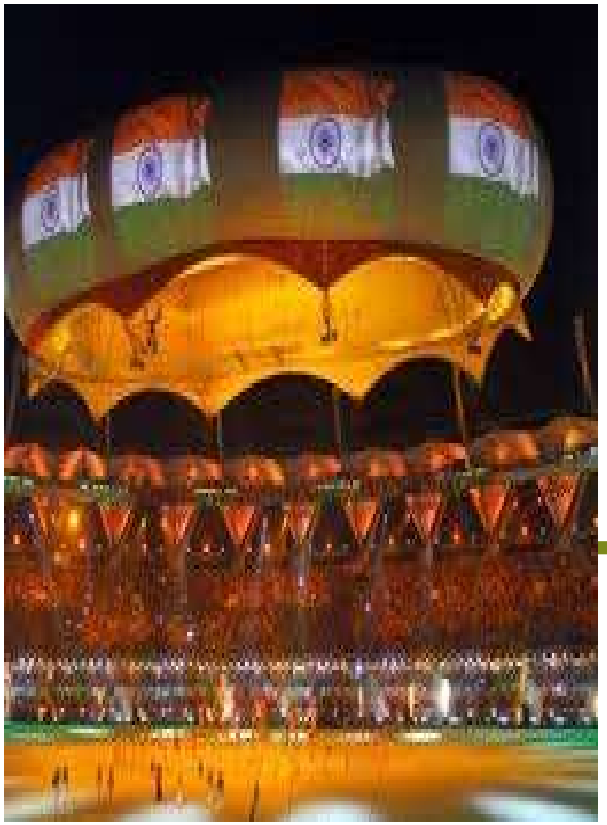
Contemporary Issues on recent decisions on international tax & TP

21 January 2018

BGSS & Associates

Chartered Accountants

Where Passion Delivers Value



Production Resource Group

*TS-626-AAR-2017

Facts of the case

- Applicant entered into a Service Agreement with the Organizing Committee of the Commonwealth Games, India (OCCG), for a term commencing on 9 July 2010 and expiring on 30 October 2010 (around 114 days) for following work
  - furnish lighting and searchlight services during the opening and closing ceremonies of the Commonwealth Games in India in 2010, on a turnkey basis
  - It required an ongoing presence available on call, to service, rectify or repair any equipment supplied by the Applicant.
  - Obtain all authorizations, permits and licenses, engaging personnel with the requisite skills, ensuring their availability, procuring and/or supplying all necessary equipment for its business, subcontracting, shipping and loading, insurance etc.
- For carrying on the above activities, the Applicant was provided with an office space, as well as an onsite space for storing its tools and equipment inside the stadium where the Games were held, under a lock
- While the services were rendered for the two days of the opening and closing ceremonies, the Applicant's employees and equipment were present in India for a period of 66 days for preparatory, installation and dismantling of the equipment

AAR Ruling

Primary factors

- The provision of a lockable space for storing its tools and equipment inside the stadium implies that the Applicant had access to and control over this space to the exclusion of other service providers engaged by the CW, including the CW itself
- This space was not merely for storage alone but, looking into the nature of the business, for carrying out the business itself
- Given the expensive equipment, time lines, precision and the highly technical nature of the work involved, it is inconceivable that the space provided to the Applicant, along with the required security, would not be at the Applicant's disposal, with the exclusive right to access and control
- Provision of an empty workspace to the Applicant implies that such workspace was placed at the disposal and under access and control of the Applicant

AAR Ruling

Additional factors

- Subcontracting of some activities by the Applicant is indicative of the fact that the Applicant had an address, an office from which it could call for and award subcontracts
- Without any premises under its control, hiring and housing key technical and other personnel who would need regular and ongoing instructions during the entire period, was difficult
- The Applicant entered into various contracts for the purpose of its business in a contracting state, and was employing technical and other manpower for use at its site. The site was, thus, an extension of the foreign entity on Indian soil, as referred to in the case of Vishakhapatnam Port Trust
- Undertaking comprehensive insurance of its equipment is also indicative of having a fixed place of business, since that is the place where it kept, assembled and created the end products required for rendering the services. No insurance company would insure any equipment, structures etc., against any risk of fire, damage or theft, unless the place was safe and in the exclusive custody and at the disposal of the customer, and in a well-defined address or physical care. Goods are not ordinarily insured when lying at a third person's premises

AAR Ruling

Additional factors

- Subcontracting of some activities by the Applicant is indicative of the fact that the Applicant had an address, an office from which it could call for and award subcontracts
- Without any premises under its control, hiring and housing key technical and other personnel who would need regular and ongoing instructions during the entire period, was difficult
- The Applicant entered into various contracts for the purpose of its business in a contracting state, and was employing technical and other manpower for use at its site. The site was, thus, an extension of the foreign entity on Indian soil, as referred to in the case of Vishakhapatnam Port Trust
- Undertaking comprehensive insurance of its equipment is also indicative of having a fixed place of business, since that is the place where it kept, assembled and created the end products required for rendering the services. No insurance company would insure any equipment, structures etc., against any risk of fire, damage or theft, unless the place was safe and in the exclusive custody and at the disposal of the customer, and in a well-defined address or physical care. Goods are not ordinarily insured when lying at a third person's premises

AAR Ruling

Additional factors

- It was mandatory for the Applicant to acquire all authorizations, permits and licenses. This indicates that the Applicant had a definite place at its disposal, as it could, otherwise, not be made liable for any default in the absence of the same
- The act of carrying out fabrication, maintenance and repair functions, or even operating the same at the opening and closing ceremonies at/from a premises in someone else's control and custody, is impossible

Disposal test

- For a PE to emerge, the fixed place need not be enduring or permanent, in the sense that it should be in its control forever. The context in which a business is undertaken is relevant
- Relying on F1 case, the duration for which the fixed place was at the disposal of the Applicant was sufficient for the business required

