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Bartronics India Limited – ITAT – Hyderabad

Outcome: In favour of taxpayer
Category: Interest-free advances

History: The taxpayer is involved in the business of automatic identification and data capture technology. For the purpose of expanding the business activities of its associated enterprises ('AEs'), the taxpayer raised funds overseas through foreign currency convertible bonds. Such funds were then forwarded to its AEs. The bonds were classified as zero-coupon bonds and had coupon rates of 7.25% p.a. and 6.65% p.a. Additionally, the overseas bond holders were entitled to an option of converting the bonds into equity shares of the taxpayer.

Facts and contentions: The intermediate tax authorities opined that the taxpayer should have ideally charged interest to its AEs for the funds forwarded and proceeded to put forth a Transfer Pricing adjustment of INR 116.8 million. The taxpayer, however, contended that it did not incur any interest costs for the funds so raised and notably, the funds were raised with a core intention of forwarding the same to the AEs for facilitating business expansion. Furthermore, the bonds were later on converted into equity shares of the taxpayer thereby implying that the loan was no more outstanding in its books.

Ruling: The Tax Court ruled in favour of the taxpayer by upholding the latter's contentions. It stated that although the funds were classified as 'loans and advances', the funds were raised overseas and were advanced to the AEs overseas only. Also, since the shares were allotted subsequently, charging interest to the AEs would've not been appropriate. Mere accounting entries in the books of the taxpayer cannot substantiate the proposed Transfer Pricing adjustment. Hence, the case got concluded in favour of the taxpayer.

Colgate Palmolive (India) Limited – ITAT – Mumbai

Outcome: In favour of taxpayer
Category: Advertising, Marketing and Promotion ('AMP') expenses

History: The taxpayer is a well-known name in oral-care and personal-care industries. It is a subsidiary of Colgate Palmolive Inc. – its AE which is based in USA ('Colgate USA'). It carries out manufacturing, trading and marketing activities for its products. The taxpayer incurred AMP expenses which constituted almost 13% of the sales for the year under consideration. Additionally, royalty payments were also made to Colgate USA.

Facts and contentions: The intermediate tax authorities had a view that the AMP expenses incurred by the taxpayer are the main reason for attaining growth in the overall group's business. It mentioned that incurring such expenses is leading to 'brand building'. Also, since Colgate USA is greatly benefitting through the taxpayer's business, it was proposed that the former should share the AMP expenses in proportion to the benefit derived by it.

The taxpayer defended that this growth in the business was purely an outcome which one would receive in an independent scenario. Plus, there wasn't any agreement or arrangement with regards to this with Colgate USA. Hence, Transfer Pricing provisions should not apply as per the Income-tax Act, 1961 ('the Act').

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Ruling: The Tax Court upheld that the taxpayer was not under an obligation to create brand value for Colgate USA. It stated that the most fundamental outcome of incurring AMP expenses is 'brand building' or 'creation of marketing intangibles'. Thus, opining that no Transfer Pricing adjustments shall be made due to assumption of certain facts.

Google India Private Limited – ITAT – Bangalore

Outcome: Against taxpayer
Category: Royalty, Tax Deduction at Source and Equalisation Levy

History: The taxpayer is engaged in IT (Information Technology) and ITeS (Information Technology enabled Services) businesses. It is also a distributor of 'AdWords Program' in India. Under this program, various businesses are provided a platform to advertise their products/services. A distribution agreement and a service agreement were signed between the taxpayer and its AE – Google Ireland Limited ('Google Ireland') through which the marketing and distribution rights were vested in the taxpayer. For such rights, the assessee had been making payments to Google Ireland without deducting TDS u/s 195 of the Act. Concerning the service agreement, the taxpayer had agreed to render ITeS and software development services to Google Ireland.

