NEWSLETTER

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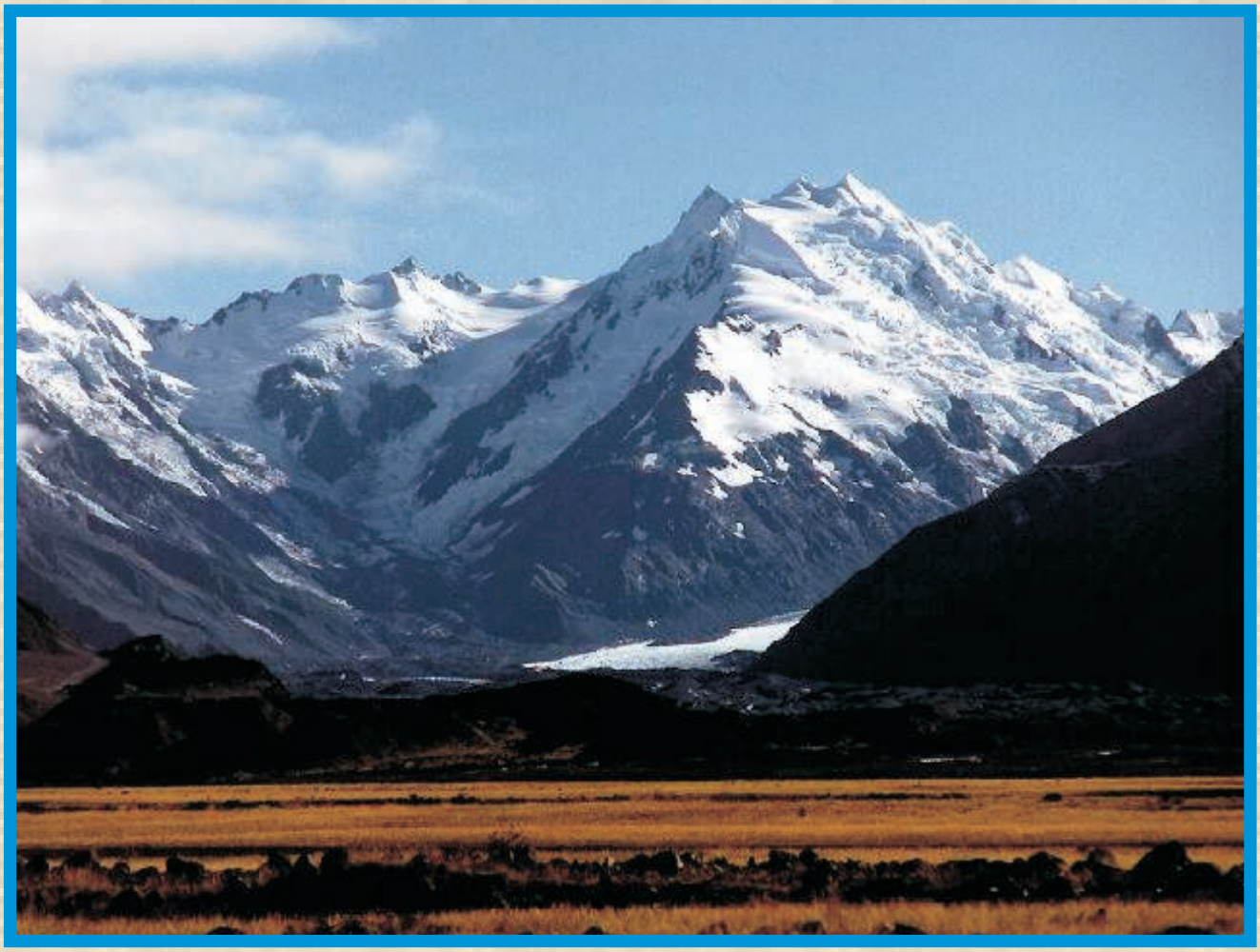

INTERNATIONAL TAX

Bajaj Hindustan Ltd, Mumbai Tribunal, 12th August 2011

Re: Professional fees paid to a foreign consultant for acquiring new business abroad not taxable under the Act as the same is paid for earning future income outside India.