Comments

- F1 decision was based on peculiar fact pattern and cannot be applied as ratio
  - Multiple agreements
  - 5 year tenure
  - Interposing of Jaypee
  - Modification of agreements
  - Splitting up activity amongst AEs
- Demarcated place has been held to give rise to PE
  - Seagate Singapore [322 ITR 650]
  - Rolls Royce [19 SOT 42]
  - Booz & Company [32 ITR 132]
- Decision blurs distinction between ‘executing a project’ and ‘carrying on of business’
- Narrow reading of duration test and disposal test likely to give rise to PE risk for service providers

Texport Overseas Private Limited

*ITA No 1722/Bang/2017

ITAT ruling

- Issue before ITAT was benchmarking of directors remuneration
- Additional ground before ITAT
  - Impugned transaction would not fall within the definition of SDT as clause (i) of section 92BA was omitted vide Finance Act 2017
- Tribunal analysed the impact of omission from statute on already ongoing proceedings and if such omission renders the proceedings redundant
- Reliance was placed on section 6 of General Clause Act, SC decision in case of Kolhapur Canesugar Works, General Finance Co and GE Thermometrics
- Once a articular provision of section is omitted from the statute, it shall be deemed to be omitted from its inception unless and until there is some saving clause or provision to make it clear that action taken or preceding initiated under that provision or section would continue and would not be left on account of omission
- Once clause is omitted by subsequent amendment, it is deemed that clause (i) to section 92BA was never on statute

Sec 6 of GC Act

- Where this Act, or any 13[Central Act] or Regulation made after the commencement of this Act, repeals any enactment hitherto made or hereafter to be made, then, unless a different intention appears, the repeal shall not-

  (a) revive anything not in force or existing at the time at which the repeal takes effect; or

  (b) affect the previous operation of any enactment so repealed or anything duly done or suffered thereunder; or

  (c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or

  (d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed against any enactment so repealed; or

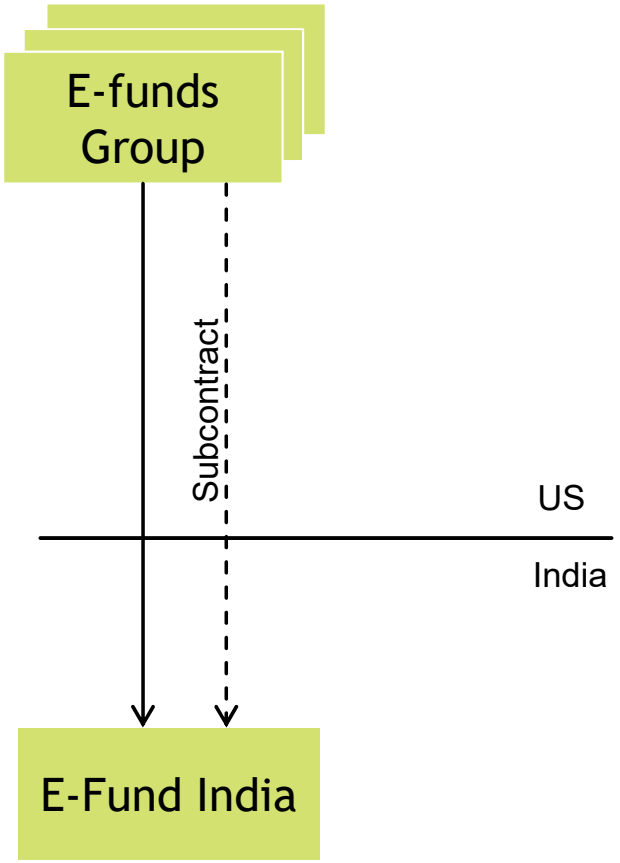
  (e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid;

  and any such investigation, legal proceeding or remedy may be instituted, continued or enforced, and any such penalty, forfeiture or punishment may be imposed as if the repealing Act or Regulation had not been passed.

E-Funds*

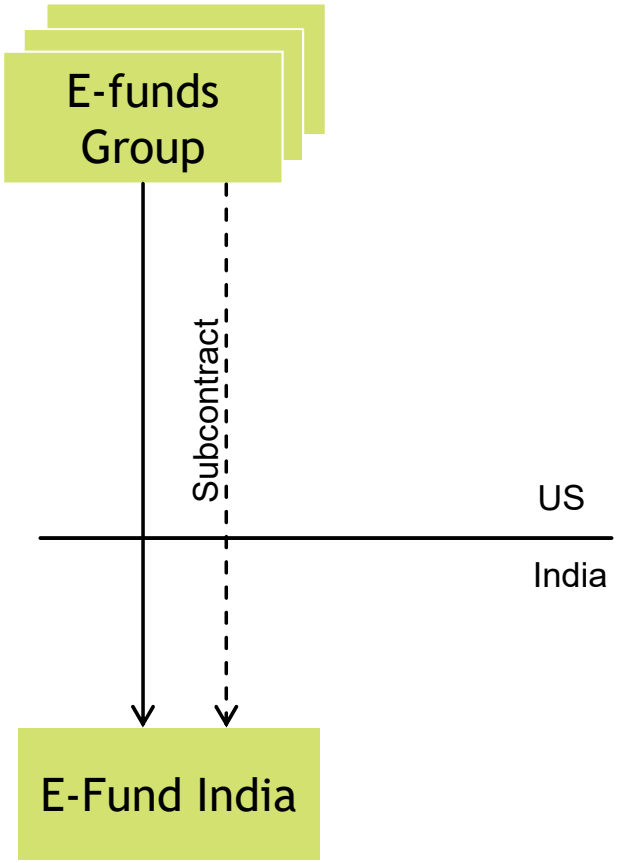
* 86 taxmann.com 240

Facts of the case



- US companies, (Taxpayers / US Cos) had an Indian affiliate namely E Fund India (I Co)
- US Cos, engaged in the business of electronic payment, ATM Management, decision support and risk management services
- Taxpayers subcontracted the back office and data entry support in respect of the three of the four main business lines of US Cos
- Tax Authorities contended that Taxpayers had a PE in India
  - US Co allowed ICO use of its technology and infrastructure free of cost
  - US Co undertook marketing activities for ICO and latter did not bear any significant risk in overall services
  - CIT(A) concluded that Service PE also exists for ICO

