Direct Tax Refresher Course – Part II

Controversies in International Tax

Gautam Doshi - CA

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Minimum Alternate Tax (‘MAT’)

Section 115JB – Minimum Alternate Tax – Relevant Extracts..

- (1) Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, [2012], is less than [eighteen and one-half per cent] of its book profit, [such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of [eighteen and one-half per cent].

…Section 115JB – Minimum Alternate Tax – Relevant Extracts…

- (2) Every assessee,—

- (*a*) being a company, other than a company referred to in clause (*b*), shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Part II of Schedule VI to the Companies Act, 1956 (1 of 1956); or

- (*b*) being a company, to which the proviso to sub-section (2) of section 211 of the Companies Act, 1956 (1 of 1956) is applicable, shall, for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of the Act governing such company

…Section 115JB – Minimum Alternate Tax – Relevant Extracts

Explanation 3

For the removal of doubts, it is hereby clarified that for the purposes of this section, the assessee, being a company to which the proviso to sub-section (2) of section 211 of the Companies Act, 1956 (1 of 1956) is applicable, has, for an assessment year commencing on or before the 1st day of April, 2012, an option to prepare its profit and loss account for the relevant previous year either in accordance with the provisions of Part II and Part III of Schedule VI to the Companies Act, 1956 or in accordance with the provisions of the Act governing such company.

\ ruling in the case of imken (. .\ ) - .avourable…

The AAR held MAT is not applicable to Timken Co. (a foreign company) for the following reasons:

- MAT regime unworkable, if one applies definition of the term ‘company’ to a foreign company without enquiring into the opening words used, i.e., ‘unless the context otherwise requires’.
- Proviso refers to profit & Loss account laid before the Company at its Annual General Meeting.
- A foreign company not having place of business in India not required to prepare its financial statements-Sections591 and 594 of Companies Act, 1956.
- Includes adjustments such as Chapter VIA applicable only to domestic companies.

…\ ruling in the case of imken (. .\ ) . avourable…

- Finance Bill, 2002 while amending section 115JB provided an insight into the minds of the legislature, with regards the introduction of MAT. The explanatory notes of the bill read as follows:

  - "Clause 49 seeks to amend section 115JB of the Income-tax Act relating to special provision for payment of tax by certain companies. The existing provisions of the said section provide for levy of a minimum tax on **domestic companies** of an amount equal to seven and one-half per cent of the book profit, if the tax payable on the total income chargeable to tax as per the provisions of the Income-tax Act, 1961, is less than seven and one-half per cent of the book profit …"

…\ ruling in the case of imken (. .\ ) . avourable…

- CBDT Circular No. 794, dated 9-8-2000 (*supra*) explaining the newly introduced provisions of section 115JB, reads as follows :

"The new provisions provide that all companies having book profits under the Companies Act, prepared in accordance with Part II and Part III of Schedule VI to the Companies Act, shall be liable to pay a minimum alternate tax at a lower rate of 7.5 per cent as against the existing effective rate of 10.5 per cent of the book profits.“

- Effective rate is rate applicable to domestic companies.

- CBDT circulars binding on department – K P Verghese vs. ITO[(198)131 ITR 597]

…\ ruling in the case of imken (. .\ ) . avourable…

- Interpretation of Sec.115JB aided by contemporaneous exposition
  - Speech of FM

"The various exemptions currently available while calculating Minimum Alternate Tax (MAT) and the credit system has undermined the efficacy of the existing provision and has also led to legal complications. To address these issues, I propose that the Minimum Alternate Tax be now levied at the revised rate of 7.5 per cent of the "book profits" as determined under the Companies Act instead of the existing **effective rate of 10.5 per cent**."

…\ ruling in the case of imken (. .\ ) . avourable…

- Memorandum Explaining the provisions of the Finance Bill, 2007

"In its place, it is proposed to insert a new provision which is simpler in application. The new provisions provide that all companies having book profits under the Companies Act, prepared in accordance with Part II and Part III of Schedule VI to the Companies Act, shall be liable to pay a minimum alternate tax at a lower rate of 7.5 per cent, as against the **existing effective rate of 10.5 per cent of the book profits**."

- Speech / Circulars relating to Sec.115JA

...\ ruling in the case of imken (. .\ )

- Impossibility / Absurdity of charging Global Book Profits.
- Accepted Position – Inapplicable to Companies Governed by Special Acts – Electricity, Banking, etc.

Other Arguments supporting non levy of MAT to Foreign Companies.

- Specific Rate under IT Act
  - Relevant income excluded from Total income.
- Application to Foreign Companies will override specific treaty based rates.
  - Not permissible – violates Treaty

\ ruling in the case of astleton nvestment td (. .\ ) - gainst…

- Department did not contend that MAT applies to Foreign Companies – **Authority suo moto decided as question had been framed by Assessee**.
- The AAR distinguished its ruling in the case of Timken Co.
- Charging provision is Sec.115JB(1). – Sec.115JB(2) and references to accounts under Companies Act, laid before AGM cannot govern Sec.115JB(1).
- Reading section 115JB as confined in its operation to domestic companies alone, one may be in violence to the special scheme of taxation adopted – no clear indication to the contrary – hence, no basis to refer to external aids to interpretation.
- Earlier decision in P No.14 (234 ITR 335) earlier to Timken had applied Sec.115JA to a Foreign Company – Basis of application was not existence or non existence of PE in India.

...\ ruling in the case of astleton nvestment . td (. .\ )

- No compelling reason to jettison the scheme of taxation adopted by the Act by reading down section 115JB as confined in its application to domestic companies alone.

- Other arguments for that could be put forth by the revenue to state that MAT is applicable to all companies:

  - Unlike 115-O, no specific mention to domestic companies

  - Certain sections like 47(iv) specifically refers to Indian companies

  - Finance Act 2015 amendment, being clarificatory in nature – MAT is applicable to Foreign companies

Recent ruling

Bank of Tokyo Mitsubishi UFJ Ltd vs ADIT (49 taxmann.com 441) – Delhi Tribunal

- The tribunal held that MAT should not apply to a foreign banking company because:
  - It is a Banking Company not governed by the Companies Act – Explanation 3 is not retrospective.
  - Intent behind introducing MAT provisions was to tax domestic companies.
  - 115JB could not override DTAAs – Taxable Income computed as per DTAA.

Snapshot of recent developments in MAT…

No MAT on foreign companies from 1 April 2015

- Budget 2015 proposes to exclude capital gains, interest and royalties/ FTS earned by foreign companies (including FPIs) from the book profits for the purposes of MAT computation

MAT on foreign companies for past years

- Indian Revenue authorities (IRA) have recently issued assessment orders, subjecting capital gains and other income earned by FPIs to MAT for FY 2011-12
- Notices have also been issued seeking to re-open cases of past FYs, based on a ruling by the Authority for Advance Rulings in the case of Castleton Investment Ltd (this matter is currently pending before the Supreme Court of India)

