International Taxation- Analysis of Basic Concepts and Case Laws with Comments.

Introduction

International taxation is that realm of taxation that is concerned with tax rules that apply to two or more countries, that has some foreign element, that is concerned with cross border transactions. It has many facets. Under the Income Tax Act, 1961(the "**Act**") income tax in the realm of international tax may be charged on the basis of residence, a transaction undertaken in India by a non-resident, a cross border transaction undertaken by a resident, or a transaction undertaken between two or more parties atleast one of which is a non-resident. There is no international forum to decide such disputes, and the charge on income depends upon the tax laws of each country. International tax is governed by the principles of tax equity and tax neutrality. Tax equity demands that tax accruing be shared equitably amongst nations and that no assessee is discriminated or given undue preference in their tax burdens. Tax neutrality refers to the relationship between the taxpayer and the State. CIN or Capital Import Neutrality refers to the equitable/neutral treatment of a non-resident's income from investment in the residence state on the same footing as domestic investment by a resident, while CEN or Capital Export Neutrality refers to the equitable/neutral treatment of investment abroad by a resident to that of domestic investment by a resident, by charging the same tax rate. In this Article, I will be focusing on issues of Residence, double taxation in Double Taxation Avoidance Agreement(s)("**DTAA**"), and Transfer Pricing.

Discussion

The Residence Rule

Under Section 5 of the Act, the total income of a resident includes income received or deemed to be received in India, which accrues or arises or is deemed to accrue or arise in India, accrues or arises outside India during any previous year. In case of a person who is resident but not ordinarily resident in India, the income which accrues or arises

to him outside India shall not be included in total income unless it is derived from a business controlled in or profession set up in India. For a non-resident, only the first two qualifications apply, the third one is excluded. Thus, any income accruing or arising to a non-resident outside India is excluded.

A resident is defined under Section 2(42) of the Act as a person who is a resident in India within the meaning of Section 6. Section 6 of the Act delineates under what circumstances a person is said to be a resident. Thus, an individual is said to be resident in India in any previous year if he is in India for a period or periods amounting to 182 days or more OR having within the four years preceding that year been in India for a period or periods amounting to 365 days or more, is in India for a period of 60 days or more in the previous year. A HUF is always resident unless the control and management of its affairs during the previous year is situated wholly outside India. A company is resident if it is an Indian company OR its place of effective management in that year is in India. Place of effective management is defined as a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are in substance made. Every other person is said to be resident in India in any previous year, except where during that year the control and management of his affairs is situated wholly outside India.

A person may also be 'not ordinarily resident' in India. Under section 6(6) of the Act, an individual is said to be not ordinarily resident in India if in any previous year, he is a non-resident in India in 9/10 previous years preceding that year, or during 7 previous years preceding that year been in India for a period amounting to 729 days or less. A HUF is not ordinarily resident if its manager has been a non-resident in India in 9/10 previous years preceding that year, or during 7 previous years preceding that year been in India for a period amounting to 729 days or less.

A non-resident is defined under Section 2(30) of the Act as a person who is not a resident, and for the purposes of Sections 92, 93 and 168, includes a person who is not ordinarily resident.

By the Finance Act, 2020 w.e.f 1-4-2021, Explanation 1(b) to section 6(1) has been modified to include that if a person being a citizen of India has income other than income from foreign sources exceeding Rs. 15Lacs, the words sixty days in sub-section 1(c) shall be read as 120 days. Further, by the Finance Act, 2020, clause (1A) has been inserted which states that if a person being a citizen of India, has income other than income from foreign sources exceeding Rs. 15 Lac, he shall be deemed to be a resident if he is not a resident in any other country by virtue of the laws of any other country. Further, by an amendment to sub-section 6 of Section 6, clauses (c) and (d) have been inserted. Clause (c) provides that a person shall be deemed to be not ordinarily resident in India if he has income from sources other than foreign sources exceeding Rs. 15 lacs if he is in India for a period of 120 days or more but less than 182 days. Clause (d) provides that a person referred to in sub-section 1A who is a resident, shall be regarded as being not ordinarily resident in India.

Income from foreign sources has been defined as income accruing or arising outside India(except from a business controlled in or profession set up in India).

Thus, ex-facie clause (d) read with sub-section 1A states that a person is deemed to be resident as well as not ordinarily resident if he satisfies the requirement under newly inserted sub-section 1A. However, clause(d) in my view, is to be read with sub-section 1A. Sub-section 1A begins with a non-obstante clause and seeks to exclude persons satisfying the conditions prescribed by sub-section 1A from being residents. Thus, any person satisfying the conditions of sub-section 1A is not resident in India. This is apparent, as otherwise if a person was to be deemed to be resident in India as per sub-section 1A, there would be no need to introduce sub-section 1A and the said sub-section 1A could have been incorporated in sub-section 1 itself. However, clause(d) makes it clear that such a person satisfying the conditions of sub-section 1A is to be regarded as being not ordinarily resident in India. Thus, such a person satisfying sub-section 1A is to be regarded as not ordinarily resident in India as per clause(d) to sub-section 6.