Facts of the case



- For past years, pursuant to MAP, certain income allocation was agreed to on “without prejudice” basis
- Tax Authority relied also on MAP resolution and held that a PE exists and thus profits to be attributed for subsequent financial years also

Issues before SC

- 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

Fixed place PE

- Relying on F1 decision SC held that PE can be constituted only if NR entity has fixed place at its disposal
- A fixed place would be treated as being “at the disposal” of a non-resident enterprise when that enterprise has right to use the said place and has control thereupon. Merely having access to such a place, for the purposes of business, would not suffice
- Control should be of a considerable amount and usually control would be present where the foreign entity can employ the place of business at its discretion
- 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
- Irrelevant considerations
  - close association between the entities or interactions or transactions
  - assigning of a contract nor sub-contracting, nor provision of intangible software free of cost
  - even if the foreign entities had reduced their expenditure by transferring the business to the Indian subsidiary, it would not by itself create a fixed place PE

SC Ruling

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
- 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

SC Ruling

Agency PE

- SC agreed with the view of the High Court that since the Revenue had not raised the argument of agency PE before the Tribunal or the High Court, it could not be raised at the level of the Supreme Court
- In any event, 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

MAP

- MAP Settlement Agreement was time and case specific and could not be considered precedent for subsequent years

Profit attribution

- Placing reliance on Morgan Stanley – SC held that arm's length principle has been satisfied in the present case, no further profits would be attributable even if there exists a PE in India

Analysis of Ruling

Fixed place PE

- OECD 2017 Commentary

  "Disposal test to be satisfied depends on the Foreign Enterprise (FE) having effective power to use the location as well as the extent of the presence of FE at that location and the activities that FE performs there

  Disposal test is met if FE has an exclusive legal right to use a particular location, which is used only for carrying on the FE's business activities

- India Position:

  "India disagrees that where the FE does not have a right to be present at a location and, in fact, does not use that location itself, that location cannot be considered as being at the disposal of the FE. India considers that such a location can, in certain circumstances, be considered as being at the disposal of the FE"

- Considering that there is no change in model convention, aforesaid observations are in contradiction to SC interpretation of disposal test

Analysis of Ruling

Service PE

- Text of India-US tax treaty:

  "the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

  (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period ; or

  (ii)the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].

- SC interpretation of aforesaid clause:

  "Insofar as a service PE is concerned, the requirement of Article 5(2)(l) of the DTAA is that an enterprise must furnish services "within India" through employees or other personnel

  ……

  It has already been seen that none of the customers of the assessees are located in India or have received any services in India. This being the case, it is clear that the very first ingredient contained in Article 5(2)(l) is not satisfied.

Analysis of Ruling

Service PE

- SC interpretation of aforesaid clause:

  “Insofar as a service PE is concerned, the requirement of Article 5(2)(l) of the DTAA is that an enterprise must furnish services "within India" through employees or other personnel

  ……

  It has already been seen that none of the customers of the assessees are located in India or have received any services in India. This being the case, it is clear that the very first ingredient contained in Article 5(2)(l) is not satisfied.

  However, the learned Attorney General, relying upon paragraph 42.31 of the OECD Commentary, has argued that services have to be furnished within India, which does not mean that they have to be furnished to customers in India. Para 42.31 of the OECD Commentary reads as under:

  > "Whether or not the relevant services are furnished to a resident of a state does not matter: what matters is that the services are performed in the State through an individual present in that State."

Analysis of Ruling

Service PE

- SC interpretation of aforesaid clause:

"19. Based upon the said paragraph, Shri Venugopal has argued that in assessment year 2005-06, two employees of the American firm were seconded in India and that, therefore, it is clear that management of the American company through these employees has obviously taken place.

…….

Article 42.31 of the OECD Commentary does not mean that services need not be rendered by the foreign assessees in India. If any customer is rendered a service in India, whether resident in India or outside India, a "service PE" would be established in India. As has been noticed by us hereinabove, no customer, resident or otherwise, receives any service in India from the assessees. All its customers receive services only in locations outside India. Only auxiliary operations that facilitate such services are carried out in India. This being so, it is not necessary to advert to the other ground namely, that "other personnel" would cover personnel employed by the Indian company as well, and that the US companies through such personnel are furnishing services in India."

Analysis of Ruling

Service PE

- In facts of the case, there are two sets of services:
  - Back office/support services furnished by E funds Into to E funds US
  - Services furnished by employees of E funds US deputed by E Funds to India
- Reconciliation with following observations of Morgan Stanley which were quoted by SC:

"As regards the question of deputation, we are of the view that an employee of MSCo when deputed to MSAS does not become an employee of MSAS. A deputationist has a lien on his employment with MSCo. As long as the lien remains with MSCo the said company retains control over the deputationist's terms and employment. The concept of a service PE finds place in the UN Convention. It is constituted if the multinational enterprise renders services through its employees in India provided the services are rendered for a specified period. In this case, it extends to two years on the request of MSAS. It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge

Analysis of Ruling

Profit Attribution

- SC in Morgan Stanley observed:

  "As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE.

- BEPS Act 7 – Additional guidance on attribution of profit to PE

  "When a PE is deemed to exist under Article 5(5) due to the activities of an intermediary, those activities are relevant to two taxpayers in the host country: the intermediary (which may be a resident of the host country) and the PE (which is a PE of a non-resident enterprise). The arm's length reward to the intermediary for the services it provides to the non-resident enterprise is one of the elements that needs to be determined and deducted in calculating the profits attributable to the PE under Article 7."

Analysis of Ruling

Profit Attribution

- SC in Morgan Stanley observed:

  "As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE.

- BEPS Act 7 – Additional guidance on attribution of profit to PE

  "When a PE is deemed to exist under Article 5(5) due to the activities of an intermediary, those activities are relevant to two taxpayers in the host country: the intermediary (which may be a resident of the host country) and the PE (which is a PE of a non-resident enterprise). The arm's length reward to the intermediary for the services it provides to the non-resident enterprise is one of the elements that needs to be determined and deducted in calculating the profits attributable to the PE under Article 7."

