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Siemens Gamesa Renewable Power Pvt Ltd – ITAT – Chennai

Outcome: In favour of taxpayer
Category: Aggregation of transactions

Tax Court rules with respect to royalty payment on availing technology, and management service fees paid by taxpayer to its AE.

Transaction: Taxpayer was involved in purchase of raw materials & components, manufacturing tools, royalty and management fees which were linked to the performance of assembly, erection and installation activities of taxpayer. It used an entity level approach to benchmark these transactions by considering them under one umbrella for aggregation purposes.

The tax authorities were against the combined benchmarking of royalty and management service transactions. It called for separate benchmarking for both transactions by applying a transaction-based approach under the Comparable Uncontrolled Price (CUP) method i.e. by testing comparable agreements relating to similar charge of royalty and external comparables for management charge. As per the tax officer, royalty payment was not related to components and it only brought down the cost of the components from the taxpayer's turnover. Further, the tax officer drew attention to Foreign Exchange Management Act, 1999 (FEMA) and pointed that royalty payments were in excess of permissible limits under FEMA. As the royalty rates charged by comparable companies were found by the tax officer to be higher than that of the royalty rates charged by taxpayer, the tax officer proceeded to make a downward tax adjustment. For the management fees, the tax officer separately determined its arm's length to be at nil in the absence of a valid comparable.

Decision: Tax Court stated that once an arm's length is tested at entity level, the tax officer has no jurisdiction to examine the need, benefit etc in relation to each transaction. On the application of CUP method by tax officer, the Tax Court held that such transaction based application would not hold good in a circumstance where an overall approach for benchmarking has been followed.

Tax Court rejected the reliance on FEMA provisions by stating that such provisions were out of the purview of transfer pricing purposes, and also pertained to an old ceiling limit on royalty payment to AE which was removed by the RBI vide Circular No. 52 dated May 13, 2010.

Tax Court disregarded the nil arm's length computation on management fees by the tax officer in the absence of a valid comparable and opined that since the taxpayer derived benefit and charged such expenses on proper basis, the nil arm's length would not be justified.

Accordingly, Tax Court deleted adjustment on royalty & management charge and upheld the combined entity level approach adopted by the taxpayer while benchmarking its overall transactions.

Eaton Industries Pvt Ltd – ITAT – Pune

Outcome: In favour of taxpayer
Category: Limitation on deductions

Tax Court rejects the restriction imposed by the assessing officer and first appellate authority on a specific deduction claimed by taxpayer.

Transaction: Taxpayer is engaged in the provision of engineering design services and operated at an arm's length price that was found acceptable to the tax officer in the transfer pricing order. However, the assessing officer proceeded to re-examine the transaction and alleged that the company made more than ordinary profits compared to its comparables. The assessing officer reduced the deduction claimed while engaged in the engineering services division and triggered the provisions of Section 10A(7) and Section 80IA(10) of the

Income-tax Act 1961 ('the Act') which addresses arrangements between 2 entities under which the taxpayer is earning more than normal profit.

Decision: Tax Court observes no merit in the actions of the assessing officer and holds that the assessing officer cannot allege that the taxpayer earns more than ordinary profits once the transaction has already been justified at arm's length by the tax officer. Further, the said provisions of Section 80IA of the Act speak of an arrangement to exist between 2 entities that would lead to more than normal profits to the taxpayer. However, in the present case, there was no proof brought on record, and in an absence of such arrangement there would be no merit in reducing deduction under Section 10A.

BP Singapore Pvt Ltd – ITAT – Rajkot

Outcome: In favour of taxpayer
Category: Treaty Benefit

Tax Court reflects on the applicability of treaty benefits on freight income earned by a Singapore-based taxpayer.

Taxpayer, involved in operation of ships in international waters became a freight beneficiary after engaging an Indian agent. This income being embedded in the freight receipts of the Indian agent was treated exempt under Article 8 of the India-Singapore DTAA in the return of income filed by the Indian agent. The assessing officer contended that there was no proof to establish that remittance was indeed made by the Indian agent to the Singapore-based taxpayer. Further, Article 24 of the DTAA was invoked which provided a limitation on the tax relief.

Before the Tax Court, taxpayer contended that the freight income is neither exempt from tax in India nor taxed at reduced rate in India. Further, as India would not have a right to tax the income, Article 24 would not be applicable to limit the tax benefit. The Tax Court rejected such contention by stating that such position was contrary to the scheme of the India-Singapore DTAA. From the evidences submitted by the taxpayer, it is observed that freight income received from India was subjected to tax in Singapore which was then exempted under the Singapore tax laws, thus virtually leading to no taxation.

Tax Court opines that the taxpayer being 'liable to tax' in Singapore is not the same as 'subject to tax'. It observed that the treaty benefit taken in one State depends on the status of taxability in another Contracting State i.e. in this case it depends on status of taxability in Singapore. The matter has currently been remitted back for a fresh adjudication in light of additional evidence filed by taxpayer.

Google India Pvt Ltd – ITAT – Bangalore

Outcome: Against taxpayer
Category: TDS provisions and Royalty

Tax Court rules in favour of Department by confirming the contentions put forth by the taxmen.