…Snapshot of recent developments in MAT

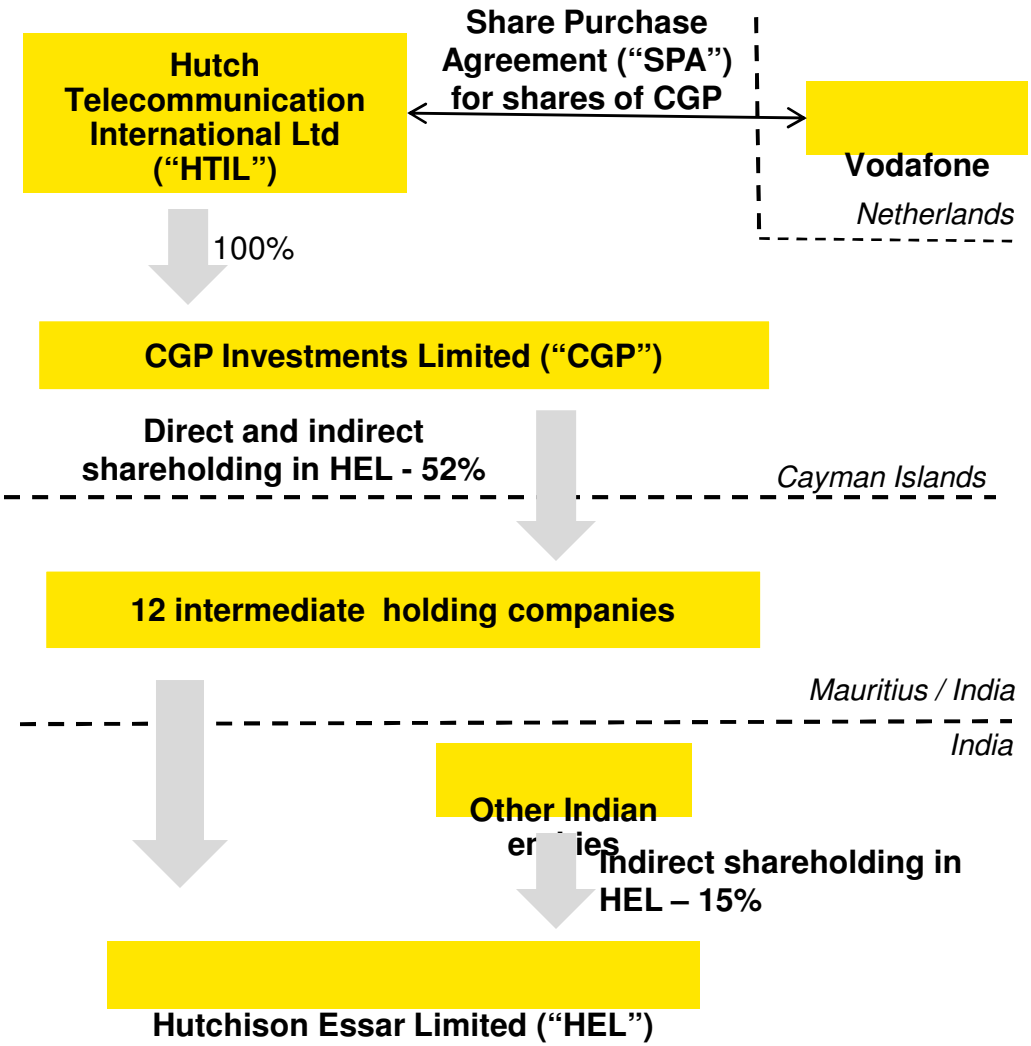
- Finance Minister had clarified that assessments for past years will be concluded as per outcome of the Indian judicial process. However, based on representations by various stakeholders on the potential retrospective impact of Budget proposal, the Government has taken following steps:
  - A committee has been constituted under Justice A. P. Shah to look into applicability of MAT
  - IRA has been directed to not take any coercive action for recovery of demand and to put on hold the issue of fresh notices for reopening of cases and completion of assessment unless the case is getting barred by limitation
- Various legal remedies are being considered by FPIs to challenge the action of IRA for past years

Typical issues

- Whether MAT is applicable to PO/ BO of a F Co in India
  - If applicable, what profits (i.e. India sourced or Global) to be taxable under MAT
- Applicability of MAT for a F Co having a POEM in India
- Applicability of MAT where F Co is not required to hold any AGM in India and consequently is not required to lay down its Balance sheet and P&L A/c
- MAT provisions and Treaty provisions – Operate in separate silos(?)
- Applicability of MAT in case of presumptive taxation:
  - Non residents engaged in the business of Shipping, operation of aircrafts, exploration of mineral oils, turnkey power projects etc

Indirect Transfer

Vodafone – Key facts



Hutch/ Vodafone position – transfer of shares of CGP (Cayman Islands) not taxable in India

Tax authorities contended that value of CGP derived from operations in India and hence transaction is taxable in India

The Supreme Court held that the transaction was not taxable in India.

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Vide Finance Act 2012, the Government of India retrospectively amended section 9(1)(i) to bring such transactions to tax

Indirect Transfer-Background…

- FA 2012 Amendment – Explanation 4 and 5 inserted in S.9(1)(i)
  - Explanation 4
    - *“For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".*
  - Explanation 5
    - *An asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be……situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India*

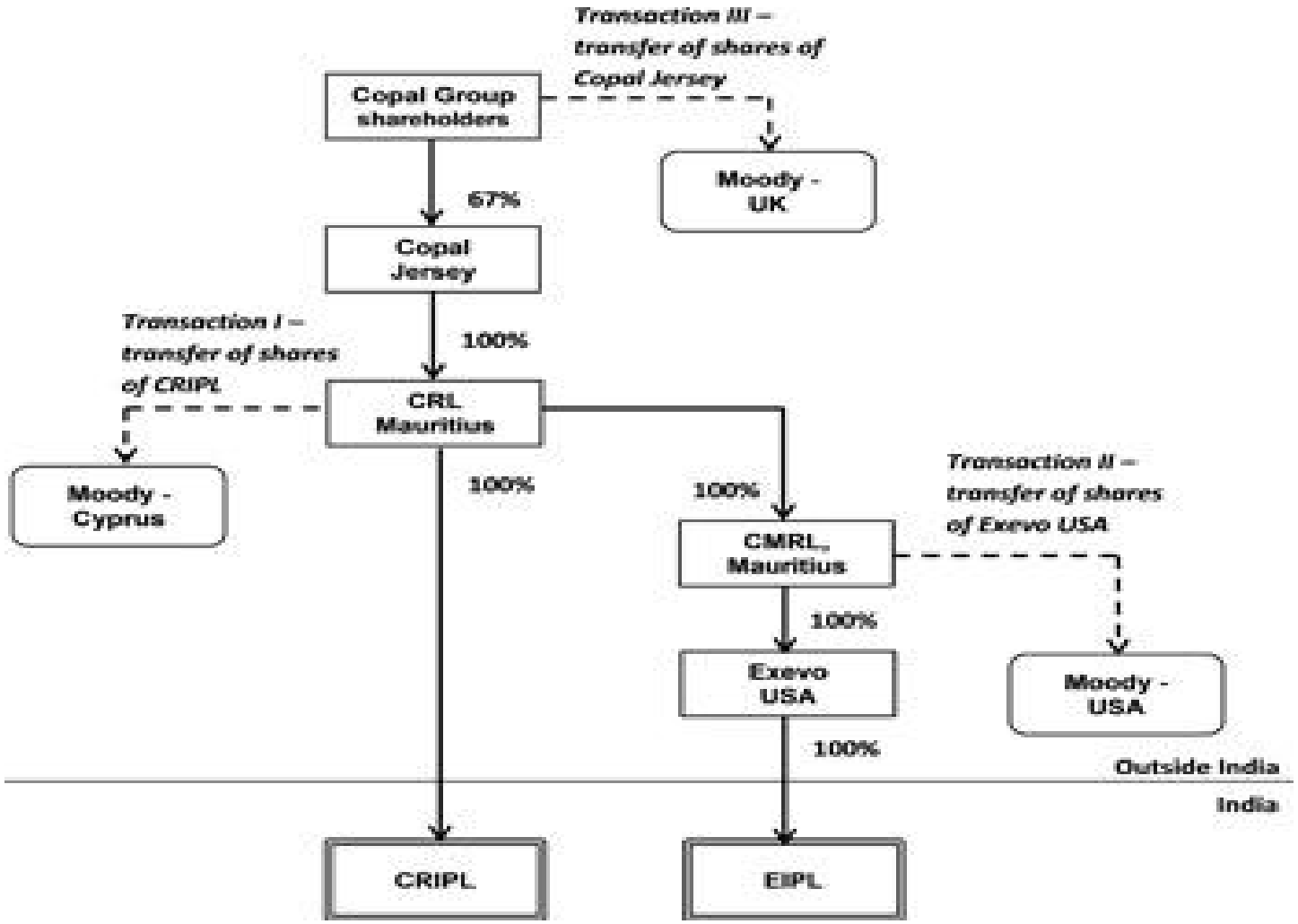
…Indirect Transfer-Background

Corollary amendments

- Explanation inserted in S. 2(14) to clarify that 'Capital asset' includes rights in or in relation to an Indian Company, including any rights of management or control or any rights whatsoever.