Analysis of Ruling

Profit Attribution

- Arguments of DR in B4U:

"In that regard he relies upon the conclusion rendered by the Hon'ble Supreme Court. That conclusion is that there being no need for attribution of further profits to the permanent establishment of the foreign company where the transaction between the two was held to be at arm's length but this was only provided that the associate enterprise was remunerated at arm's length basis taking into account all the risk taking functions of the multinational enterprise. Thus, Mr. Tejveer Singh's reliance on these observations in the Supreme Court judgment are strictly on the alternate argument canvassed by the assessee. That alternate argument was th at assuming that B4U India is a dependent agent of the assessee in India it has been remunerated at arm's length price and, therefore, no profits can be attributed to the assessee. Mr. Tejveer Singh would submit that the Tribunal failed to note that the situation would be different if the transfer price analysis did not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be need to attribute profits to the permanent establishment for those functions / risks that had not been considered. Mr. Tejveer Singh's argument is that the assessee had not subjected itself to the transfer price regime. T herefore, no assistance can be derived by it from this judgment."

Analysis of Ruling

Profit Attribution

- Del HC in case of Adobe Systems (2016) 240 TAXMAN 0353 (Delhi):

  "cases where a subsidiary acts as an agent of its holding company, the income from the `activities conducted by the subsidiary for and on behalf of its principal would be assessed in the hands of the principal - that is, the holding company - and not in the hands of the subsidiary. The subsidiary would only be liable to pay tax on the remuneration receivable as an agent and such remuneration would clearly be deductable while computing the income in the hands of the holding company."

- SC observation in case of E-funds

  "Shri Ganesh is correct in stating that as the arm's length principle has been satisfied in the present case, no further profits would be attributable even if there exists a PE in India. This was specifically held in Morgan Stanley (supra) as follows."

Can it be said that difficulty of attributing risk taking function of NR to remuneration of agent is watered down by SC ? Is it an end or beginning of new controversy

DAPE change in OECD Commentary

DAPE

- Changes in OECD Commentary 2017:

"The cases to which paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf and, in order to perform the obligations deriving from these contracts, obtains goods or services from other enterprises or arranges for other enterprises to deliver such goods or services. In these cases, the person is not acting "on behalf" of these other enterprises and the contracts concluded by the person are neither in the name of these enterprises nor for the transfer to third parties of the ownership or use of property that these enterprises own or have the right to use or for the provision of services by these other enterprises. Where, for example, a company acts as a distributor of products in a particular market and, in doing so, sells to customers products that it buys from an enterprise (including an associated enterprise), it is neither acting on behalf of that enterprise nor selling property that is owned by that enterprise since the property that is sold to the customers is owned by the distributor. This would still be the case if that distributor acted as a so-called "low-risk distributor" (and not, for example, as an agent) but only if the transfer of the title to property sold by that "low-risk" distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold) so that the distributor would derive a profit from the sale as opposed to a remuneration in the form, for example, of a commission."

DAPE change in OECD Commentary

DAPE

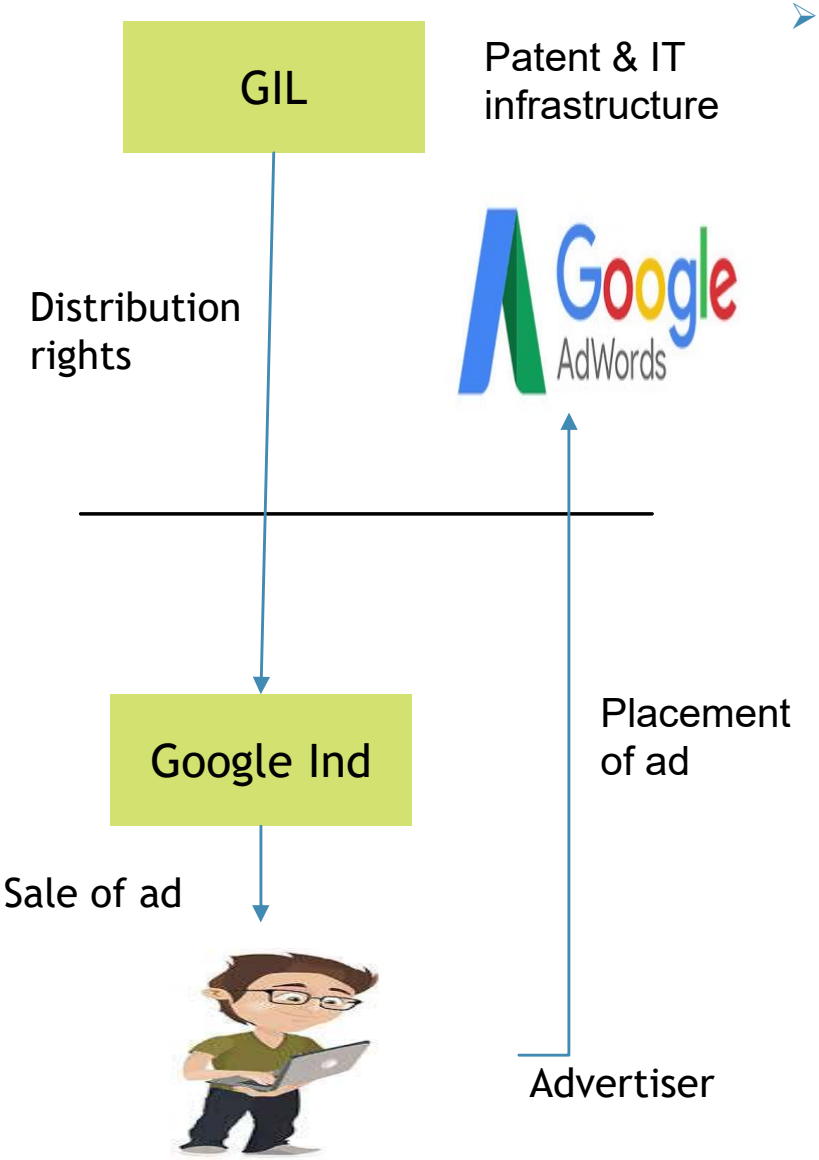
- India Position on above

  “India does not agree with the interpretation given in paragraph 96 because it considers that distribution of goods owned by an enterprise by an associated enterprise or a closely connected enterprise, particularly in a case where the risks are not born by such enterprise, such as the so called “low risk distributor”, may give rise to a permanent establishment of the enterprise, whose goods are being sold