Double Taxation Avoidance

Chapter IX of the Act deals with Double Taxation Relief. Parliament has made provisions in this Chapter providing that the Central Government may enter into double taxation avoidance agreements with other countries to: eliminate double taxation; to grant relief where tax has been paid both outside India as well as in India, for exchange of information for the prevention of evasion or avoidance of income tax chargeable under the Act or under the law in force of the corresponding country, and for recovery of taxes under the laws of both the countries. Also, where such an agreement has been entered into with another country, the provisions of the Act would apply only so far as they are beneficial to the assessee. An assessee being a non-resident also has to obtain a certificate of residence along with such documents and information as are prescribed by the Income Tax Rules, 1962 from the Government of such foreign country if it claims relief under the agreement without which no relief shall be granted.

Thus, it can be seen that the power of the Central Government to enter into such agreements is on account of delegated legislation expressly provided in the Act by Parliament. Such agreements need not therefore be laid before Parliament. If the Act is inconsistent with the treaty, the provisions of the treaty would prevail. However, if the Treaty is silent on a particular issue and has not dealt with the subject matter, then recourse may be made to the provisions of the Act. India has entered into DTAA's with several countries for avoidance of double taxation.

Under a DTAA, there is almost always provision made for what is known as a permanent establishment("**PE**") which can be either a fixed place PE, service PE, agency PE etc. This PE is a virtual projection of the business of the non-resident assessee on the soil of the source country. Profits directly or indirectly attributable to such PE are liable to tax. However, the non-resident assessee is the taxable person and its income in the source country is measured with respect to the attribution of profits to its PE.

The provisions of the Act will apply only to the extent they are beneficial to the assessee. This has been interpreted by the Courts to mean that if the income is not taxable under the Act, there will be no question of taxing such income under the DTAA. Section 9 states what income is deemed to accrue or arise in India. In this context, income arising or accruing from a business connection is deemed to accrue or arise in India. Explanation 2 inserted w.e.f. 1-4-2004 by the Finance Act, 2003 defines what is business connection.

Explanation 2A has been inserted by the Finance Act, 2018 w.e.f. 1-4-2019 which states that a significant economic presence of a non-resident in India would constitute a business connection. Thus, a significant economic presence in India means any transaction is respect of goods, services, property carried out by a non-resident in India including provision for download of data and software, if the aggregate payments exceed such amount as may be prescribed. This amount has not been prescribed as yet. It also includes soliciting of business activities or engaging in interaction with such number of users as may be prescribed in India by digital means. Either of these two clauses may apply to constitute significant economic presence in India whether or not the agreement or transaction is entered in India, the non-resident has a place of business in India, or the non-resident renders services in India. Also, only so much of the income that is attributable to such activity will be income deemed to accrue or arise in India.

Transfer Pricing Rules and Regulations

Transfer pricing assumes significance if one takes into account the large volume of international transactions which happen within an MNE(Multi National Enterprise). Thus, when two associated enterprises within an MNE enter into an international transaction, in order to prevent the shifting of profits out of India, or to avoid paying tax in India, transfer pricing provisions are put into place. The transfer price is the price at which the associated enterprises carry out the international transaction or the price agreed upon and charged by the assessee to its AE or vice versa, and this price must conform to the arm's length price. Thus, if the tax rates in India say 30% are higher than

that of a foreign country say 20%, and the assessee being a resident in India has an AE in that foreign country, it might under charge the AE for any goods or services supplied by it due to the high tax rate in India. Likewise, the assessee may purchase property at a higher price to avail higher deductions and reduce its profit taxable in India. This under pricing results in the assessee paying a lesser amount of tax in India which is against Indian TP regulations. Therefore, the price is required to be reevaluated to arrive at the arms length price and the assessee may be taxed accordingly. Further, the assessee may choose to transact with its AE at a lesser price instead of transacting with an unrelated party. The price charged to the AE may be lesser resulting in lesser tax payable in India irrespective of the tax rate in India. Similarly, an MNE(Multi National Enterprise) may try to shift profits out of India in order to enable the assessee in India to utilise its tax losses. This once again is prohibited by the Act.

Chapter X deals with Special Provisions Relating to Avoidance of Tax. Section 92 states that any income arising from an international transaction shall be computed having regard to the arms length price. Thus, when two 'associated enterprises'(defined under Section 92A) enter into an 'international transaction'(defined under section 92B), the price at which the transaction is executed must conform to the arms length price which is defined under 92F(ii) as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. Section 92B which defines an international transaction states that either or both the parties involved in the transaction must be non-residents. Thus, atleast one party must be a non-resident. Further, that the transaction must have a bearing on the profits, income, losses or assets of such enterprises and for this purpose any purchase, sale, lease, provision of services, borrowing of money, allocation or apportionment of costs needs to be taken into account. Thus, the touchstone for determining whether a transaction is an international transaction or not depends firstly whether one of the parties is a non-resident and secondly, whether the transaction affects the profits, income, or losses, or assets of such enterprises. To determine the arm's length price, Section 92C states that the most appropriate method must be taken into account having regard to the nature of the transaction or class of transaction or class of associated

enterprises or functions performed by such persons or such factors as the Board may prescribe. The methods available to determine the arm's length price are:

(a) Comparable uncontrolled price method: The price at which the assessee trades with an independent enterprise or the price at which the AE trades with an independent enterprise(internal CUP), or the price at which two independent parties trade(external CUP), is compared with the price charged between the assessee and the AE to arrive at the ALP. This method is ideally used when the functions performed and the volume at which the transaction is undertaken are the same and there is an identity in the property purchased or services availed in both the controlled and uncontrolled transactions.