- Explanation 2 inserted in S. 2(47) to clarify that 'Transfer' includes disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

Indirect transfer – Substantial value
Copal Research (Delhi HC)



Indirect transfer – Substantial value
Copal Research (Delhi HC)

HC Ruling

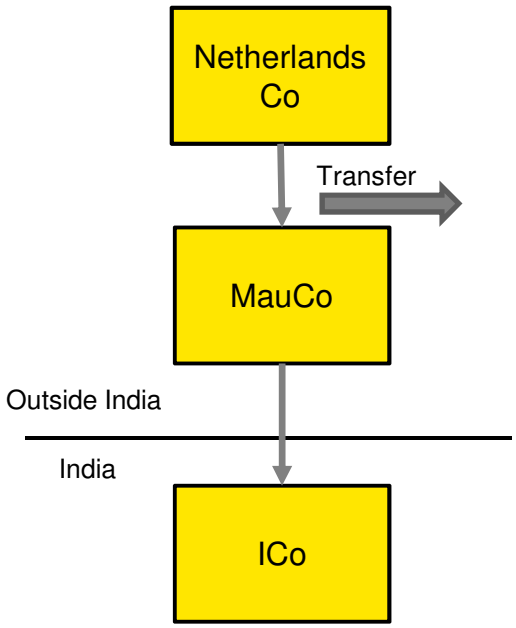
- - Each transaction I, II and III had independent consideration and commercial rationale,

- - Transactions not structured for tax avoidance – if 67% stake in Copal Jersey was transferred than Moody Group would not have achieved 100% holding in Indian Cos

- - Copal Jersey does not derives substantial value from India assets as it is only 30.5%

- - In view of OECD commentary, gains from sale of shares deriving <50% value from India assets would not be taxable in India

Indirect Transfer-Background



- Indirect transfers protected under certain tax treaties – will continue
- Treaty with UK or USA does not provide any special relief to a taxpayer in respect of capital gains income
- If shares of the Mauritius company are sold to a non-resident, the transaction would not be taxable in India, under the India-Netherlands tax treaty

FA 2015 amendments - Snapshot

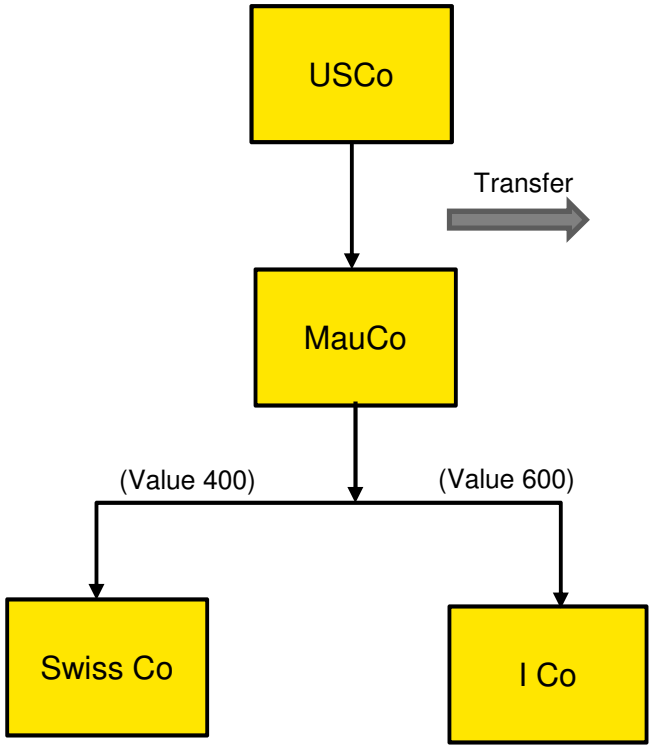
- FA 2015 intends to address concerns raised by various stakeholders…

  - Explanation 6 – Explains “substantial”, provides for substantial threshold limit
  - Explanation 7(b) – Provides for proportionate basis of taxation
  - Explanation 7(a) – Small shareholder exemption (10%)
  - S. 47(viab)/(vicc) – Exemption on amalgamation/demerger
  - S. 285A – Reporting obligation on Indian concerns
  - S. 271GA – Penalty for failure to report – 2% or INR 5,00,000

Indirect transfer, specified date - Explanation 6

- Value derived substantially from Indian assets, if as on *"**specified date**"*
  - Value of assets located in India, directly or indirectly, owned by company/entity whose shares/interest are transferred > INR 10 Cr **and**
  - Value of assets located in India is at least 50% of the value of all assets owned by the company/entity whose shares/interest are subject of transfer
- What is "specified date"?
  - In general, the end of the "accounting period" of F Co **preceding** the date of transfer.
  - **Date of transfer** if book value of assets of F Co as on date of transfer **exceeds** book value at preceding year end by 15%
    - Preceding year end if book value as on date of transfer is less than the date of transfer
    - To determine whether 15% value threshold is breached, requires preparation of balance sheet as on transfer date

Proportionate Tax – Explanation 7(b)



- Sale of shares of Mau Co - Since MauCo share derives 50% value from India assets, indirect transfer of shares of MauCo is chargeable to tax
- Taxation in proportion to value of Indian assets
  - "Reasonably attributable to assets located in India and determined in such manner as may be prescribed"
  - If value of Indian assets say is 600, then roughly, 60% of capital gain made on transfer of shares in Mau Co

capital gains on indirect trasfer for past years taxable on a proportionate basis? – CIT vs Vatika Township P Ltd (367 ITR 466)

Indirect transfer - process in a nutshell

- Step 1:
  - Determine 'specified date' on basis of book value of assets of Foreign Company / Foreign Entity of which shares / interest are being transferred ()
- Step 2:
  - Determine if FMV of India located assets (without liabilities) exceeds > INR 10 Cr **and** ≥ 50% of FMV of all assets of FCo/FE as on specified date, as determined in Step 1
- Step 3:
  - If test of Step 2 fulfilled, amount reasonably attributable to assets located in India to be determined in the prescribed manner

Above exercise redundant

- If no tax trigger for certain excluded (exempt) transactions; e.g. Small value or small shareholder exclusion
- In case of exemptions for amalgamating / demerging foreign company subject to fulfillment of specified conditions

Indirect transfer – Some Issues

- Computation on Specified date
- Value of assets – without reduction of liabilities(?)
  - What is the “asset” – Undertakings, business, specific Fixed Assets, Current Assets.
- Small shareholder exemption:
  - Holding together with associates (very broad definition)
  - Indirectly owned assets in India.
- Reporting obligations on Indian Company
- Explanation 4 vs. Explanation 5

Royalty - Software

Royalty - Software

Section 9(1) (vi) - Extracts

"income by way of royalty payable by –

(*b*) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India."

Explanation 2 to Section 9(1)(v) – Extracts

"For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work…"

Samsung Electronics – Karnataka HC judgment [(2012) 345 ITR 294]

Facts of the case:

- Assessee imported shrink-wrapped computer software from non-resident suppliers for: distribution, use in business

- No tax was withheld on the ground that the same is not royalty either under the Act or under DTAA

Department's contention:

- The assessee was granted license to 'use' the copyright work in which the copyright vests with the NR – licence to 'use' amounted to use of copyright.

- Payments are made for 'use' of computer program and would fall within the definition of royalty under the Act as well as DTAA

Samsung Electronics – Karnataka HC

High Court's observations:

- As per agreements with NRs, only license to use the copyright belonging to NR is transferred, - NR continues to be the owner of copyright

- What is transferred is right to use a copy of the program for internal business, by making copies and back-up copies. **In the absence of such license, such act would have constituted infringement**. Therefore, such licence would itself amount to use of copyright under the provisions of the Copyright Act.

- Contention that there is no transfer of any part/ whole of copyright and that the transaction only involves sale of the copy of the copyrighted program, not acceptable

- Therefore, the program payments constitute 'royalty' both under DTAA, and under the broader definition of the Act.