Google India*

*

Facts of the case

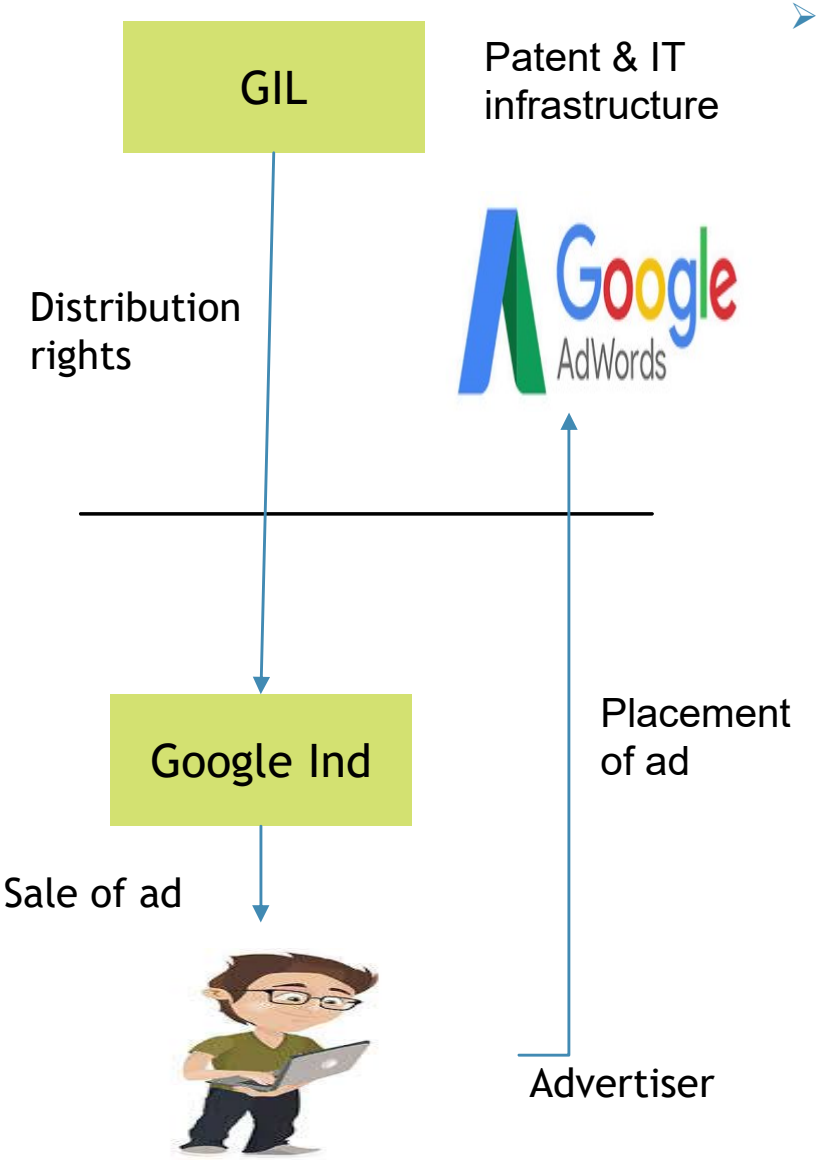


- Google India entered into following agreement with GIL
  - Proving IT & ITES service in the nature of back office, quality control fucntions for AdWords program across the world
  - Non-exclusive distribution agreement granting marketing and distribution rights

Role of Google Ind:

- Enter into resale agreement with GIL
- Perform marketing related activities in order to promote the sales of advertising space to Indian Advertisers
- Enter into a contract with Indian advertisers in relation to sale of space
- Provide assistance/training to Indian advertisers if needed in order to familiarize that with the features/tools available as part of our Adword product
- Resale invoice to the above advertisers
- Collect payments from the aforesaid advertisers
- Remit payment to GIL for purchase of advertising space