(b) Resale price method: The gross profit margin of an enterprise realised by property purchased or services obtained from an AE and resold or provided to an unrelated party, is compared to the gross profit margin realised by property purchased or services obtained by the enterprise from an unrelated party and resold to an unrelated party. This method is ideally used in the case of distributors, when the property purchased is normally resold to retailers/customers.

(c) Cost plus method: The direct and indirect costs of production are identified by the enterprise to which a normal gross profit mark-up is added. The gross profit margin added in uncontrolled transactions is compared with that of the controlled transaction to arrive at the ALP. This method is ideally used when the services or property are the same in both the transactions and the functions performed are the same. The evaluation of costs should also be normal and any exorbitant costs incurred in either transaction by an enterprise should render the transaction uncomparable.

(d) Profit split method: This method is used when two or more AE's functions are highly integrated and there are a lot of intangibles involved in the transaction. The profits are split between the AE's either at a gross level or at an operational level before deduction of interest and taxes. PSM is rarely used since the concentration of intangibles is usually with a single entity within a group.

(e) Transactional net margin method: Under this method the net profit margin is calculated with an appropriate base such as costs/sales etc. and is reflected in the form of a percentage known as the Profit Level Indicator or PLI. This PLI is compared with the mean PLI calculated with reference to the PLI's of several other unrelated enterprises engaged in uncontrolled transactions. The difference between the PLI's is applied to the costs of the enterprise in cases where costs is taken as the base, or in cases where sales is taken as the base, in accordance with the following formula:

If mean of PLI of comparables is 20%, and assessee's PLI is 10% and assessee's operating cost is Y then the assessee must charge a higher price; the profit is X to be computed as follows:

$$\frac{X}{X+Y} = 20\%(\text{OR } 0.2)$$

After deriving the profit, the difference in the profit between the uncontrolled transactions and controlled transactions is the income chargeable to tax. To arrive at the ALP, add the profit derived to the cost(Y).

In cases of Operating profit/operating costs, the arithmetic mean of the comparables PLI is multiplied into the operating cost of the assessee to arrive at the ideal price to be charged by adding the price derived to the operating cost. If

this price is higher than the price charged, the difference is the profit chargeable to tax, or this resultant price is the ALP.

(f) such other method as may be prescribed by the Board.

Transfer pricing analysis is undertaken with the aid of comparables which are entities having engaged in uncontrolled transactions. These comparables are selected by the TPO from appropriate databases available on the internet, and filters are used to find ideal comparables. Functional filters, turnover filters are examples of some filters used in TP analysis. The TP analysis is done with reference to the tested party. The tested party is the party to the controlled transaction whose data is analysed with the comparable uncontrolled transactions and is the party with the least amount of intangibles and whose data is easily available and is such that it can be easily compared with the comparables for deriving results.

As per Section 92CA, when an assessee has entered into an international transaction or specified domestic transaction in the previous year, the Assessing Officer(the "**AO**") shall, after obtaining the approval from the PCIT or CIT, refer the computation of the arm's length price to the Transfer Pricing Officer(the "**TPO**").

Under Section 144C, the AO shall forward a draft of the order of assessment to the eligible assessee if he proposes to make a variation in income or losses returned on or after the 1.10.2009. An eligible assessee is defined as a person whose income or losses is determined consequent to an order of the TPO, or any foreign company. Usually, the order of the TPO is incorporated in the draft order of the AO which is forwarded to the assessee. The assessee may then accept such a draft order or file its objections with the DRP. If the assessee files its objections, a hearing is scheduled and the DRP passes an order. The AO then passes an order in conformity with such a decision. An appeal lies to the ITAT against the order of the AO passed pursuant to the directions of the DRP.

Miscellaneous

Under section 197 of the Act, if tax is required to be deducted at source, but if the AO is satisfied that no tax is required to be deducted at source or a lesser amount may be deducted, the assessee may apply for a certificate to the AO and he may grant such certificate to the assessee. Under sub-section 2A, the Board may make conditions and specify rules under which the certificate is to be granted.

These applications are usually made by non-residents on sale of residential properties in India. As such there is great prejudice towards these non-residents as the AO refuses to grant lower rate of deduction at source and almost never grants nil rate of deduction at source. As held in CIT vs. Garware Nylons Ltd. (1995) 212 ITR 242 (Bom.) the order passed by the AO on the application is final and no appeal lies against such an order. However, by virtue of CBDT Notification 74/2018 dated 27.10.2018, the application is to be made electronically in Form No. 13 under digital signature or through electronic verification code. The certificate will be issued directly to the person making the deduction at source under the advise of the person who made the application. This is a salutary measure for taxpayers.