Ericsson Radio AB–Delhi HC [(2012) 204 taxmann 192 (Del)]

Facts of the case:

- The assessee (Ericsson Radio Systems A.B.) - a company incorporated in Sweden - supplied various hardware and software, used in the business of rendering telecommunication services, to various cellular operators

Department's contention:

- Sale of software would attract royalty as right to use the software amounted to 'copyright' and was vested with the Indian Company purchasing the hardware and software.

Ericsson Radio AB–Delhi HC [(2012) 204 taxmann 192 (Del)]

High Court's observations:

- For a payment to qualify as royalty - necessary to establish transfer of all or any rights in respect of copyright of a literary ,artistic or scientific work – As per copyright Act – computer programme is to be regarded as 'literary work'

- For payment to be considered as royalty – necessary to establish that the cellular operator, obtains all or any of the copyright rights of such literary work

- Mere right to use software is not a copyright right

- Lumpsum Payment is not covered under DTAAs

  - Payment has to be dependant on use of copyright

- Software when put into media and sold is akin to goods and cannot be treated as royalty

Quick recap of key provisions

- Retrospective amendments to Section 9(1)(vi) introduced by Finance Act 2012

Explanation 4

For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred

These explanations were introduced to put to rest the on going litigation on interpretation of some aspects of the definition of royalty

Quick recap of key provisions

- Retrospective amendments to Section 9(1)(vi) introduced by Finance Act 2012

Explanation 5

For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—
(a) the possession or control of such right, property or information is with the payer;
(b) such right, property or information is used directly by the payer;
(c) the location of such right, property or information is in India.

These explanations were introduced to put to rest the on going litigation on interpretation of some aspects of the definition of royalty

TDS on royalty payments for software CBDT Notification – Applicability to Sec.194J

No deduction of tax is required to be made on payment by a person for acquisition of software from another person, being a resident, where-

(i) The software is acquired in a subsequent transfer and the transferor has transferred the software without any modification,

(ii) Tax has been deducted:

(a) under section 194J on payment for any previous transfer of such software; or

(b) under section 195 on payment for any previous transfer of such software from a non-resident, and

(iii) The transferee obtains a declaration from the transferor that the tax has been deducted either under sub-clause (a) or (b) of clause (ii) along with the PAN of the transferor

Open issues:

- Can non-discrimination clause be invoked by a non-resident ?

Royalty – Software - Some Issues

- Does Explanation 4 have the effect of overriding Delhi High Court in Ericsson's case

- Considering conflict between Karnataka and Delhi high Courts, can Assessee's (other than in Karnataka) safely follow Delhi High Court.
  - Solid Works Corporation [(2012) 51 SOT 34]
  - Sonata Information Tech Ltd. [(2013) 55 SOT 455]

    Vs.
  - Reliance Infocom Ltd. [(2014) 64 SOT 137]

- Practical difficulties in complying with Sec. 194J

Place of Effective Management ('POEM')

POEM-Case

- In the case of Radha Rani Holdings (P) Ltd (2007) (16 SOT 495), the Delhi Tribunal adjudicated on the residential status of a company based on the following facts:
  - The company was incorporated in Singapore and had a valid tax residency certificate
  - 99% shares of such company were held by a resident in India who was also a director of the company;
  - Board meetings of such company were held in Singapore
- The Tribunal held that the company is a non resident company since the whole of its control and management of its affairs was not in India

The above ruling was prior to the introduction of the POEM concept

POEM-Meaning

- Concept of POEM substituted current test of residency

- As per the Finance Act 2015, a company would be resident if:
  - it is an Indian company; or
  - its **place of effective management** in that year is in India

- Further, an explanation has been provided to define POEM in line with OECD

  "*For the purpose of this clause "place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.*"

POEM- Purpose, Cosequences

- If POEM is in India, income of foreign company would be taxable in India
- Concept of POEM :
  - Aligns the ‘residency’ concept with international standards (Article 4(3) of OECD Model Commentary); and
  - Targets the shell companies which are registered outside India in low tax jurisdictions

POEM-Key Factors

- Some of the key factors relevant for determining POEM as per OECD:
  - where the meetings of its board of directors or equivalent body are usually held;
  - where the chief executive officer and other senior executives usually carry on their activities;
  - where the senior day-to-day management of the person is carried on;
  - where the person's headquarters are located, which country's laws govern the legal status of the person;
  - where its accounting records are kept

POEM- Some Issues

- Some of the issues arising due to POEM concept:
  - Real authority – not with directors/ shareholders;
  - Disaggregated decision making – multiple locations;
  - Distinction between management and operational decisions;
  - Proving/ establishing decision making authority;

- Multi-national groups who have standard policies and where business is carried on under the same brand name may have adverse tax implications if they have Indian residents on the board of directors providing management services to the foreign company

- Would adversely affect outbound structures where resident Indian act as directors

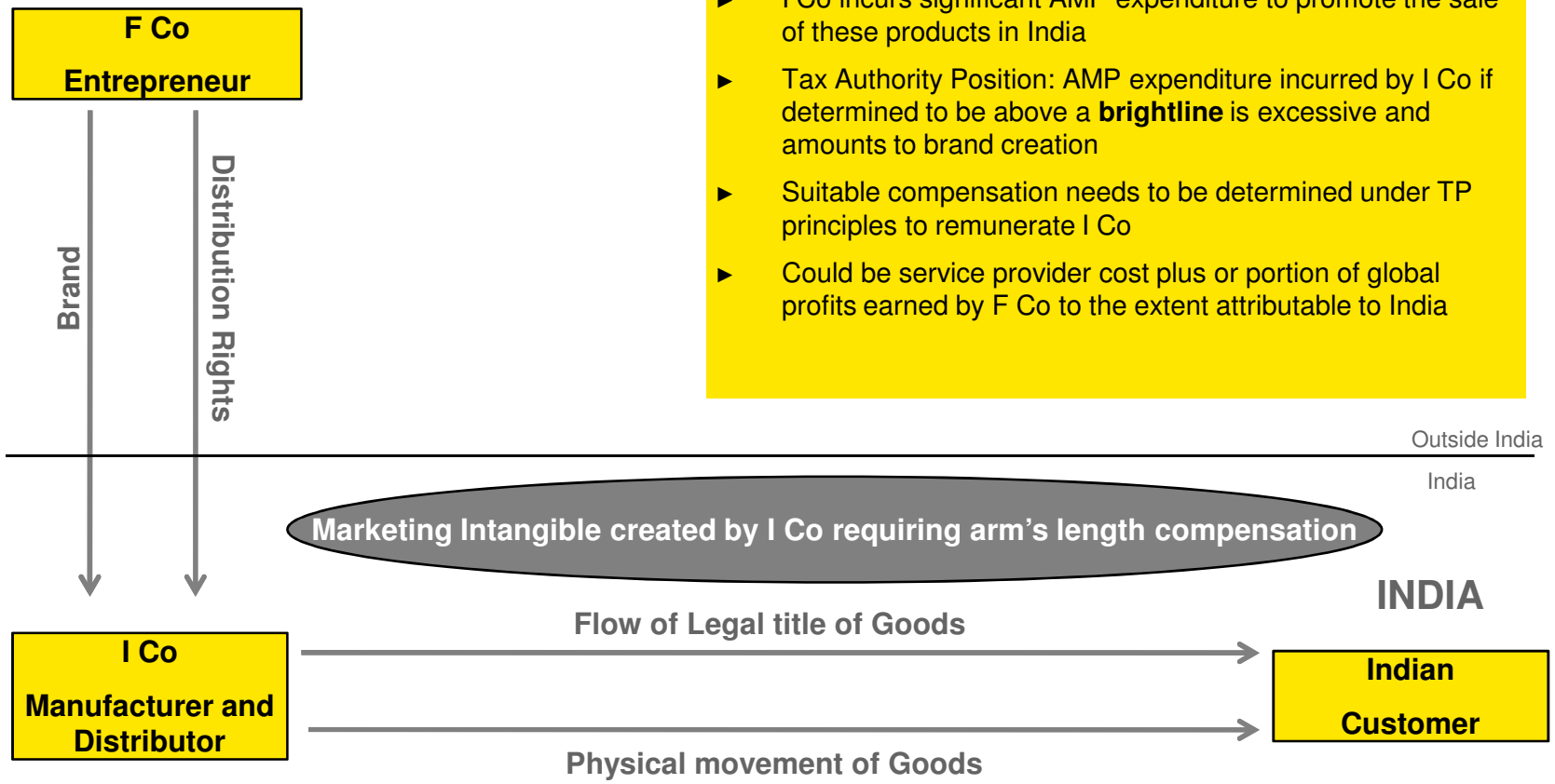
Test of residence-International viewpoint