Facts of the case

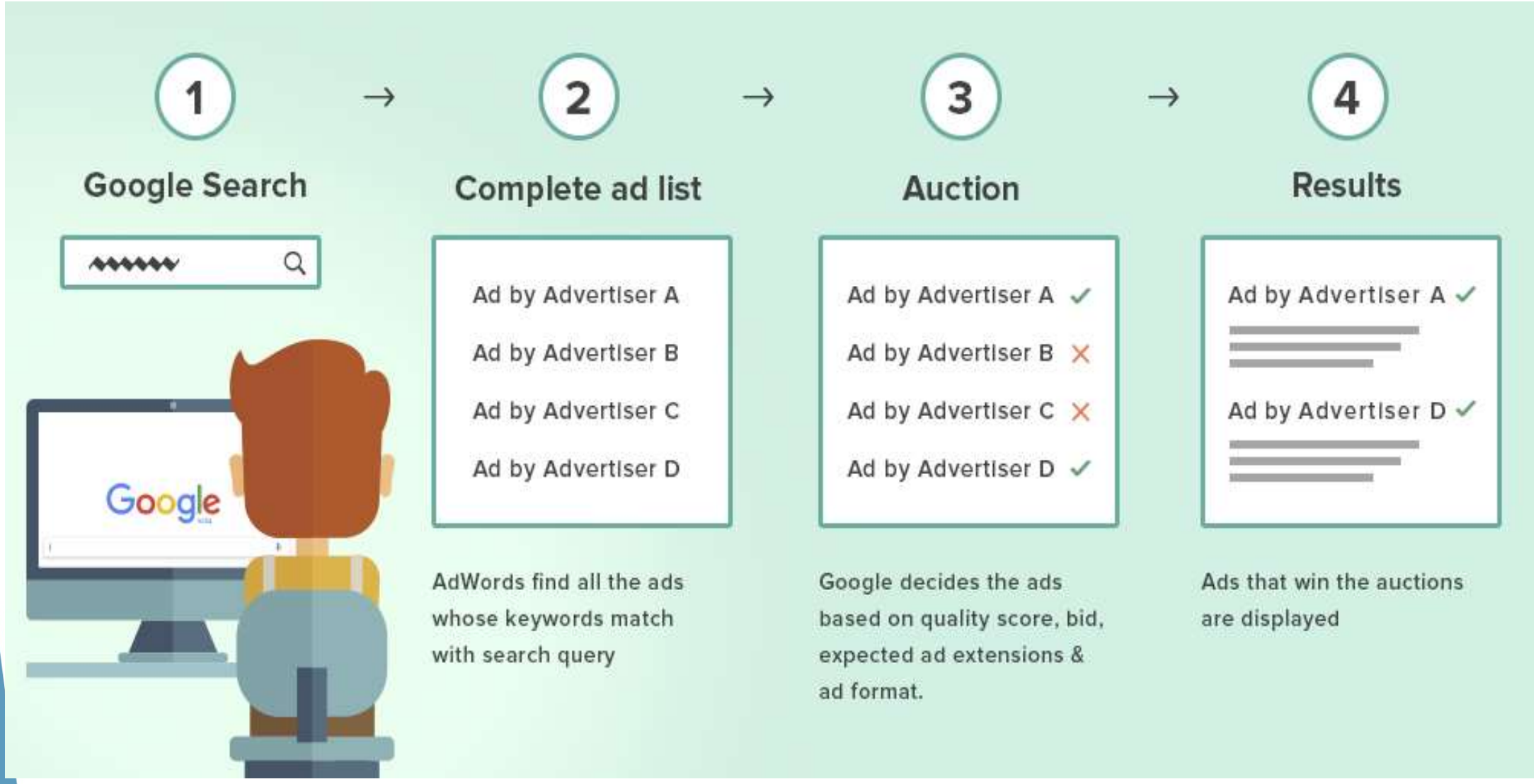


- Google India entered into following agreement with GIL
  - Proving IT & ITES service in the nature of back office, quality control fucntions for AdWords program across the world
  - Non-exclusive distribution agreement granting marketing and distribution rights

Role of Google Ind:

- Enter into resale agreement with GIL
- Perform marketing related activities in order to promote the sales of advertising space to Indian Advertisers
- Enter into a contract with Indian advertisers in relation to sale of space
- Provide assistance/training to Indian advertisers if needed in order to familiarize that with the features/tools available as part of our Adword product
- Resale invoice to the above advertisers
- Collect payments from the aforesaid advertisers
- Remit payment to GIL for purchase of advertising space

Google AdWords



Advertisement process

- Advertisers gets its advertisement uploaded into Adword program, and thereafter it directly logged on the Adword program website owned by Google and follows the various steps to create the Adword account for itself
- Advertisers select the key words, content and presentation related to its ads and places a bid on the online system for the price it is willing to pay overtime its user clicks on its advertisement
- One of the steps is the selection of the payment in INR and once the terms and conditions displayed are accepted an assigning contract is entered between the advertiser and Google India (assessee) for sale of ad space
- Once the advertisers creates the accounts and upload and advertisement the same automatically gets stored on Adword platform owned by Google on the servers outside the India and the ads are displayed in the manner determined by the programs running on automated platform
- Assessee periodically raises the bill on advertisers for advertising spend incurred by the advertiser on clicks through the users

Tax authorities argument

Royalty

- Agreement is for transfer of distribution rights which are intellectual property similar to patent, know-how under Exp 2 to 9(1)(vi)
- Google India obtains a right to access the confidential information and IP rights of G Co. i.e., mainly customer data which is comprised of information like user profile, age, sex, language, type of mobile, time when customer is visiting particular web site/ searching on search engine, how much time is spent on internet and on which web site
- Google India has been permitted to use Google Ireland's trademarks and brand features in order to market and distribute the AdWords Program
- The license to use the search engine in which Google Ireland holds copyright, would amount to right to use copyright
- Grant of distribution right also involves transfer of know-how, Taxpayer has been provided access to internal tool such as confidential information and IPRs of Google Ireland for the purpose of performing the obligations under the agreement

Tax authorities argument

Royalty

- license to use the search engine in which G Co holds copyright, would amount to right to use copyright

Point of taxation – receipt v. accrual

- SC in the case of GE India and Elli Lilly that the provisions of section 195 has to be read along with charging provisions i.e. section 4, 5,9 and 90 of the Act. On conjoint reading of the above provisions, it is clear that Google Ireland is chargeable under the Act on accrual basis))

Aggregating agreement

- 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

Taxpayers argument

Royalty

- 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

Taxpayers argument

Royalty

- 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
- 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

Taxpayers argument

Royalty

- 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.
- 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.

Taxpayers argument

Point of taxation – receipt v. accrual

- So far as taxability of Royalty is concerned, twin conditions of "arising in India" as also the "payment" are to be satisfied. Taxpayer relied upon the order passed by the Mumbai Tribunal in National Organic Chemical Industries Ltd

Aggregating agreement

- ITES and the distribution agreement are different and are not inter related or interdependent. The ITES function was undertaken by the Taxpayer even prior to the appointment as a non-exclusive distributor of advertisement space. Hence, if any IP or rights in it are obtained by taxpayer under the ITES Agreement, the same is not material for separate consideration paid towards distribution of advertisement fee

ITAT Ruling

Royalty

- 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.
- 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

ITAT Ruling

Royalty

- 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"
- 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

ITAT Ruling

Royalty

- The Tribunal distinguished OECD TAG and HPC 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
- 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
- Distribution agreement specifically empowers the taxpayer to delete/remove/withdraw the advertisement. This vesting of power demonstrate that Tapayer had right to access portal