Facts:

- Bajaj Hindustan (The Company) is engaged in the business of manufacture of sugar.
- The Company intends to acquire a sugar mill or distillery plant in Brazil.
- For this purpose, the Company engages services of a foreign Consultant to provide consultancy services.
- The foreign consultant provided following services to the Company:
  - Identify and contact the suitable target Companies.
  - Present information on these Companies.
  - Perform price analysis.
  - Assist the Company in acquisition process.
- Subsequently, the Company set up a subsidiary Company in Brazil to acquire a sugar mill/distillery plant.
- The Company paid professional fees to the consultant without deduction of tax at source under section 195.
- The Assessing Officer (AO) held that the payment made to the Consultant falls is in the nature of "Fees for Technical Services" and did not fall within the exceptions under section 9(1)(vii). Accordingly, the Company ought to have deducted tax at source on such payment and proceeded to treat the Company as taxpayer in default.
- On appeal, the CIT (A) agreed with the contention of the assessee that the payment was made to the non-resident for providing services in a business carried out outside India. Further, the payment could also be considered as made for the purpose of earning income outside India.
- Aggrieved by the decision, the revenue authorities preferred an appeal before the Tribunal.

Issue before the Tribunal:

- Whether the fees paid by the Company could be considered as having paid for the purpose of carrying on business outside India by the Company or earning any income from a source outside India and hence not in the nature of FTS under section 9(1)(vii) of the Act?

Observations and Ruling of Tribunal:

- The Company was exploring possibility of acquiring a sugar mill/distillery plant in Brazil and for that purpose also set up a subsidiary Company in Brazil. Thus, the Company was

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contemplating to create a source of earning income outside India.
- The source of income did not exist at the time of availing such services or making such payments.
- However, there is nothing in the language of Section 9(1)(vii) of the Act which suggests that the source of income should have come into existence for the taxpayer to be covered by the second exception.
- The payment made to a foreign consultant would be covered by the exception ie. For the purpose of earning a future source of income outside India and hence not taxable as FTS under the Act. Accordingly the taxpayer was not liable to withhold tax at source under section 195 of the Act.

Anchor Health and Beauty Care, Mumbai Tribunal, 26th August 2011.

Re: Accreditation fees paid to British Dental Health foundation is neither Royalty nor FTS and in absence of any PE in India, such payment is not taxable in India.

Facts:
- The Company is engaged in the business of manufacturing and trading of tooth powder, tooth paste and other healthcare products.
- The Company paid Accreditation fees to British Dental Health Foundation, UK (BDHF) without deduction of tax at source.
- The Assessing Officer (AO) disallowed the claim of the Company under section 40(a)(i) on the ground that the taxpayer had not submitted any certificate in proof of the amount is not taxable in India and tax has to be deducted at source while remitting payment outside India.
- The CIT (A) deciding the appeal in favour of the Company deleted the disallowance.
- The revenue authorities preferred an appeal before the Tribunal.

Issue before the Tribunal:
- Whether the fees paid to BDHF for accreditation services could be taxable in India?

Observations and Ruling of the Tribunal:
- An accreditation by a reputed body only provides comfort level to the end users of the product and may be used for marketing purpose.
- The accreditation does not allow the accredited product the use or right to use a trademark, nor has any information concerning industrial, commercial or scientific experience been imparted.
- The nature of such payment neither has a character of Royalty nor Fees for Technical services as per the Treaty between India and UK.
- Further BDHF does not have any Permanent Establishment in India and hence the payment made cannot be taxable in India under the head "Business Profits".
- Therefore such payment is not taxable in India.
- The obligation to withheld tax under section 195 arises only when the payment is "chargeable to tax" in India in the hands of non-resident recipient.
- Accordingly the tax payer was not obliged to deduct tax at source under section 195.

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CIT vs. Cargill Global Trading Pvt. Ltd. Delhi High Court

Re: Discounting charges deducted by the associate Singapore Company is not in the nature of interest and no tax needs to be withheld at source on such amount.

Facts:

- The Company was engaged in export business. On the exports being made by the Company, it draws Bills of Exchange on the buyers.
- These Bills are then discounted with its associated Company, Cargill financial Services Asia Pvt. Ltd. (CFSA) which is a Company incorporated in Singapore and engaged in the business of financial services.
- CFSA discounts the bills and remit the funds to the assessee after deducting the discounting charges. Thereafter, it is the obligation of CFSA to release the amounts from buyers.
- CSFA has no Permanent Establishment (PE) in India in terms of Article 5 of the India Singapore treaty.
- The AO took the view that the discounting charges for getting the bills discounted is nothing but interest within the meaning of Section 2(28A) of The Act and since the assessee did not deduct tax on such interest, the same should be disallowed under section 40(a)(i) of The Act.
- On appeal, the CIT (A) held that the discounting charges paid cannot be considered as interest and hence Section 40(a)(i) is not applicable.
- On appeal, the Tribunal agreed with the view of CIT (A). It further observed that the assessee had received the net amount after deduction of discounting charges and in absence of CFSA having any PE in India, the same is not taxable in India and hence no tax was required to be withheld.
- Aggrieved by the order, Revenue preferred appeal before the High Court.