Country	Residency Test
Brazil	Companies incorporated and managed in Brazil
China	POEM is an establishment that exercises, in substance, overall management and control over the production and business, personnel, accounting, properties, etc. of an enterprise
South Africa	The place where 'real' Board of directors actually make decisions on important business affairs of the company and not where the decisions are merely rubber stamped.
UK	Place where de facto central management and control exists. Shadow directors who actually control and influence the directors in the running of the business of the company are regarded as actual directors

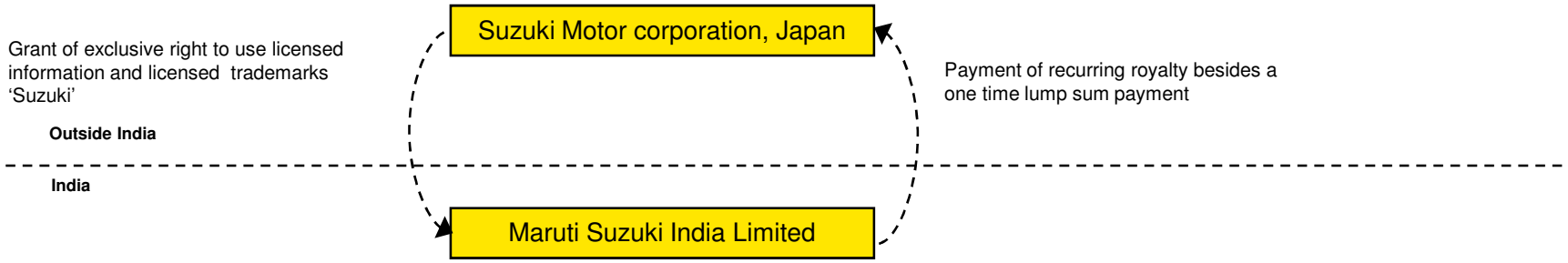
Transfer pricing – Marketing Intangibles

Marketing Intangibles – General Dispute

- F Co owns the brand
- I Co distributes the products of F Co in India
- I Co incurs significant AMP expenditure to promote the sale of these products in India
- Tax Authority Position: AMP expenditure incurred by I Co if determined to be above a **brightline** is excessive and amounts to brand creation
- Suitable compensation needs to be determined under TP principles to remunerate I Co
- Could be service provider cost plus or portion of global profits earned by F Co to the extent attributable to India



Marketing Intangibles – Trigger in India



- AMP expenditure held by revenue as creating "marketing intangible" by contributing to brand promotion of "foreign owned" brand
- Maruti India, even if not the "legal owner", held to be the local "developer" of trademark
- Maruti India should be compensated by Suzuki Japan for the brand development activity, compensation may be by way of:
  - reimbursement of "excess AMP expenses" – determined on the basis of the bright line test espoused by the US Court in the case of DHL Inc
  - reduced purchase price for Maruti India
  - lower royalty rate

Gaining brand recognition for itself with Maruti-Suzuki in four wheeler segment, Suzuki launched 2 wheelers under its own brand without coalition with Indian brands (ie Maruti). Here, one could think of Marketing intangible created by Maruti-Suzuki for Suzuki brand

Judicial Precedents

- M/s LG Electronics India Pvt Ltd vs ACIT - (2013) 152 TTJ 273 (Del – Tribunal SB)
  - ITAT upheld the tax departments contention and applicability of Bright –Line test

- Sony Ericsson Mobile Communications India Pvt. Ltd vs CIT (TS-96-High Court-2015(DEL)-TP) (Delhi HC)
  - Brand creation depends on a number of factors and not confined to advertisement and sales promotion.
  - Economic ownership of brand & marketing intangibles, is an important factor for determining the pricing mechanism of distributors, having long term distribution licenses, overturning the ruling of the Special Bench.
  - HC upheld that AMP expenditure is an international transaction.
  - For comparability analysis, the key factors are characteristic of property or services transferred; functions performed, assets employed and risk assumed.
  - AMP expenses can be aggregated to other transactions and where aggregated, it would be illogical and improper to treat AMP expenses as a separate international transaction, since AMP expenses have been duly accounted for.
  - AO / TPO can resort to de-bundling the transactions, when bundled transactions cannot be adequately compared on aggregate basis.

Judicial Precedents - contd

- The AO/TPO can de-bundle but only after elucidating grounds and reasons for not accepting the bunching adopted by the assessee

- The ***'bright line test' has no statutory mandate*** and a broad brush approach is not mandated or prescribed.

- ***Direct marketing and selling expenses*** or discounts/ commissions would not be a part of AMP expenses

- Cost Plus Method can be applied by the AO/TPO in case AMP expenses are treated as a separate international transaction – TNMM cannot be applied

ITAT Ruling in the case of Toshiba India (P) Ltd (ITA No. 1101/DEL/2015)

- ITAT held examination of AMP functions carried out by the Assessee and probable comparables is sine qua non in the process of determination of ALP of international transactions.
- States if TP adjustment of AMP expenses is deleted without examination of AMP functions carried out by the assessee and comparables, 'this will ***amount to snatching away the tag of international transaction from AMP expenses, assigned by the Hon'ble High Court.'***
- On Bright Line Test, ITAT stated that ***'it primarily concentrates on the quantitative aspects of the AMP expenses alone and overlooks the examination of AMP functions carried on by the assessee and the comparables.'***
- The ITAT further observes that:
  - AMP functions carried on by the assessee and the comparable companies should be examined;
  - In case of functions being different, suitable adjustment to be made in the case of probable comparables, so as to make it uniform with the assessee;
  - If no proper comparable survives, TNMM should be discarded and any other suitable method should be applied for determining ALP.

Perfetti Van Melle India Pvt Ltd (ITA No. 407/DEL/2015) - Manufacturer

- For a manufacturer, no adjustment should be made on account of AMP expenses because such expenses stand subsumed in the overall operating profit.
- ITAT held that AMP is international transaction even in case of manufacturers
- HC ruling is in case of distributors and cannot be completely relied upon in case of manufacturers
- ITAT observes that:
  - TNMM is not appropriate and proper in case of assessee engaged in manufacturing activities
  - The core of the above para is that in the case of a `Manufacturer', the international transactions concerned with the manufacturing activity cannot be aggregated with the AMP activities as both are separate and distinct
- ITAT held that: "