ITAT Ruling

Time limit for TDS proceeding

- Non-resident payee should be treated at par with resident payee under Act and under tax treaty
- The non-discrimination clause under the tax treaty requires equal treatment of non-resident with resident under the provisions of tax treaty
- It cannot be said that non-resident would be given special and beneficial treatment in comparison to the resident or treated unequally by proving unlimited time to initiate proceedings under section 201

Point of taxation – receipt v. accrual

- Uniform policy is required to be adopted for deduction of taxes at source. Whether it is business profit or royalty, in both the circumstances, taxpayer is duty bound to ded tax unless there is order under sec 195(2) to the contrary
- The argument of taxpayer under the provisions of the tax treaty, the royalty is chargeable to tax in hands of non-resident on receipt basis needs to be rejected as benefit of tax trweaty is only available to non-resident and not to resident payer

ITAT Ruling

Point of taxation – receipt v. accrual

- Tax treaty can only provide characterization of the income, the country where it is to be taxed. However, it is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged
- Literal rule of interpretation need not be followed for interpreting tax treaty
- Decision of Saira Asia Interiors is distinguishable on facts as there is no mechanism available with tax department to know whether actual amount was paid or credit in hands of Google Ireland
- If taxpayer has any doubt about chargeability then Taxpayer should have filed application under section 195(2)

ITAT Ruling

Tax Avoidance

- The services rendered under ITES agreement cannot be divorced from the activities undertaken by the Taxpayer under the distribution agreement. Both the agreements are connected with naval chord with each other. The Taxpayer was duty-bound to provide as per the distribution agreement various ITES services, which the Taxpayer has wrongly claimed to have been provided not under the distribution agreement, but under a separate service agreement. This is only a design / structure prepared by the Taxpayer to avoid the payment of taxes. Hence, Taxpayers argument that access to IPs obtained under the ITES Agreement is independent and separate from distribution Agreement is rejected
- Tax treaty can only provide characterization of the income, the country where it is to be taxed. However, it is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged
- Literal rule of interpretation need not be followed for interpreting tax treaty
- Decision of Saira Asia Interiors is distinguishable on facts as there is no mechanism available with tax department to know whether actual amount was paid or credit in hands of Google Ireland
- If taxpayer has any doubt about chargeability then Taxpayer should have filed application under section 195(2)

Analysis of ITAT ruling

Royalty

- Taxpayer merely resold advertisement slots – entire backend function was done by servers outside India
- Entire understanding of AdWords programme is based on information available in public domain
- OECD Commentary in context of software distributors observes:

  "Transaction where a distributor makes payments to acquire and distribute software copies (without right to reproduce software) the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business profits in accordance with Article 7"
- ITAT does not comment on right which ultimate advertiser gets – can it be contended that if at all consideration paid by advertiser constitutes royalty

Analysis of ITAT ruling

Point of taxation – receipt v. accrual

- Ruling needs to be read contextually – observation are in context of obligation of payer to withhold tax
- Arguably, should not have impact on liability of payee
- Present ITR form supports ITAT view as option is granted to carry forward tax credit
- ITAT seems to have been influence by that fact that tax liability is deferred upto year of actual payment. ITAT has not considered that payment cannot be kept outstanding under FEMA for more than prescribed period

Analysis of ITAT ruling

Withholding obligation

- As per ITAT Taxpayer “If taxpayer was having any doubt about chargeability then the taxpayer should have filed an application under section 195(2) of the Act”
- SC in case of GE India (327 ITR 456)

  “From this it follows that where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof

  The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not so assessable, there is no question of TAS being deducted

Analysis of ITAT ruling

Withholding obligation

- SC observation in case of Formula One (193 Taxman 324)

"We are, however, inclined to accept the submission of Mr. Datar that only that portion of the income of FOWC, which is attributable to the said PE, would be treated as business i ncome of FOWC and only that part of income deduction was required to be made under Section 195 of the Act. In GE India Technology Centre (P.) Ltd. (supra) this Court has clarified that though there is an obligation to deduct tax, the obligation is limited to the appropriate portion of income which is chargeable to tax in India and in respect of other payments where no tax is payable, recourse is to be made under Section 195(2) of the Act. It would be for the Assessing Officer to adjudicate upon the aforesaid aspects while passing the Assessment Order, namely, how much business income of FOWC is attributable to PE in India, which is chargeable to tax.

Analysis of ITAT ruling

Equalisation levy

- Impact of EL on similar payment from FY 2016-17 onwards:
  - Payment by advertisers to Google India
  - Payment by Google India to Google Ireland
- Payment by Google India not covered as payment is between residents – However, payment may be treated as royalty under Exp 2 to 9(1)(vi)
- Section 165(1) of FA 2016 reads:

  "On and from the date of commencement of this Chapter, there shall be charged an equalisation levy at the rate of six per cent. of the amount of consideration for any specified service received or receivable by a person, being a non-resident from…."
- Specified service defined under section 164(i) as:

  "specified service" means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf"

Analysis of ITAT ruling

Non – discrimination clause

- Typical non-discrimination clause:

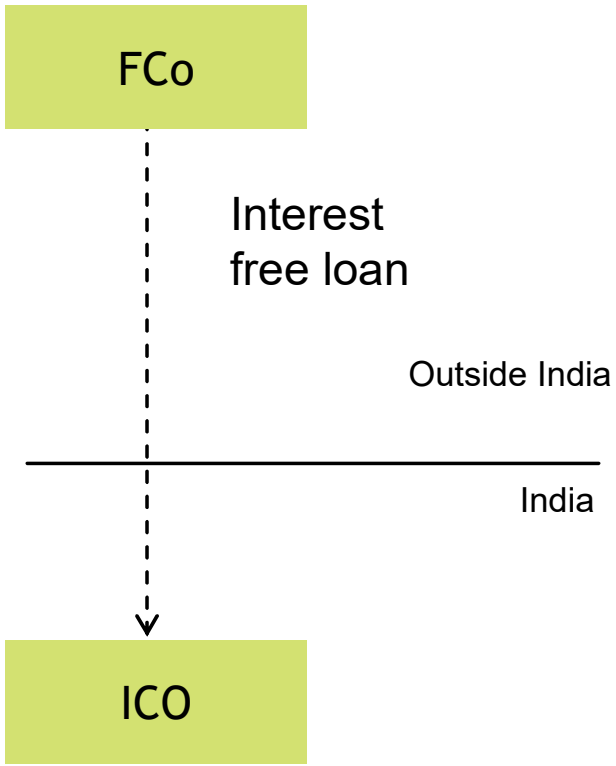
  "Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals that other State in the same circumstances are or may be subjected. This provision shall apply to persons who are not residents of one or both of the Contracting States."