Google India Pvt Ltd ('Google India' or 'Taxpayer) is a wholly owned subsidiary of Google International LLC, USA. The Google group had come up with an 'AdWords Program' wherein the group provided a platform for businesses to advertise their products/services. Google Ireland Ltd. ('Google Ireland') – one of the associated enterprises ('AE') of Google India appointed Google India as a non-exclusive authorized distributor of AdWords Program to the prospective advertisers in India. As a result, an agreement was signed between the two companies in December 2005 through which the marketing and distribution rights were vested in Google India. For such rights, the taxpayer had been making payments to Google Ireland without deducting TDS u/s 195 of the Act.

The taxmen had 2 understandings on the above-mentioned scenario:

1. TDS should've been deducted while making payment outside India and if the same is not deducted, a disallowance of such a payment shall come into picture u/s 40(a)(i).

2. The payment made to Google Ireland is nothing but 'royalty' as per Section 9(1)(vi) of Income-tax Act 1961 as well as royalty defined Double Taxation Avoidance Agreement between India and Ireland.

With reference to understanding **1** – the taxpayer contended that the payment received by Google Ireland was not chargeable to income tax under the Act and thus there was not any need to deduct TDS u/s 195. Tax Court stated that the taxpayer u/s 195(2) could have approached an assessing officer for determining the taxability of such a payment in the hands of Google Ireland. Along with this, Tax Court firmly held that the taxpayer is 'duty bound' to deduct TDS while making payments unless the assessing officer explicitly orders not to do so.

Regarding understanding **2** – the taxmen expressed that the agreement between the taxpayer and Google Ireland does not constitute a simple distribution agreement but rather is an agreement which also allows the taxpayer to access to certain confidential information and intellectual property.

While analysing the AdWords Program business model in detail; it was determined by the taxmen that Google India access to all the relevant confidential information as well as intellectual property that are necessary for marketing and distribution activities.

Refuting this, the taxpayer mentioned that using the customer data was purely for rendering services under the ITES agreement and not for the distribution agreement. However, it was observed by the revenue authorities that the taxpayer was using such data for marketing and distribution activities as well and determined that using such data was fundamental in the business model of AdWords program. Therefore, the claim of the taxpayer that the agreement is merely an agreement to provide advertisement spaces stands invalid.

Tax Court states that such a secret process of identifying target audience is not available in the public domain and concludes that the payment to Google Ireland was in lieu of patent invention, secret formula, model, design, etc.

According to the provisions of DTAA between India and Ireland, the use of this secret process/formula is included in the meaning of 'royalty'. As a result, the understanding of the taxpayer that payments to Google Ireland are 'business profits' of the latter become inappropriate. Tax Court upholds that this royalty income shall be taxable as per DTAA in the hands of Google Ireland.

In the end, Tax Court closed the case by pronouncing that Google India and Google Ireland made an attempt to misuse the provisions of the Act and DTAA by structuring the transaction to escape tax liabilities which in no way is acceptable or favourable for the exchequer of the country. It was concluded that the information, patented technology etc, used from GIL to be classified as royalty and therefore as per Article 12(2) of the DTAA, the royalty would be taxed as per the laws of India.

Kadimi Tool Manufacturing Co Pvt Ltd – ITAT – Delhi

Outcome: In favour of taxpayer
Category: Receivables from AE

Tax Court rules in favour of the taxpayer by removing an interest adjustment proposed by the intermediate tax authorities.

Transaction: The taxpayer is engaged in manufacturing thread rolling dies, milled flat dies, milled ground dies and sale of screws. During the year under consideration, the taxpayer had certain outstanding balances receivable from its Associated Enterprise ('AE'). It was observed that the AE had delayed in making payments to the taxpayer and no interest was charged on this.

According to the intermediate tax authorities, taxpayer should've charged interest on the amount due from its AE. Thus, an addition on account of notional interest was proposed.

Decision: After going through the facts of the case and various other judicial pronouncements, the Tax Court holds that the taxpayer is a debt-free company and such an adjustment shall be deleted. Therefore, concluding the case favouring the taxpayer.

The Bombay Dyeing & Mfg Co Limited – ITAT – Mumbai

Outcome: In favour of taxpayer
Category: Real Income

Tax Court settles the case favouring the taxpayer by relying on the 'real income' theory.

Transaction: The taxpayer had rendered technical know-how services to its associated enterprise ('AE'). Along with this, it had provided guarantee to a third party in relation to loans advanced to its AE. The taxpayer had been debiting charges for such services to its AE's account. However, no interest was being charged to the AE on account of its bad financial condition.

The intermediate tax authorities were of the view that interest must be charged on such a balance. The taxpayer opposed this in front of the Tax Court and mentioned that even if interest was charged, it would've not been able to recover the same due to heavy losses of the AE. The taxpayer also added that its AE had defaulted in honouring various other obligations. Hence, expecting recovery of interest was unjustifiable.

Decision: The Tax Court holds that one must determine 'real income' with a realistic and a practical approach and a mere hypothetical income should not be subjected to tax. As a result, the adjustment put forward by the intermediate tax authorities was scrapped thus giving a relief to the taxpayer.

RECENT NEWS

CBDT provides Form 67 for claiming Foreign Tax Credit

India to accept all MAP and bilateral APA applications

In a press release dated 27th November 2017, CBDT has clarified India's position on acceptance of MAP and bilateral APA in cases of countries where Article 9(2) of OECD Model Tax Commentary is absent. India, having several tax treaties is engaged with countries that do not contain Article 9(2) or its context relating to 'Corresponding Adjustment'. Now, CBDT has decided to accept all transfer pricing MAP and bilateral APA applications regardless of whether the context of this Article is prevalent in the treaty or not.