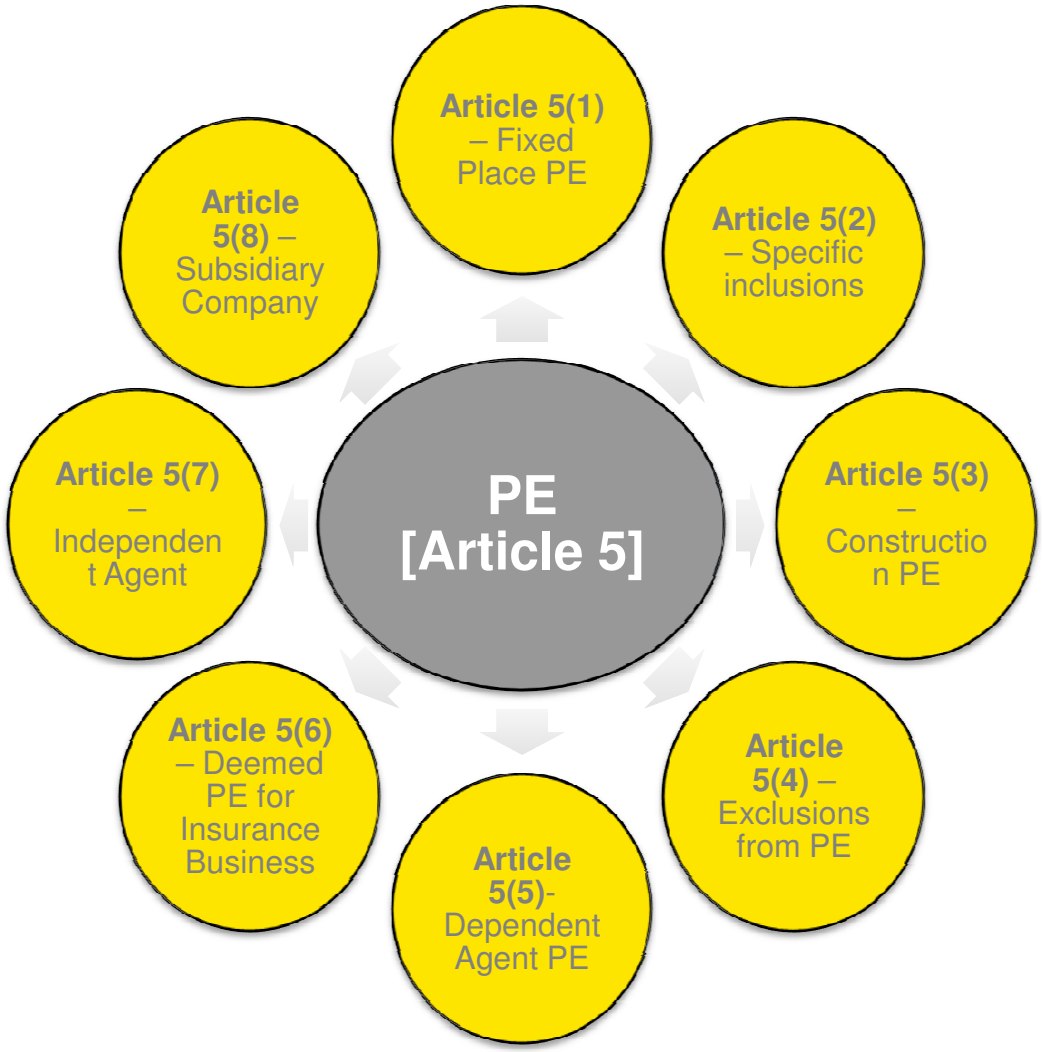
"In this fresh exercise, the TPO will follow the parts of the judgment in Sony Ericson (supra) as are common to both Manufacturers and Distributors; apply the parts of the judgment as are applicable to a `Manufacturer'; and ignore the parts of the judgment which pertain exclusively to a `Distributor'."

What Next…?

- Whether the Tribunal would decide based on the facts available, or remand back to the AO, in open cases before it – already started remanding back (Refer Toshiba case).
- What is likely to be TPO's strategy for ongoing assessments and for cases remanded by ITAT
- How to quantify the value of international transaction, once the Bright-line test ("BLT") has been discarded?
- How to compare and subsequently defend the functional comparability (intensity of AMP function) of the taxpayer with comparable companies, other than by application of BLT ?
- How to defend that the transactions are closely linked, and should not be unbundled?
- In case the TPO unbundles the AMP transaction from other transactions, whether he should allow any excess revenues/ profits from the other transactions, to set-off against the AMP costs, and then apply the BLT.
- Whether AMP expenditure should be reported in Form 3 CEB?