Chapter X-A contains provisions dealing with General Anti-Avoidance Rule or GAAR. It was inserted by the Finance Act, 2013 w.e.f 1-4-2016. If an assessee enters into an arrangement being an impermissible avoidance arrangement, the tax may be determined in accordance with law. An impermissible avoidance arrangement is defined under Section 96. It says that it such an arrangement so as to obtain a tax benefit and deals wit the circumstances in which it can be said that there is a tax benefit. Section 98 deals with the consequences of an impermissible avoidance arrangement. It says that the consequences in relation to the tax arising therefrom may be redetermined such as by disregarding the arrangement or reallocating expenses, costs, accruals, receipts etc. Section 102 contains the definitions applicable to the chapter. The provisions of the Chapter are to apply only with respect to an assessment year beginning on or after 1-4-2018.

Case Laws

Transfer Pricing

- In DIT(International Taxation) vs. Morgan Stanley and Co. Inc. and Ors. [2007] 292 ITR 416 (SC), a support service agreement was entered into between two companies of an MNE. Under the agreement, MSAS an Indian company was to render certain support services to MSCO located in the US. MSCO outsourced some of its activities to MSAS. MSAS was set up to support the main office functions involving equity and fixed income research, account reconciliation and providing IT enabled services such as back office operation, data processing and support center to MSCO. The activities also involved stewardship activities of employees of MSCO sent to MSAS and the activity of deputationists of MSCO sent to MSAS (These are discussed under Double Taxation Avoidance Agreements' case laws). On the issue of transfer pricing, the Court held that the income attributable to the PE in India is taxable, in the hands of the MNE. Thus, the foreign company is the taxable unit and so much of the profits attributable to the PE are taxable in its hands. In this case, the profits were attributed at arm's length since the determination of ALP by the assessee by taking into account TNMM as the most appropriate method was accepted by the TPO. The Supreme Court also noted, that in service agreements TNMM is the correct method as it uses the operating profit to an appropriate base such as cost/sales etc. Therefore, for the services availed by MSCO from MSAS, the price paid/payable was in accordance with the ALP. Further, with respect to the question whether any further profits are required to be attributed to the PE, the Court held that in such cases no further profits are required to be attributed since the transaction is undertaken at the ALP. The Court noted that it would be a different matter if the functions and risks were not accounted for while determining ALP, for then the profits attributable would have had to be recomputed. The Court then very importantly has held as follows:

'The entire exercise ultimately is to ascertain whether the service charges payable or paid to the service provider (MSAS in this case) fully represents the value of the profit attributable to his service. In this connection, the Department has also to examine whether the PE has obtained services from the multinational enterprise at lower than the arm's length cost? Therefore, the Department has to determine income, expense or cost allocations having regard to arm's length prices to decide the applicability of the transfer pricing regulations.

Therefore, for undertaking the TP analysis, even the services received by the PE from the MNE have to taken into account to determine the ALP.

In sum and substance, MSCO is rendering its services to MSAS by deputing its employees(deputationists) and that is why a service PE emerges. On the other hand, MSAS is rendering services to MSCO under the support services agreement, and the price payable or paid by MSCO to MSAS is required to be determined in accordance with TP regulations to know whether the profits are correctly attributable to the PE(MSAS) in India. Once the attribution of the profits by MSCO to MSAS in the form of price paid or payable by MSCO for services rendered by MSAS is in accordance with the ALP, no further profits are required to be attributed, which is the present case. However, the services availed by MSAS(i.e the price paid by MSAS for services rendered by MSCO/service PE) has to be taken into account to determine whether the ALP has been correctly ascertained. This is what the Supreme Court has held in its judgment with respect to the TP analysis.

Thus, subject to the above, the Supreme Court concluded that no further profits were attributable to the PE since the attribution had already taken place at the ALP. In essence, the profits attributable for price paid/payable by MSCO for services rendered by MSAS having already been shown to be determined at ALP no reworking is to be done in that respect. However, whether or not MSAS has obtained services at lower than the arm's length cost in the case of deputationists has to be redetermined to see whether it has had an effect on the ALP.

MSAS is held to be a service PE on account of MSCo rendering services to MSAS through its employees/deputationists. Now, it seems logical that if MSAS is the PE for this purpose, income/profits attributable to MSAS ought to be considered on the basis of this transaction between MSCo and MSAS i.e of deputationists. This is for the reason that a PE is recognised for a particular purpose and the income attributable to it is based on the functions performed based on that purpose. However, the profits attributable to the PE are based upon what MSAS has charged MSco under the services contract and not for the transaction of deputationists. Therefore,

(i) Can it be said that MSAS is a service PE?

(ii) Can it be attributed profits when it is designated a service PE for a different purpose/another transaction altogether?

There seems to be incoherence. I am confounded by the application of attributable profits to the service PE based on another transaction. In my view, since the transactions are distinct, there must be determination of two ALP's. One, for the services rendered by MSCo to MSAS in India wherefrom a service PE emerges. Secondly for the transaction between MSAS and MSco under the services contract where MSAS has rendered services to MSCo. There must be two ALP's since there are two distinct international transactions independent of one another.

