covered by the Explanation, these are necessarily covered by the scope of section 40(a)(ii) as well. Accordingly, the Tribunal rejected the taxpayer’s stand that the meaning of “tax” u/s 40(a)(ii) must remain confined to the taxes levied under the IT Act, 1961.
FACTS OF THE CASE

• GE Energy Parts Inc. (‘the assessee’) is a company incorporated in the United States of America (‘USA’) and is also a tax resident of the USA. The assessee is a part of the GE Group, which makes equipments for the customers in India relating to oil and gas, energy, transportation and aviation business.

• A survey u/s 133A of the Income-tax Act, 1961 (‘the Act’), was conducted at All India Fine Arts and Crafts Society premises, i.e. liaison office of General Electric International Operations Company Inc. (GEIOC). During the course of survey and post-survey enquiries, the revenue authorities obtained certain incriminating material / documents / information and also recorded statements of some persons.

• On the basis of the material/ information gathered, the Assessing Officer (‘AO’) issued notices u/s 148 of the Act to 24 GE group entities (including the assessee) which were incorporated in various countries like UK, Japan, USA, Germany, Canada, Italy, Mauritius, Singapore, etc.
Facts Of The Case

- The AO observed that many activities relating to marketing and sales were carried out in India. The AO also observed that the expatriates from GE International Inc., US (‘GEII’) along with the employees of GE India Industrial Private Limited, India (‘GEIIPL’) constituting the Indian team (‘GE India’) were always involved and participated in the negotiation of prices.

- Thus, the AO passed an order and held that the GE group entities were selling goods in India with the involvement of its Permanent Establishment (PE) (i.e. a fixed place PE and a dependent agent PE) in India and, accordingly, the profits attributable to such PE were chargeable to tax in India. The Commission of Income-tax (Appeals) ['CIT(A)'] also upheld the order of the AO.

- Aggrieved by the order of the AO / CIT(A), the GE group overseas entities filed a batch of 139 appeals. The GE group selected the assessee’s case as lead case and fairly admitted that there are four broad common issues to be dealt with. The following broad issues are as under:
  a. Whether there exits any Fixed Place PE or Agency PE in India;
  b. Attribution of profits to such PE;
  c. Whether re-assessment proceedings are valid and
  d. Levy of interest u/s. 234B
A. EXISTENCE OF PE

i. Fixed Place PE

• The ITAT considered the Double Tax Avoidance Agreement (‘DTAA’) between India and USA to examine the provisions in respect of 'Fixed Place PE'. Article 5 of the said DTAA deals with PE, and in particular paragraphs 1 to 3 deal with the fixed place PE, relevant extract of paras are reproduced below:

1. For the purposes of this Convention, the term ‘permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term ‘permanent establishment' includes especially:
   (a) a place of management;
   (b) ....
   (c) an office;
   (d) to (l)....
3. Notwithstanding the preceding provisions of this Article, the term ‘permanent establishment' shall be deemed not to include any one or more of the following:

(a) to (d)

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise.’

- The ITAT observed that on a conjoint reading of the relevant parts of paras 1, 2 and 3 of Article 5, a PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on and such fixed place is not maintained for activities of a preparatory or auxiliary character.

- Thus, based on the facts, the ITAT found that expatriates from GEII, permanently using the liaison office premises of GEIOC at AIFACS building. It was also observed that these expats and employees of GEIIPL working under expats were working in AIFACS building, has never been denied by the assessee.
The ITAT also observed the primary, specific and original substantiated material in the form of survey documents, self-appraisals, manager assessment, etc., and held that GE overseas entities were selling its products in India and the core activities in regard to sale, namely, pre-sale, during-sale and post-sale were being carried out in India by GE India.

Thus, the ITAT held that all the conditions for constituting a fixed place PE in terms of paras 1, 2 and 3 of the Article 5 are fully satisfied, as AIFCAS building is a fixed place from which business of GE overseas entities is partly carried on in India and the activities carried out from such fixed place are not of preparatory or auxiliary character.

II. AGENCY PE

The Agency PE is subject matter of paras 4 and 5 of Article 5 of the DTAA. Relevant extract of paras are reproduced below:
'4. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 5 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State if:

(a) he has and habitually exercises in the first-mentioned State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercise through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;

(b) to (c)……

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.
**KEY OBSERVATIONS & DECISION OF DELHI ITAT**

However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph.’