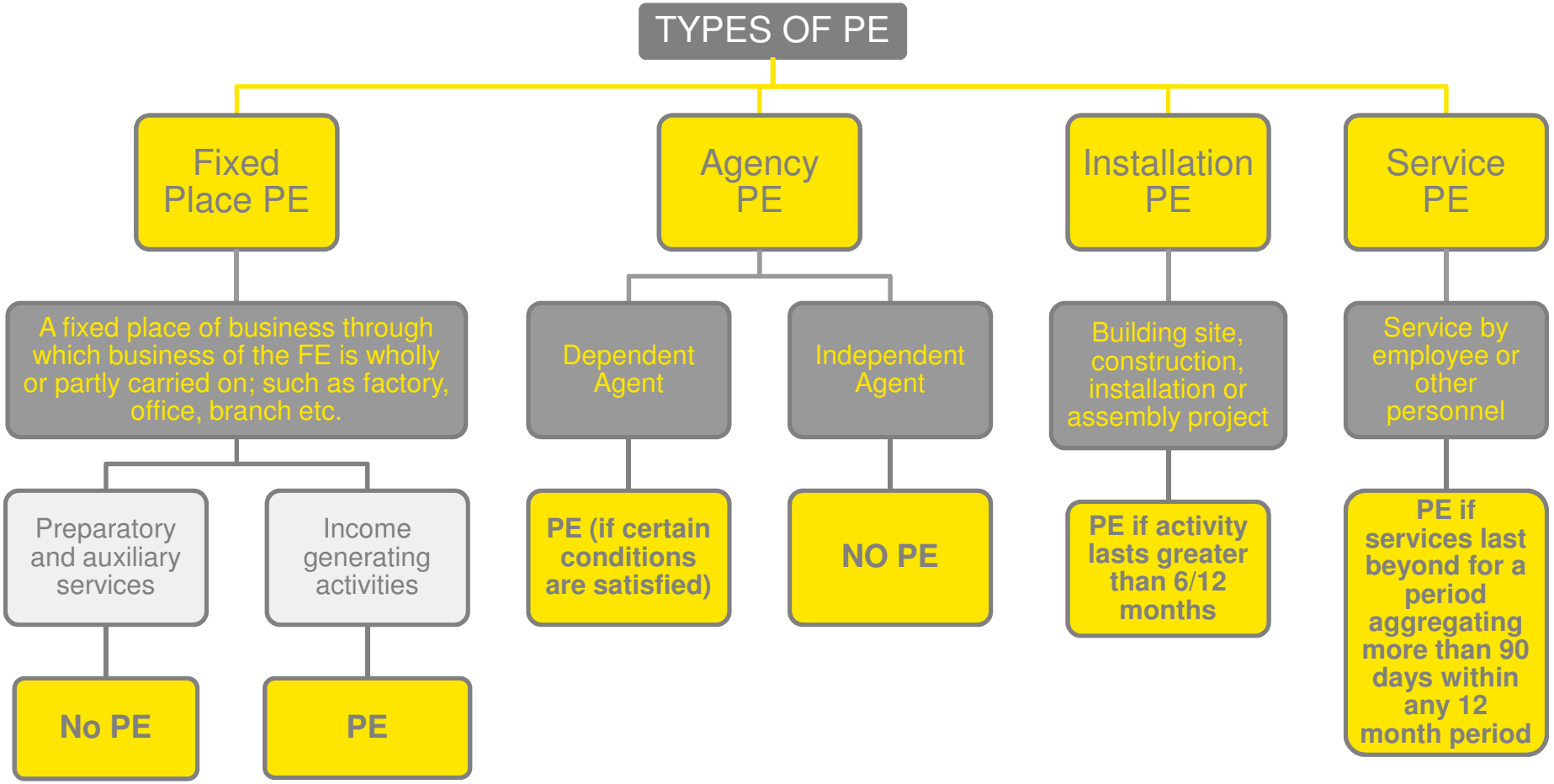
Permanent Establishment – Case studies

Structure of Article 5

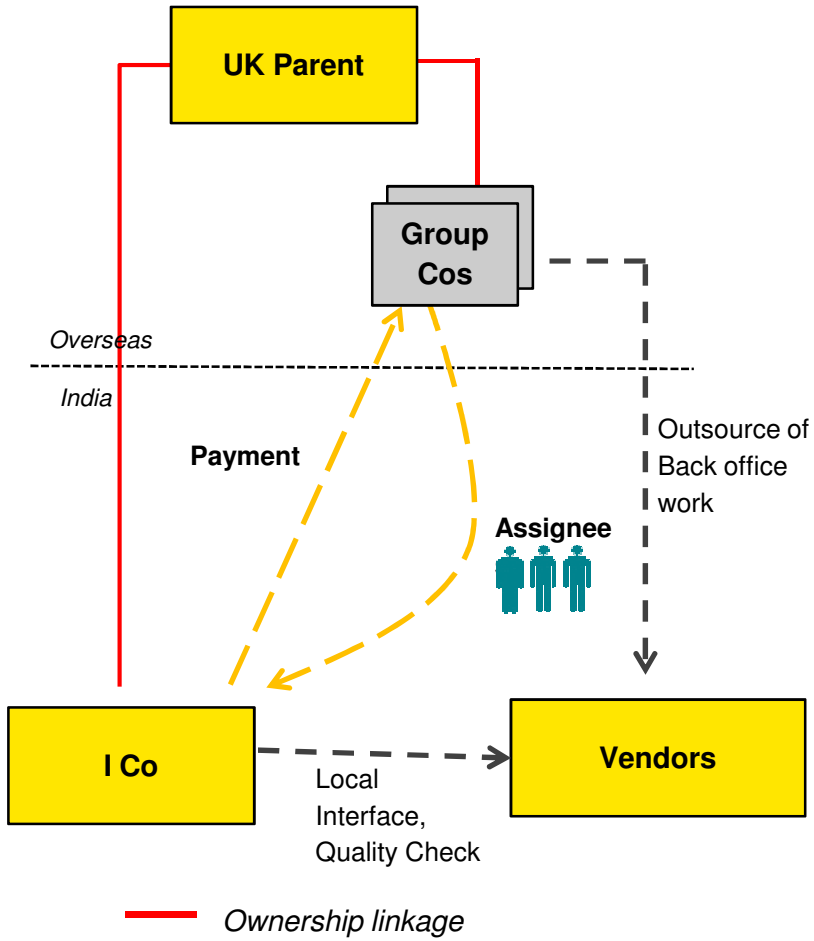


- ✓ **Article 5(1)** Basic Rule for PE (Fixed Place PE)
- ✓ **Article 5(2)** Specific inclusions
- ✓ **Article 5(3)** Construction PE
- ✓ **Article 5(4)** Exclusions from PE
- ✓ **Article 5(5)** Dependent Agent PE
- ✓ **Article 5(6)** Deemed PE for Insurance Business
- ✓ **Article 5(7)** Independent Agent
- ✓ **Article 5(8)** Subsidiary Company

Types of PE


TYPES OF PE
Fixed Place PE
A fixed place of business through which business of the FE is wholly or partly carried on; such as factory, office, branch etc.
Preparatory and auxiliary services
No PE
Income generating activities
PE
Agency PE
Dependent Agent
PE (if certain conditions are satisfied)
Independent Agent
NO PE
Installation PE
Building site, construction, installation or assembly project
PE if activity lasts greater than 6/12 months
Service PE
Service by employee or other personnel
PE if services last beyond for a period aggregating more than 90 days within any 12 month period

Case study 1



Background and facts of the case

- I Co and Group Cos were subsidiaries of UK Parent.
- Group Cos outsourced back office support functions to third party vendors in India. I Co was required to act as a local interface with Vendors in India.
- Since I Co was newly incorporated, it needed the knowledge of processes and practices of the Group Cos. For the purpose, Group Cos seconded some Assignees with knowledge and experience to work with I Co in India.
- Salary disbursed overseas by Group Cos and it was recovered monthly from I Co

Issue

Tax treatment of the payments made by I Co to Group Cos and whether Group Cos had a PE in India?

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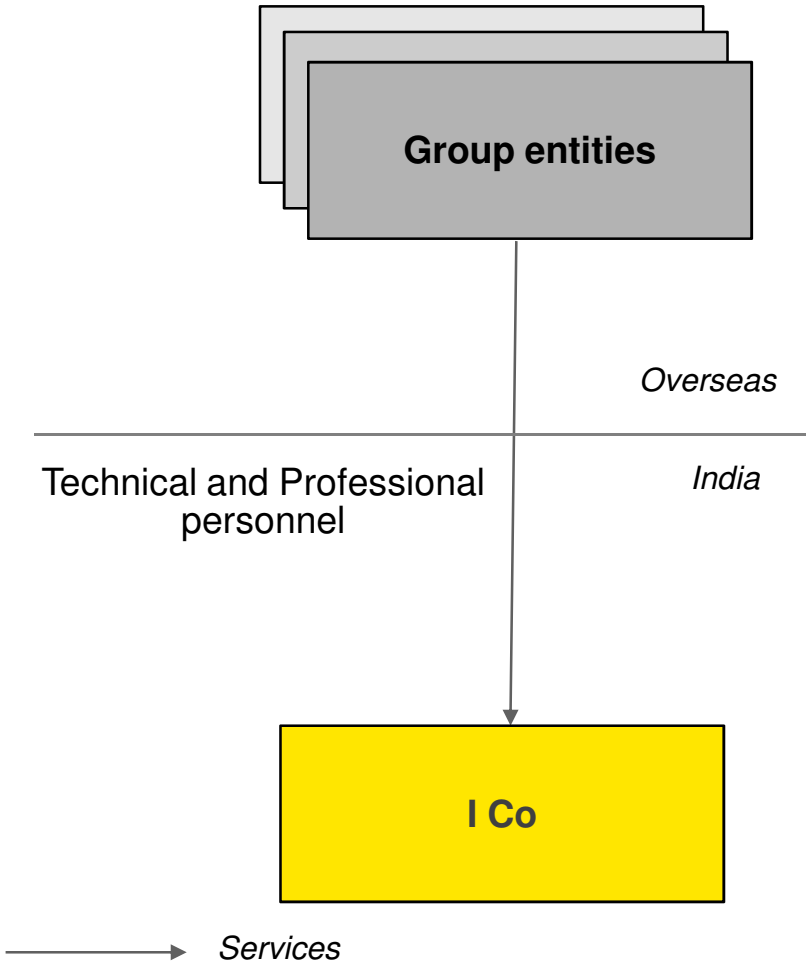
Case study 2



Background and facts of the case

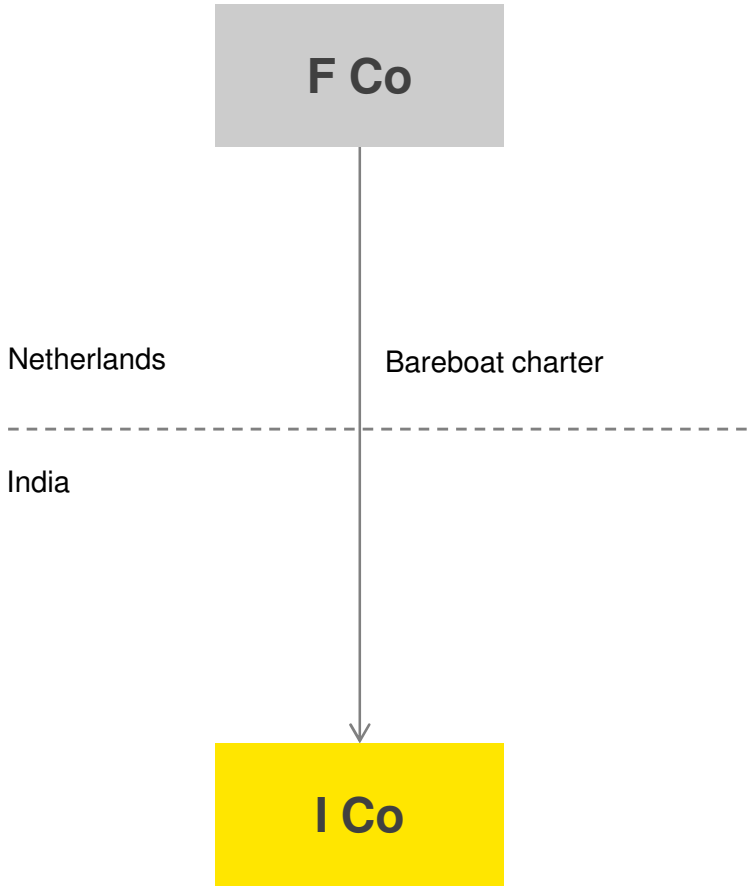
- Group entities provided as well as availed of services from each other with the intention of optimizing its global business network and expertise
- All projects won by the Group entities were catered to by a common pool of personnel.
- Certain Group entities received payments from I Co for provision of technical and professional personnel (personnel)

Issue

- Whether fee received by Group entities qualified as FTS or business profits?
- Whether Group entities had a PE in India ?