Facts and contentions: While analysing the AdWords Program's business model in detail; the intermediate tax authorities contended that the taxpayer's search engine provided advertisers with a database of people using 'key-words' such as name, sex, religion, city, state, country, etc. based on which a target audience for an advertisement was selected. It was thus asserted that the assessee is not just offering 'advertising space' but is also aiding the advertisers in selecting the target audience. Such an aid is possible only with the confidential information that is being built up in the database of Google Ireland. Moreover, the distribution agreement between the two AEs included a clause which allowed the taxpayer access to all the confidential information as well as intellectual property that are necessary for marketing and distribution activities. Thus, it was opined that the payments made to Google are 'royalty' payments as per the Act and the Double Taxation Avoidance Agreement ('DTAA') of India and Ireland.

The taxpayer argued that payments made are business profits of Google Ireland and since Google Ireland does not have a PE in India, such business profits would not be taxed. It also stated that the Indian Ministry of Finance introduced the concept of 'equalisation levy' in Finance Act, 2016 wherein consideration paid to a non-resident engaged in businesses of online advertisement, any provision for digital advertisement space, etc. would be taxed at 6%. The taxpayer drew attention to the intention of introducing this concept. It asserted that earlier such profits were not taxed and to tax the same, equalisation levy was introduced. Thus, in the pre-equalisation levy phase, the business profits should not be taxed in the absence of PE. Accordingly, there was not an obligation to withhold tax u/s 195 of the Act.

Ruling: The Tax Court highlighted that firstly, both the agreements – distribution as well as service agreements were very inter-related and not independent of each other as marketing and distribution activities are not possible to be carried out without performing ITeS functions. Hence, the taxpayer attempted to give a different colour to this transaction. Secondly; as pointed out by the revenue authorities, the payments made to Google Ireland rightly fit into the definition of 'royalty'. Thus, indicating that taxes on the royalty income of Google Ireland should've been duly withheld. Apart from this, the Tax Court agreed with the taxpayer's assertion regarding the intention of introducing equalisation levy but quashed the taxpayer's contention and mentioned that equalisation levy is applicable only to the services that are specified in the Act. Since matters pertaining to use of intellectual property rights, intangibles and copyrights are not covered under the specified services; equalisation levy won't apply in this case. Hence, the case was closed in favour of the revenue authorities.

Note: Bangalore ITAT had earlier passed a judgement relating to this case in October 2017. However, Karnataka High Court directed Bangalore ITAT to adjudicate this case independently since certain other issues and various other fiscal years were involved. To find a snapshot of the judgement passed in October 2017, click here.

Jay Maa Durga Buildtech Private Limited (merged with Lodha Construction Private Limited) – ITAT – Mumbai

Outcome: In favour of taxpayer
Category: Incoming Escaping Assessments

History: The taxpayer is engaged in construction business. During the year under consideration, it had declared issue of preference shares at a premium to a non-resident individual in its income-tax return. The intermediate tax authorities held that the non-resident would appropriately get covered in the definition of AE as given in the Act and accordingly, Form 3CEB (report containing details of international transactions entered into with the AEs) should've been furnished by the taxpayer. It made the authorities believe that income escaped assessment and consequently, a notice for reopening the assessment was issued to the taxpayer.

Ruling: The Tax Court noted that the receipts were of 'capital' nature and not of 'revenue' nature. It also stated that the intermediate tax authorities were unable to back their contention that the taxpayer's income had escaped assessment. Issuing shares at a premium to a non-resident cannot be a cause that triggers income escaping assessments u/s 147 of the Act. The fact that no reference was made to a Transfer Pricing Officer was also emphasized by the Tax Court. This indirectly indicates that there weren't any issues with regards to the arm's length price and for that reason, the judgement was passed in the favour of the taxpayer by cancelling the income escaping assessment.

RECENT NEWS

OECD to welcome public views and comments: The Organisation for Economic Co-operation and Development ('OECD') has been contemplating to revise Chapter IV – Administrative Approaches and Chapter VII – Intra-group Services of the 2017 OECD TP Guidelines. Accordingly, public comments have been invited to evaluate the scope of revisions. However, it is to be noted that OECD is looking for comments on practical application instead of potential theoretical disagreements. The procedure for sending the comments has been laid down by OECD.