- The ITAT observed that para 4 of Article 5 states that where a person, other than an agent of independent status to whom para 5 applies, and fulfills the conditions as set out in the para 4, the said person will constitute a PE of the enterprise.

- The ITAT further observed that the first part of para 5 refers to an agent of independent status and the second part of para 5 refers to an agent of independent status who is not considered an agent of independent status because of the conditions set out in the said paragraph.

- Thus, it is axiomatic, that the ‘person’ referred to in para 4 refers to an agent of dependent status and also an agent of an independent status who is covered in part 2 of para 5. Exception to the first part of para 5 created in part 2 is restricted only to ‘an agent of independent status’. On the other hand, if there is an agent of dependent status per se whose activities are devoted to one or multiple related enterprises, he will be directly covered within the scope of para 4 of Article 5 of the DTAA.
KEY OBSERVATIONS & DECISION OF DELHI ITAT

• Thus, the ITAT observed that the nature of activities done by GE India, which are of core nature, and they clearly indicate GE India’s authority to conclude contracts on behalf of GE overseas entities. Thus, the ITAT held that GE India constituted agency PE of all the GE overseas entities in India.

B. ATTRIBUTION OF PROFITS

• The ITAT observed that the AO was correct in its approach in estimating total income at 10% of sales made in India due to non-availability of year-wise, and entity-wise profits of GE overseas entities for the operations carried out in India.

• Further, the ITAT held that GE India conducted core activities and the extent of activities by GE Overseas in making sales in India is roughly one fourth of the total marketing effort. Thus, it was estimated that the 26% of total profit (i.e. 10% of sales) in India, as attributable to the operations carried out by the PE in India, instead of 35% estimated by the AO.

C. VALIDITY OF RE-ASSESSMENT PROCEEDINGS

• The ITAT on the basis of various facts/ information collected during and after the survey proceedings observed that various GE group entities are carrying out the business in India.
The ITAT also observed that the assessee has taken several legal objections against the initiation of reassessment, but did not deny correctness of factual assertions in this regard in the reasons.

The ITAT relying on various judgments held that the initiation of reassessment proceedings requires the AO to form a prima facie view about the escapement of income and there is no need to conclusively establish at that stage that such income escaped assessment. Thus, the ITAT held that that the AO was justified in initiating reassessment proceedings based on the incriminating material found during the survey.

**The important aspect of the decision is the attribution of income under the Act to the activities carried on by the PE in India. The key in such attribution, is the identification of the economic nature of the activities of the PE, and the contribution of such activities to the profits of the enterprise and its attribution to the income chargeable to tax in India to the PE.**
FACTS OF THE CASE

• ABB FZ (assessee), a company incorporated in the UAE rendered certain services to ABB Limited (“ABB India”), a company incorporated in India. In relation to these services, three employees of the Assessee visited India for 25 days

• The Assessee claimed that the amount received from ABB India was not taxable as Royalty in India since there was no FTS clause in the India-UAE DTAA and as a result, the taxability of such payments would have to be determined under the residual clause of Article 22 – 'Other Income'‘

• Article 22 of the DTAA, provides for taxation of Assessee only if it had a PE in India. The Assessee argued that it did not have a Fixed place of business in India as its employees were not physically present in India for a long period of time and hence, it did not establish a Service PE in India
FACTS OF THE CASE

• Assessee also argued that only three employees were physically present in India for a period of 25 days, which was well below the required threshold of nine months required under the India-UAE DTAA for constituting a Service PE. Accordingly, it was contended that the service received from ABB India was not taxable in India.

• On the contrary, the tax authorities held that the Assessee constituted a Service PE in India. They further held that in the absence of a FTS clause in the India-UAE DTAA, the domestic law will prevail and the amount received by the Assessee would be covered

• by the definition of FTS as per the IT Act and thus, the Assessee was liable to pay tax on such amount.

Being aggrieved, the Assessee filed an appeal before the ITAT.

ISSUES

Whether the Assessee has a Service PE in India?

Whether the amount received by the Assessee from ABB India is taxable as royalty in India?
ARGUMENTS — ASSESSEE AND REVENUE

• In relation to the issue of Service PE, the Assessee argued that it did not constitute a Service PE in India as it did not have a fixed place of business in India as its employees were not physically present in India beyond the threshold limit specified in the DTAA. However, the IRA argued that the Assessee had a Service PE in India and that for the constitution of a Service PE, there is no requirement to have a fixed place of business in India.

