

Recent International Tax Decisions

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Sony India 288 ITR 52 (Del.)

Facts of the case

- A, India, WOS of B, Japan was engaged in manufacture and distribution of electronic goods
- TPO passed an order under section 92CA(3) in respect of exports made by A to B
- The AO passed the assessment order after allowing an opportunity of hearing, adding the transfer pricing adjustment made by the TPO to the income of A

Issues before the Court

- Validity of Instruction No. 3 of 2003 dated 20th May, 2003 to the extent it requires compulsory reference by AO to TPO where the aggregate value of international transactions exceeds Rs. 5 crores
- Consequent setting aside of the assessment order

Arguments of the assessee

Instruction No. 3 of 2003 is invalid because:

- Classification of international transactions into those of value exceeding Rs. 5 crores is not based on intelligible differentia
- Instruction issued by the CBDT is ultra vires the Act
- Instruction takes away the discretion granted to the AO by section 92CA of the Act
- Instruction seeking to supplant the TPO cannot be permitted as the TPO is not bound to follow the steps outlined in section 92C (1) to (3)

Concession by the assessee

- If it is clarified that the TPO is bound to follow the steps envisaged by section 92C (1) to (3) then the assessee would not press points (a) to (c) in the earlier slide
- Revenue also agreed that TPO is bound to follow the steps envisaged by section 92C (1) to (3)

Propositions laid down by the Court

- CBDT can prescribe the method to be applied and the manner of its application for computation of ALP de hors the powers conferred by section 119
- Power to make reference to TPO not to be exercised mechanically but on objective criteria

Propositions laid down by the Court

Procedure to be followed by AO/TPO to determine ALP:

- AO not required to form an opinion under section 92C(3) before he makes reference to TPO
- AO only required to form a prima facie opinion
- TPO expected to perform the exercise envisaged in section 92C(3)
- AO to give an opportunity to the assessee after receiving the report of the TPO
- The report of the TPO is not binding on the AO

Propositions laid down by the Court

- Classification in the Instruction is based on an objective intelligible differentia
- Classification is not ultra vires the Act
- Classification acts as a guideline to the AO in the exercise of his discretion and is helpful to ensure that the discretion will not be abused

Issues which require consideration

- Whether CBDT can issue Instruction # 3
- Whether the conditions in section 92C must be fulfilled by the AO himself before TPO can proceed to determine ALP under section 92CA
- Other issues arising out of the Decision

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Dredner Bank AG 105 TTJ 149 (Mum.)

Facts of the case

- D is a non-resident bank incorporated in Germany (GE) and operating in India through its branch office in Mumbai (PE)
- Inter branch interest (income) charged by PE was excluded by GE in arriving at its total income in India

Issue before the Tribunal

- Whether interest receivable by PE of the assessee from its head office / other branches is 'income' liable to tax in India
- Since the Bank did not seek treaty protection, would the interest come within the scope of 'total income' under the provisions of the Income-tax Act

Propositions laid down by the Tribunal

- The taxable unit under the Act is the foreign company and not its branch or PE in India
- The foreign company could be taxed only on such income which accrues or arises in India
- This would involve artificial division of overall profits of GE between profits earned in and outside India
- This can be done only by treating the Indian PE as a fictionally separate profit centre

Propositions laid down by the Tribunal

- Intra-organisation transactions can be ignored only when profits of the organisation as a whole are to be computed or when these transactions fall within one tax jurisdiction
- Tax credit will be available in GE state in respect of the tax paid in PE state
- In any case, tax authorities of PE state are not concerned with the availability of tax credit in GE state

Propositions laid down by the Tribunal

- Substance over form approach - subsidiary v. PE
- Application of treaty and accountancy principles
- Matching of expenditure with income
- Cherry-picking between Act and Treaty not allowed

Issues which require consideration

- Separate entity approach under the Act
- Position of Betts Hartley Huett & Co. Ltd. 116 ITR 425 (Cal) vis-à-vis Tribunal's decision
- Position of ABN Amro Bank NV 97 ITD 89 (Kol. – SB) vis-à-vis Tribunal's decision
- Effect of Transfer Pricing provisions on the principle laid down by the Tribunal
- Section 90(2) – Cherry picking between Act and Treaty

Rajiv Malhotra 284 ITR 564 (AAR)

Facts of the case

- Mr. M organises shows in India
- FCo appointed for planning, directing and executing the sales campaign
- FCo rendered the entire services in France
- Commission was payable to FCo outside India within 30 days of the exhibition or the exhibitor making payment to M whichever was later

Issue before the Authority

Whether FCo would be liable to tax in India in this case where the services are rendered outside India for which the payments are also received by them outside India

Conclusion reached by the Authority

- Under the Income-tax Act
 - Commission accrues or arises to FCo in India under section 5(2)(b) r. w. s. 9(1)(i) since the “source of income” namely participation by the exhibitors in the show is in India
- Under the DTAA between India and France
 - Commission will be governed by article 23

Issues which would arise

- Under the Income-tax Act
 - Scope of total income – confined to accrual or arisal or deemed accrual or arisal in India
 - Business connection or Fees for technical services
- Under the DTAA between India and France
 - Business profits Article and FTS Article – not considered!!

BON APETIT !!