Booz & Co. Group
[TS-76-AAR-2014]

Case study 3



Background and facts of the case

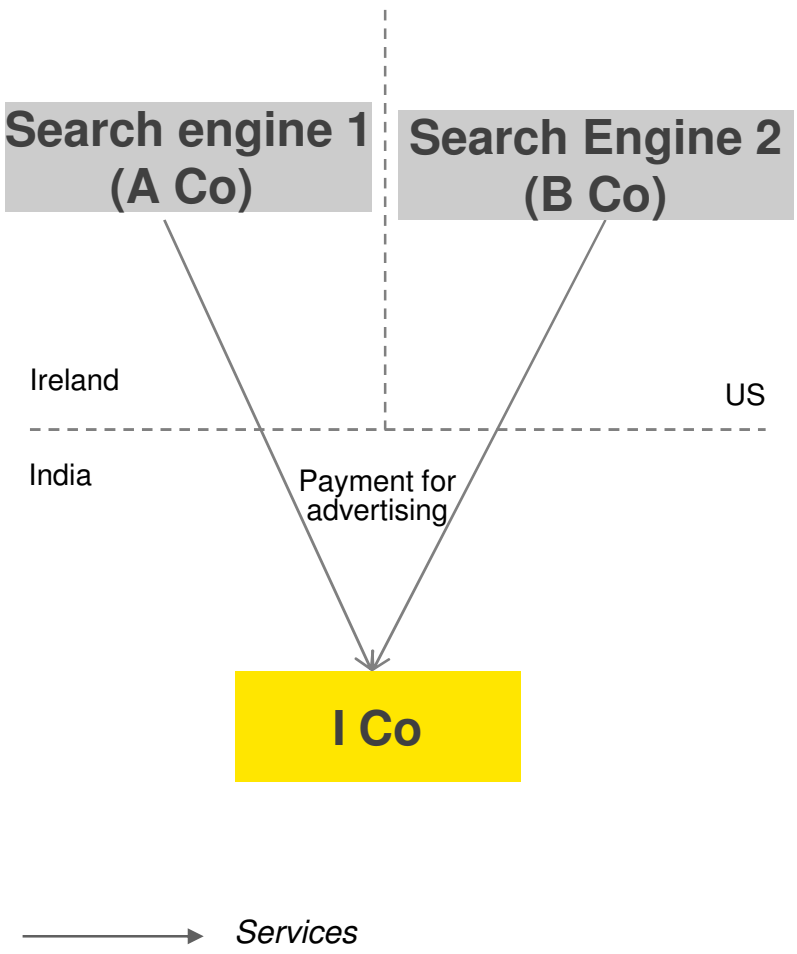
- F Co is a company incorporated in Netherlands,
- F Co entered into an agreement with its group company in India, I Co to let out dredging equipment to it
- The leasing contract is limited to bare leasing of equipment, i.e. the equipment is let out on bareboat basis
- Control over the equipment lies entirely with I Co

Issue

- Whether the leasing of dredging equipment by F Co would create a PE in India?

Commissioner of Income-tax, Chennai v. Van Oord ACZ Equipment BV [2015] 273 CTR 548 (Madras)

Case study 4



Background and facts of the case

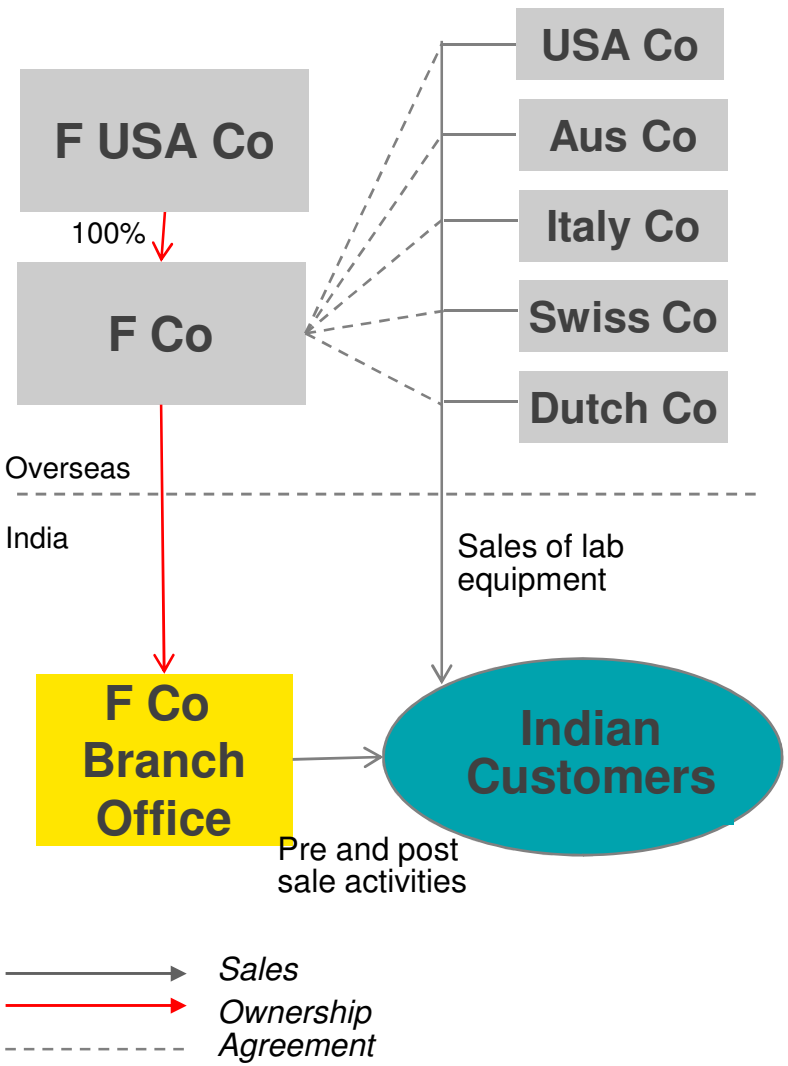
- I Co (Taxpayer), used search engines of for advertising its business
- Payments were made to A Co Ireland and B Co US, for displaying the Taxpayer's advertisement when certain key terms were used on such search engines

Issue

Whether A co/ B Co have a taxable presence in India?

Right Florist Pvt Ltd
[2013] 154 TTJ 142 (Kolkata Trib.)

Case study 5



Background and facts of the case

- Assessee was Indian branch of an American company F Co which in turn was a 100 per cent subsidiary of F USA Co
- The group had five overseas entities in USA, Australia, Italy, Switzerland and Netherlands
- F Co entered into distribution and representation agreement with all five overseas entities for supply and sale of analytical lab instruments manufactured by them to Indian customers directly
- As per agreements, overseas entities sold analytical lab instruments to Indian customers directly and Assessee carried out pre-sale activities like liasoning and other incidental post-sale support activities for which it was entitled to commission

Issue

Whether the assessee-company, i.e., F Co through its Indian branch, constituted a PE for USA Co, Australia Co and Italy Co ?

Varian India (P.) Ltd v. ADIT (International taxation) [2013] 33 taxmann 249 (Mumbai - Trib.)

Overlap between Article 5(1) and Article 5(3)

- Article 5(3), being a specific provision dealing with construction/ supervisory activities should prevail over Article 5(1)/ 5(2) which is general in nature
- Accordingly, once Article 5(3) is attracted, even if it does not constitute a PE due to non fulfilment of threshold limit, application of 5(1) is excluded
- However, in case Article 5(3) is not applicable at all, then the PE trigger would need to be tested under Article 5(1) i.e. the fixed base PE rule
- These principles govern that construction PE under Article 5(3) overrides Article 5(1)
  - The above principles should apply in case of **service PE** also.

Illustration : If a project office is opened for the purpose of undertaking an construction project/ supervisory activities and the duration of such project does not exceed the threshold prescribed under Article 5(3), then such office would not constitute a PE

GIL Mauritius Holdings Ltd v. ADIT [ITA No. 5686(Del)/2010]