• On the issue of whether the payment made by ABB India could be construed as Royalty, it was argued that the services rendered by the Assessee to ABB India were in the nature of technical services and since there is no FTS clause under the India-UAE DTAA, it will not be taxable in India. It was further submitted that since the Assessee did not have a PE in India, the sum received by the Assessee would not be taxable in India.

• On the other hand, the IRA argued that the services rendered by the Assessee were in the nature of sharing or permitting to use the special knowledge, expertise and experience of the Assessee and covered under the realm of 'Royalty' as defined in Article 12(3) of the India-UAE DTAA. Alternatively, the IRA contended that the payments made to the Assessee were made for the managerial, technical and consultancy services rendered by the Assessee to ABB India and thus, would be taxed in India as per Section 9(1)(vii) of the Act.
Whether the Assessee has a Service PE in India?

- The ITAT held that argument of the Assessee cannot be sustained as the services can also be rendered without the employees being physically present in India. It is evident that Article 5(1) of the DTAA requires that there should be a fixed place of business and the business of the non-resident enterprise should be carried on wholly or partly through that place. The fixed place of business is necessary for a PE under Article 5(1) of the DTAA. However, it is not a requirement for constitution of a Service PE under Article 5(2)(i) of the DTAA, which stipulates the following conditions for the constitution of a PE:

  (i) That the enterprise furnishing services including consultancy services belongs to the other contracting state;
  (ii) The said services were furnished through the employees or other personnel in the other contracting state;
  (iii) Such activities continued for the same project or connected project for a period or periods aggregating more than 9 months within any twelve month period.

In other words, the ITAT was of the view that Article 5(2) provides for an inclusive definition of a PE and enlarges the scope of the definition given under Article 5(1) of the DTAA and thus, the requirement laid under Article 5(1) need not be filled while constituting a PE in terms of Article 5(2) of the DTAA.
DECISION

It further observed that this reasoning was in line with the various judgments of the SC regarding inclusive clauses. Thus, it held that Article 5(2)(i) is an independent clause and the requirement of having a fixed place of business specified under Article 5(1) need not be attracted for a PE under Article 5(2).

It further observed that in the present age of technology where the services, information, consultancy, management etc., can be provided with various virtual modes like e-mail, internet, videoconference, remote monitoring, remote access to desktop, etc., the argument of no physical presence of employees raised by the Assessee cannot be sustained.

It must be noted that the Assessee had furnished services including consultancy services to ABB India for a project in India or with connected projects. The employees were not required to physically stay in India for more than nine months, but the services had to be rendered for a period in excess of nine months. The ITAT also held that once the activity of the Assessee commences, it may constitute a Service PE depending upon the continuation of activity for the same project or connected project for a period or periods aggregating to more than 9 months during any 12 month period.
**DECISION**

- It was accordingly held that the Assessee may have a service PE in India. However, since the India-UAE DTAA specifies that other Articles of the DTAA would override Service PE clause, the ITAT analysed whether the consideration received for rendering services would constitute Royalty.

*Whether the amount received by the Assessee from ABB India is taxable as royalty in India?*

After examining the activities proposed to be undertaken by the Assessee as per the terms of the Agreement, the ITAT concluded as under:

- The information provided to ABB India were acquired by the Assessee from its expertise, experience and knowledge based on its association with ABB Group Zurich. *This information remains unrevealed to the public and also cannot be acquired by ABB India on its own effort.*

- The Assessee had merely provided access to the specialised knowledge, skill and expertise. After giving such access to ABB India, *the Assessee had not done anything more for rendering the services.*

- It was not possible for the Assessee to render services merely with the help of three employees sent to India only for 25 days since the nature, scope and ambit of clauses or activities in the Agreement were very wide.
The Assessee had also not provided any evidence of actual rendering of services.

Therefore, instead of Assessee providing services through its employees, it had merely granted access to ABB India of various secret, confidential and intellectual property rights, protected information and other information acquired by the Assessee from its past experience.

As evident from the Secrecy Clause of the Agreement, the dominant character of the Agreement was for sharing secret, confidential and protected information.

Therefore, once payment of any kind received as a consideration for the use or the right to use, industrial, commercial or scientific equipment by the assessee, it will fall within the realm of Royalty as per DTAA and accordingly, it was held that the services rendered by the Assessee to ABB India shall be construed as Royalty as per the provisions of the DTAA and be chargeable to tax in India.
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