- In PCIT vs. S.G. Asia Holdings (India) Pvt. Ltd.(Civil Appeal No. 6144 of 2019(SC) dated 13.8.2019), the Hon'ble Apex Court held that it is mandatory for the AO to refer the computation of the ALP to the TPO due to Instruction No. 3/2003 dated 20.5.2003 issued by the CBDT. In this case, the AO had doubts regarding the brokerage charged by the assessee to its parent company and thought that the same was charged at too low a rate. However, he did not refer the matter to the TPO and passed the assessment order under Section 143(3) of the Act. The Tribunal dismissed the appeal of the department and did not remand the matter to the AO for reference to the TPO. However, the Apex Court held that the Tribunal ought to have done so.

- In a recent judgment of PCIT vs. Gulbrandsen Chemicals Pvt. Ltd. (R/TAX APPEAL NO. 751 of 2019(Guj) dated 3.2.2020), the Hon'ble Gujrat held that if there is no perversity in the method adopted by the assessee in computing the ALP, or if the Tribunal does not commit any act of perversity in selecting comparables, or selecting the most appropriate method, then the appeal cannot be entertained under Section 260A of the Act. The Court agreed with the judgment of the Delhi High Court in Make My Trip India wherein it was held that the difference of opinion between the CIT(A) and the TPO for selecting the most appropriate method cannot be the basis for interference, that unless the method adopted is absolutely contrary to Rule 10B or Rule 10C, no interference is called for. The Court quoted from the judgment of PCIT vs. Tudor India wherein it was held that the Tribunal is manned with a judicial member and an accountant member and is an expert in its own field of undertaking transfer pricing analysis. That unless a substantial question of law is shown to exist i.e any perversity in selection of comparables/filters etc. no appeal is entertainable under Section 260A otherwise the High Courts would go into a whirlpool of such data and it would defeat the very purpose of an appeal before the High Court. That the same findings would apply to the case of the assesse's as well. In the circumstancs, the Court finding no perversity in the TP analysis undertaken by the Tribunal, dismissed the appeal of the Revenue. The same view has been taken in PCIT vs. Eight Roads Investment Advisors Pvt. Ltd(Income Tax Appeal No. 1125 of 2017(Bom.) decided on 27.2.2020)

- In Airport Retail P. Ltd. vs. DCIT(I.T.A. No. 4816/Mum/2015 decided on 09.01.2019(Mum)), the assessee was an owner of duty free shops in India and purchased/imported goods from its AE and resold them to customers in India. The assessee adopted RPM as the Most Appropriate Method("**MAM**") and determined its PLI using GP/Sales to determine the ALP. The assessee compared its PLI with the comparables and the PLI of the assesee was higher and therefore it did not make any adjustment towards ALP. However, the TPO chose TNMM and rejected RPM as the MAM. The Tribunal held that when goods are purchased and resold to

customers RPM must be used. The TPO ought not to reject RPM, CPM or CUP straightaway and proceed to adopt TNMM as the MAM. It is only in cases where the above methods cannot be used that TNMM must be applied as a last resort. The Tribunal also observed that the TPO spoke of CUP being the MAM but rejected it without any reason. Secondly, RPM applied by the assessee was rejected by the TPO while selecting the MAM without assigning any reasons. The Tribunal upheld the selection of the assessee of RPM as the MAM.

- In Dongfang Electric Corporation vs. ACIT(ITA Nos. 2563 and 2564/Kol/2017 dated 17.05.2019(Mum), the assessee was a company located in the People's Republic of China and had set up a PE in India which was involved in turnkey projects and setting up of power plants. For the purpose of setting up two power plants, it's PE had entered into two contracts namely onshore and offshore contracts which were mainly contracts for supplies, to set up the power plants. The non-resident assessee entered into contracts with DPL and the West Bengal government for the setting up of the power plants. The TPO sought to apply TNMM to benchmark the ALP for transactions between the assessee and the AE. However, the assessee insisted that CUP be applied since the non-resident assessee had engaged in the transaction with the contractee's which could suitably be compared with the PE transaction. The Tribunal rejected TNMM as the MAM and sought to apply CUP. TNMM was rejected since the comparable Thermax Ltd. was not a project office such as the assessee's PE, the activities of the comparable were different than those of the assessee etc. CUP was accepted as the MAM since according to the Tribunal there was internal CUP in the form of the transaction between the assessee and the West Bengal government and DPL which was comparable with the transaction between the PE and its AE(assessee).

In my view, the Tribunal ought to have examined whether the transaction between the PE and the non-resident assessee was an international transaction. A PE is a virtual projection of the enterprise on the soil of a foreign country. It does not constitute an independent enterprise. Therefore the transaction cannot be termed as

an international transaction since the PE and the assessee are not associated enterprises within the meaning of Section 92A. The AO therefore ought not to have computed the ALP as there was no international transaction in the first place. Even the assessee has averred that there was no transaction with its PE in the previous year. The real question is whether the income that the non-resident assessee has earned through its PE in India is declared correctly being the income chargeable to tax as business profits. The AO could have reworked the profits/losses of the transactions between the assessee/PE and the contractee's and recalculated the income chargeable to tax. But in my view, there is no question of determining the ALP in such transactions.