- ITAT interpreted above clause to impose more onerous burden on NR and bring it at par with R

Instrumentarium Corporation*

*(2016) 138 DTR 0225 (Kol)(Trib)

ITAT Ruling



- FCO granted interest free loan to its loss making Indian subsidiary
- TPO imputed interest in hands of FCO on application of TP provisions
- Primary defense of FCO was that AL interest would lead to base erosion in India
- ITAT held:
  - Sec 92(3) does not contemplate taking wholistic view considering overall profits of both AEs
  - Sec 92(3) contemplates taking profit or losses only for year under consideration
  - Extent of set off of losses by ICO is academic as there is no way whether actually losses would be set off against profit in future

Analysis of ITAT ruling

Section Extract

- Scope of aforesaid ruling – whether applicable to all payments ?
- Benchmarking strategy in hands of NR AE
- Is ruling fact specific or lays down legal proposition
- Other implications in hands of Indian payee – section 40(a)(ia), AID proceeding, secondary adjustment
- Applicability of ruling to shareholders function
- Ultimate end game
  - Can penalty be levied
  - Taxability in hands of payee in case of guarantee whether other income article does not give India taxing right

Transfer Pricing : Country-by-Country Reporting

BEPS Action Plan 13

- OECD released final guidance on TP Documentation and Country-by-Country Reporting on 5 October 2015. OECD has developed a three-tiered documentation structure (as summarized below) to enable tax authorities to have sufficient information to assess risk

Country-by-country reporting	➢ To provide jurisdiction-wise information on global allocation of income, taxes paid/accrued, the stated capital, accumulated earnings, number of employees and tangible assets ➢ Entity-wise details of main business activities which will portray the value chain of inter-company transactions.
Master File	➢ **To provide the MNE's blueprint** ▪ The group's organisational structure ▪ A description of the group's business, intangibles, R&D activities, intercompany financial activities, and financial and tax positions.
Local File	➢ To provide material transfer pricing positions of the local entity/taxpayer with its foreign affiliates ▪ Demonstrates arm's length nature of transactions ▪ Contains the comparable analysis.

Indian Government introduced BEPS documentation norms through Finance Bill 2016 to align with OECD BEPS guidelines; which is to be made effective from fiscal year 1 April 2016.

CBDT Notification No. S.O. 3497 (E) dt.31/10.2017

- CBDT vide Notification No. S.O. 3497(E) dated 31 October, 2017 released Final Rules in relation to Master File and CbC. Rules 10DA and 10DB were inserted in the Income-tax Rules, 1962 ('the Rules')
- **Rule 10DB - Country by Country Reporting :**
  - Rule 10DB notified by CBDT vide notification no. S.O. 3497(E), has outlined the reporting requirements for CbC
    - Threshold of EUR 750 million
    - To be filed on or before the due date of filing of Return of Incomei.e. 30 November 2017 [extended to 31 March 2018 vide Circular No. 26/2017)]
- **Rule 10DA – Master File:**
  - Master file to be maintained and filed before 31 March 2018 for FY 2016-17. Threshhold being
    1. Rs. 500 cr. Of consolidated group revenue of the International group for the accounting year; **and**
    2. Aggregate value of international transactions:
       a) During the accounting year, as per books exceeds Rs. 50 cr. ;OR .
       b) Purchase, sale, transfer, lease or use of intangible property during the accounting year as per books Rs. 10 cr

Reporting requirements (1/2)

Master File Reporting Requirements

Form No.3CE-AA PART A	➢ By every person, being a constituent entity of an international group whether or not fulfils the required conditions for applicability of master file. ➢ But where there are more than one constituent entities resident in India than the designated constituent entity (designated by the international group to file the relevant report/information) can file the said form provided it has filed Form 3CEAB. ➢ Thus, no other constituent entity resident in India is required to file the same, if the designated entity has filled Form 3CEAB.	31 March, 2018
3CE-AA PART B	➢ **Main Master file form** ▪ By Constituent entity of the international group satisfying the conditions prescribed for master file requirement. ▪ By designated entity (when there are more than one constituent entities resident in India).	31 March, 2018
3CE-AB	➢ Intimation by designated entity resident in India that it will be filling master file in India.	1 March, 2018

Reporting requirements (2/2)

CbC Reporting Requirements

3CE-AC	➢ Intimation by every constituent entity of the international group being resident in India whose parent entity is not resident in India	**31 January, 2018**
3CE- AD	➢ **Main CbC Report Form** ➢ Case 1: By every parent entity or alternate parent entity resident in India. ➢ Case 2: By every constituent entity resident in India whose parent country does not have an agreement providing for exchange of the report or there has been systematic failure by the parent country and the said failure has been intimated by the prescribed authority to the such constituent entity. ➢ By designated entity (when there are more than one constituent entities resident in India) in both the cases mentioned above. (provided for case 2, the designated entity has intimated the department in Form 3CEAE)	**31 March, 2018**
3CE- AE	➢ Intimation by designated entity resident in India to whom Case 2 mentioned above is applicable.	**No Due date specified**

Thank You

Our Offices

MUMBAI

605, Zee Nayak, M.G. Road, Vile Parle (East), Mumbai – 400 057

Email : bhaumik@bgss.co.in

Mobile No: +91 98339 15583

AHMEDABAD

402, Suyojan Tower, Hotel President Lane, CG Road, Ahmedabad, - 380009

Email : saumya@bgss.co.in

Landline : +91 79 300 22 330

Mobile No: +91 90999 27783