The Delhi High Court observed and ruled:

- For any amount to be construed as interest, it has to be established that the same is payable in respect of money borrowed or debt incurred.
- The Tribunal was right in its observation that the discounting charges paid were neither in respect of money borrowed nor debt incurred. The assessee had merely discounted the sale consideration on sale of goods.
- Circular No. 65 of 1971which clarifies that when supplier of goods makes over hundi to his bank which discounts the same and credits the net amount to the suppliers account without waiting for the realisation of the bill on the due date, the property in the bill passes on to the bank and the collection on the due date by the bank is in its own behalf and not on the behalf of the supplier. Such nature of payment made by the bank is for the price paid for the bill and cannot be considered as interest and therefore no tax needs to be withheld at source.
- In view of the above, the High Court rejected the revenue's appeal and decided the issue in favour of the assessee.

Compiled by Mr. Malay Damania

TRANSFER PRICING

Transfer Pricing Issues in Intra Group Services - Recent developments in India:

In recent years, the appropriate treatment of the intra group provision of services has become a critical transfer pricing (TP) issue. In multinational groups, it is common to arrange for a wide scope of services to be made available to members of the group, particularly:

- Administrative, technical, financial, and commercial services.
- Management, coordination, and control functions for the whole group.

If it is determined for transfer pricing purposes, that services have been provided by one member of a group to other members of that group, arm's length pricing for these intra group services must be established. The issues that arise in this context include justifying that a benefit is anticipated to be or has been obtained from the performance of services and determining that the amount charged is arm's length.

The Indian regulation has prescribed detailed transfer pricing documentation requirements for some inter-company transactions but, no specific guidance has been given for intra-group services. The information/data request made by IT department also states that the arm's length price for the intra group service will be treated as nil if the taxpayer fails to furnish the necessary information. Hence In our opinion, Proper documentation and supporting facts are must in case of intra group transactions.

Sample Document checklist for Intra Group Services/transactions:

- A copy of the inter-company service agreement for providing and receiving the intra group service;
- Information pertaining to the services, including description and uniqueness of services;
- Demonstration of the benefits;
- Details of the cost-benefit analysis undertaken at the time of entering into the inter-company agreement showing expected benefit from the receipt of such services vis-a-vis payment made for the same;
- Copies of time sheet or cost center reports to evidence the provision of service;
- Details of time spent with respect to services rendered to India;

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Transfer Pricing Issues In Intra Group Services-Recent developments in India:

- Quantification of the benefits derived to establish that the services rendered are not shareholder activities" or incidental in nature;
- Organization chart and job descriptions of the staff at the service provider and the recipient to establish that there is no duplication of services;
- Other documents like copies of emails exchanged, minutes of meeting/calls, management reports, periodic activity report, proof of visit, etc., to demonstrate the receipt of services

Indian company needs to substantiate arm's length price by considering various issues such as:

- Is a charge justified relative to the benefits?
- Basis of determination of the service charge whether it is a direct charge or an indirect charge;
- Detailed invoices from the service provider, which should give full details of services provided during the period of contract and confirmation that fee calculation is in accordance with the agreement;
- Details of service charge paid by other affiliates to the affiliate service provider;
- Whether the service provider is providing similar services to an independent party and if yes, the charge rate to such independent party;
- A certificate from an "accountant", if possible, certifying the charged cost and the method of charge allocation among affiliates

Recent Tribunal ruling:

The Bangalore Income Tax Appellate Tribunal (Tribunal), in the case of M/s Gemplus India Pvt. Ltd (Gemplus India), ruled on transfer pricing aspects of management services fees paid by Gemplus India to its regional headquarter company (HQ). The Tribunal held that Gemplus India had not proved the commensurate benefits received for the service fees paid to the HQ and, hence, ruled the payment of the management services was not justified under arm's length principles. The Tribunal, in this case, relied on the underlying documentation of Gemplus India before concluding there were no details available on record with respect to the nature of services rendered by the HQ to Gemplus India.

Suggested Approach:

In our opinion, due to absence of specific TP rules in India dealing with intra group services and the controversial nature of some of the issues is likely to result in complex and monetarily significant transfer pricing disputes and risks of double taxation.

Knowing the above stated facts and ruling, it seems that, Indian Entity should have the ability to demonstrate that a service has been rendered by an overseas affiliate and that the Indian entity has received an economic or commercial benefit that has enhanced commercial position of the recipient. This test, known as the benefit test, is critical to determine whether an unrelated party would pay for an intra group service and therefore, whether the service provider can justify a charge for the provision of the intra group service under arm's length conditions. It also appears that the Indian company should demonstrate that the benefits received are not remote or incidental or the activities are not shareholder activities or the services are not duplicative in nature. Supporting evidence should indicate functional analysis of the members of the group to establish the relationship between the relevant services and the members' activities and performance.

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