- In Firmenich Aromatics India P. Ltd. vs. DCIT(ITA No. 2590/Mum/2017 decided on 23.07.201(Mum)), the assessee was a manufacturer of fragrances, perfumes, chemical components, and was paying royalty to its AE located in Switzerland for technical know-how on net sales and then gross sales since 1997. The assessee computed the ALP by adopting the TNMM method. In its return it had declared a loss. The TPO disregarded the TP analysis of the assessee and chose CUP method but arbitrarily fixed an ad-hoc amount as royalty payable by the assessee to its AE. The Tribunal held that such arbitrary fixation of the royalty was not acceptable as it was against the TP rules and regulations. It also stated that the comparables chosen by the TPO while applying the CUP method were all foreign comparables and thus uncomparable with the transaction between the assessee and its AE. The Tribunal also stated that due to increased sales, and minimal product recalls, the royalty was genuinely paid and negatived the contention of the TPO that royalty would not be payable for so many years in respect of technical know-how. Therefore, the Tribunal upheld the TP analysis of the assessee.

  In my view, simply because the comparables were located in foreign territory is not ground for refusing them as comparables. It is true that an ad-hoc estimate ought not to be made by the TPO but if the analysis of CUP by the TPO is otherwise rational and logical, the matter could have been remanded to the TPO to redetermine the ALP

using CUP method. Also, in cases of royalty payments, TNMM is not the appropriate method and CUP is generally preferred. Further, the TPO was probably right in holding and had a reasonable doubt that royalty could not be paid for so many years only with respect to technical know-how since availing technical know-how services for so many years is not practical and is illogical.

Ground No.2 was with respect to software services availed by the assessee where it had capitalised certain expenses in its books and offered the remaining as revenue expenditure. A portion of the expenses were capitalised since the softwares were converted into other software by the assessee. The TPO however, made an addition on an ad-hoc basis and this was once again objected to by the assessee and the objection was upheld by the Tribunal.

Double Taxation Avoidance Agreements

- In DIT(International Taxation) vs. Morgan Stanley and Co. Inc. and Ors. [2007] 292 ITR 416 (SC), a support service agreement was entered into between two companies of an MNE. Under the agreement, MSAS an Indian company was to render certain support services to MSCO located in the US. MSCO outsourced some of its activities to MSAS. MSAS was set up to support the main office functions involving equity and fixed income research, account reconciliation and providing IT enabled services such as back office operation, data processing and support center to MSCO. The activities also involved stewardship activities of employees of MSCO sent to MSAS and the activity of deputationists of MSCO sent to MSAS. On the question of back office functions, the Court held that the functions were preparatory/auxiliary in character and thus there can be no fixed place PE. On the question of stewardship activities, the Court held that the customer(MSCO) would demand efficiency in the service rendered to him and thus, the stewardship activities being simply services to take care of the needs of the customer cannot be regarded as a service rendered by MSCO to MSAS. Thus the stewardship activities do no constitute a service PE. However, on the question of deputationists, the Court held that the employees of

MSCO retain a lien on their employment with MSCO when they come to India, and thus a service PE can emerge. Further, they lend their experience to MSAS staff and therefore there is a service PE(MSAS). Though not expressly mentioned in the judgment, services performed for a related enterprise amount to a service PE under Article 5(2)(l)(ii) of the Treaty and that is the reason for the Court to hold that MSAS is the service PE.(Please refer Morgan Stanley under TP Case Laws for TP analysis).

- In DIT(International Taxation) vs. M/S Samsung Heavy Industries Co. Ltd. Civil Appeal No. 12183 Of 2016 decided on 22.7.2020(SC)), ONGC awarded a turnkey contract to a consortium comprising the assessee and L&T Ltd. The assessee set up a project office in India and as per the Board Resolution the project office was set up for co-ordination and execution of delivery of documents in connection with construction of offshore platform modification of existing facilities for ONGC. The Supreme Court took note of this Board Resolution and came to the conclusion that the project office was merely preparatory or auxiliary in character and thus would not constitute a PE in India. Also, that no expenditure was incurred by the project office in India and hence, there was no question of the office having real functions to qualify as a PE. Further, there were only two personnel having no qualifications to conduct any business/core functions at the office. That, the office was merely to act as a liaison between ONGC and the assessee. In the circumstances, the appeal of the Department was dismissed since there was no PE in India.

- In UoI vs. U.A.E. Exchange Centre (Civil Appeal No. 9775 OF 2011 decided on April 24th, 2020) the assessee was a limited company based in UAE and had set up a liaison office in India. Its business was *inter alia* of remitting funds for NRI remitters through its liaison offices in India to beneficiaries located in India. For this purpose, the liaison office would download the drafts/cheques and forward them to the beneficiaries located in India. The respondent in UAE would earn a commission towards these transactions from the NRI remitter. As per the permission accorded by RBI, it was not to enter into any business activity in India and could *inter alia* negotiate with Indian corresponding Banks etc. The question was whether the

respondent-assessee had a PE in India; whether the liaison office of the Respondent could be regarded as a PE in India. The Supreme Court held that the respondent does not have a PE in India since its business is preparatory or auxiliary or supportive in charachter. That the transaction stood completed on the earning of the commission by the respondent in UAE. That no income was earned by the liaison office in India, and for all these reasons, the Court held that the Respondent does not have a PE in India.

- In UOI vs. Azadi Bachao Andolan and Ors. [2003] 263 ITR 706(SC), certain circular was issued by CBDT whereby persons being tax residents of Mauritius were exempt from capital gain arising in India on account of alienation of shares in Indian companies and would be taxed only in Mauritius. This Circular was simply clarificatory and the relevant provisions were already contained in the DTAA. The Circular was challenged by way of a PIL alleging that such persons or FII's cannot escape tax altogether. The High Court in its impugned judgment quashed the Circular citing various reasons.

  The judgment delineates on the role treaties play in tax avoidance and in securing relief from double taxation for taxpayers. It notes that the Central government has the power to enter into DTAA's with foreign countries. That sections 4 and 5 of the Act being charging sections were expressly made subject to the rest of the provisions of the Act in order to make the Treaty prevail over the provisions of the Act. The appellant contented that the central government cannot exempt persons from tax as it has no authority to do so and that the power rests solely in Parliament. The Court overruled this contention by stating that a delegate acting under the powers of delegated legislation does have the power to grant exemption, and similar provisions have been made in the Central Excise Act, and the Central Sales Tax Act. The validity of the delegated legislation in favour of the central government was also upheld by the Supreme Court by stating that the delegation was perfectly in order.

The respondent contended that in the facts and circumstances, such Mauritius residents are not liable to pay tax in Mauritius since they have no business in Mauritius and therefore no income and hence, the Circular ought to be struck down. In other words, the contention of the respondents was that tax ought to be made payable in India since such persons being residents of Mauritius did not have to pay any tax in Mauritius and that income would therefore escape taxation altogether. The Court held that benefits of a DTAA are available even if the country where the income is to be taxed chooses not to tax such income. Thus, such residents can claim the benefits of the DTAA even if they do not have to pay tax in their country of residence. The DTAA provided for income from the alienation of shares to be taxed only in Mauritius. Thus, this contention was expressly negated.

The Court also upheld the contention of the appellant-UOI that unless a limitation clause is provided for in the treaty, there is no restriction in third parties making use of the treaty provisions. The Court after discussion of a plethora of judgments upheld the principle that tax planning is permissible as long as it is not a colorouble/dubious device to avoid paying taxes.

- In Formula One World Championship Ltd. vs. CIT [2017] 394 ITR 80(SC), A Race Promotion Contract was entered into between Formula One World Championship Limited(FOWC), a UK resident, and Jaypee for conducting formula one races in India. An artwork agreement had also been entered into between the said parties. The question to be decided by the Supreme Court was whether the International Buddh Circuit wherefrom the formular one races were conducted in India, amounted to a fixed place PE or not. The Supreme Court analysed the various agreements entered into between FOWC and FIA- from whom commercial rights were obtained, and FOWC and affiliates of FOWC, and concluded that FOWC did indeed have a fixed place PE in India, in the form of the Buddh International Circuit. The Court held that FOWC had fixed its stamp on the event, that the High Courts findings that FOWC was actually the promoter of the event and in control of the event could not be disputed. However, the Court held that only so much of the income attributable to

the PE was liable to tax and accordingly, tax ought to be deducted at source towards that amount. That it was open for the assessee to contend before the AO, who was to compute the income attributable to the PE, that no penalty is leviable as the non-deduction at source was bona-fide. Also the issue of either party approaching the HC by way of a writ petition under Article 226 of the Constitution of India against a finding of the AAR was upheld. The judgment makes references to several books on International Tax by learned authors which expound on the law applicable to PE's.

In my view, the ruling will have an adverse effect on FOWC. It is the sole holder of commercial rights which it exploits by granting the said rights to parties all over the globe interested in holding such races. Now, this precedent can be used by every Court in each country where the race is held to say that FOWC be taxed in that country as it has a PE in that country, since FOWC would be engaged in similar control/promotion of every race/event in each country. This would defeat the very purpose for which the RPC is entered into between FOWC and each country. Thus, the Supreme Court after carefully weighing the facts, ought to have held that a PE is constituted only if the facts very clearly held that the PE is so constituted. In other words, more favour ought to have been accorded to the view that there is no PE, unless there are such exceptional facts and circumstances where a fixed place PE clearly emerges.

- In ADIT vs. E-Funds IT Solution Inc. [2017] 399 ITR 34(SC), the question was whether two assessee's both resident in the USA namely e-Fund Corp. and e-Fund Inc had a PE in India and thus were taxable on the profits attributable to the PE's in India. The non-resident assessee's had entered into an agreement with an Indian company namely e-Fund India. The non-resident assessee's were engaged in ATM Management Services, Electronic Payment Management, Decision Support and Risk Management and Global Outsourcing and Professional Services. Admittedly, the services were carried on outside India. Relying on the report of their Chartered Accountant, it was held that no fixed place PE could be made out since the functions of e-Fund India were limited to support-based functions. That only auxiliary operations were carried out by e-Funds India and hence no fixed place PE existed.

On the point of whether a service PE was made out, none of the customers were located in India and services were rendered outside India and therefore the Court held that no service PE was made out since the services are required to be rendered in India for a service PE to be made out. Further, for one of the AY's i.e 2005-2006, two employees were seconded to work for e-Fund India for the companies' domestic business. 100% of the expenditure was borne by e-Fund India and 75% of the expenditure was borne by e-Fund US. The said expenditure borne by e-Fund US was re-imbursed to it. The Court upheld these findings of the High Court that in these facts, e-Fund India had borne the entire expenditure and it could not be said that the employees were that of the non-resident assessee's. As regards agency PE, that was not argued before the High Court and therefore, the Supreme Court did not examine the same.

Since the ALP had been accepted by the TPO no further profits were attributable to e-Fund India, even if e-Fund India was held to be a PE of e-Fund Corp. As regards Mutual Agreement Procedure(MAP), though there was some proportionate attribution and tax was payable by the non-resident assessee's under the MAP procedure, the Court replying upon para 3.6 of the OECD Manual on MAP Procedure held that an agreement reached by the authorities cannot be regarded as a precedent for subsequent years. Therefore, no PE existed in India on the facts of the case.

- In Ishikawajma-Harima Heavy Industries Ltd. vs. DIT[2007] 288 ITR 408(SC), the appellant was part of a consortium of companies which had entered into an agreement with an Indian company for supply of onshore and offshore services and equipment/materials. The onshore supplies were undisputedly liable to tax. The question centred around the liability to pay tax on the offshore supplies. The Supreme Court held that the contract dealing with offshore and onshore supplies was not a composite one such that tax would be payable on both the supplies. It held that there was no business connection in India and even though there was a PE in India no profits could be attributed to the PE since the transaction took place outside India on the high seas. Further, the mere fact that the contract was executed in India was not

sufficient. That the transaction took place abroad and hence the PE had no role to play. That there is no business connection due to the PE's non-involvement in the transaction. Very importantly, that since the provisions of the Act were not applicable, application of the treaty provisions would not arise and no tax would be payable.

Miscellaneous

- In a recent judgment of PILCOM vs. CIT [2020] 425 ITR 312(SC), a Committee namely PILCOM was set up by the boards of cricket associations of three countries namely India, Pakistan and Sri Lanka for the conduct of the World Cup of cricket for the year 1996 in these three countries. PILCOM's headquarters was at London. It operated two bank accounts in which income from TV sponsorship, rights etc. was received and expenses were met. The question before the Supreme Court pertained to the guarantee money paid by PILCOM to the participant teams who played cricket matches both in and outside India pursuant to the world cup. The Supreme Court upheld the view of the Tribunal that income of the non-resident boards/associations of the foreign countries represented by their cricket teams accrued in India only to the extent that the income of the teams was from matches played in India. Therefore, this income was to be calculated on the basis of the total receipt of income to be applied to the same proportion the matches played in India to the total number of matches played. The Supreme Court held that this amount would represent income accrued or arisen in India on which TDS was liable to be paid by PILCOM. On the question of the applicability of the DTAA, the Supreme Court held that the liability to deduct tax at source arose primarily under the Act and was obligatory and the benefits of the DTAA could be derived later on i.e refund could be granted if the DTAA provided the necessary relief. Thus, on this point, the Supreme Court upheld the judgment of the High Court.

- In the case of GE (G.E.) India Technology Centre Private Ltd. vs. CIT [2010] 327 ITR 456 (SC), the appellants were distributors of software and paid non-resident suppliers during the relevant financial years for software representing the purchase

price. The question before the Supreme Court was whether any TDS is likely to be deducted at source the moment there is any remittance abroad. The Court held that Section 195 states that TDS is to be deducted only to the extent that the amount is chargeable to tax under the Act. That this would apply to composite payments also. The application under sub-section 2 will have to be filed only when the deductor is not sure as to the amount taxable or the amount to be deducted at source. That section 195 is in the nature of a safeguard. That if the Department's contention is accepted that the moment there is remittance, TDS is likely to be deducted the words 'chargeable to tax' will be omitted from consideration. That the other sections such as Section 194EE prescribe deduction at source even if the income is not chargeable to tax which is not the case with Section 195. That it is the payer who will be treated as an assessee in default if he refuses to make the deduction but is not the assessee. That refund can be obtained only by the assessee and if the TDS is to be deducted even if the income is not chargeable to tax, it would mean that the payer would be liable to pay from his own pocket without refund in case it is found that the TDS was not liable to be deducted, which can never be the intention of the legislature. That there are adequate safeguards put into place for checking whether there has been deduction at source by virtue of the provision of Secton 40(a)(i) of the Act whereby if the TDS is not deducted on royalty, fees for technical services, no deduction can be claimed on such amounts of royalty, fees for technical services in the hands of the payer as the assessee. Also, sub-section 6 to section 195 has been inserted with provides for the payments to be disclosed in such form and manner as may be prescribed which is to have effect from 1.4.2008. Thus there are adequate safeguards for checking whether deduction has been made. That in the case of Transmission Corporation it was clearly held that the application under Section 195(2) was to be made only when it was unclear as to how much of the amount is liable to be deducted otherwise, if no application is made, the deduction has to be on the gross amount. Since, the High Court had not given any finding whether the payment constituted Royalty, the question was to be decided by the High Court and the incidental question of whether TDS is liable to be deducted on the amount and the steps to be taken thereon would depend upon the finding of the High Court on that question.