NEWS CRUNCH

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NEWS CRUNCH

What's inside . . .

DIRECT TAX

1. Delhi Tribunal rules that the services provided by the seconded employees of the parent company to the subsidiary company do not constitute fixed place Permanent Establishment ("PE") as the employees are carrying out functions & activities of Indian subsidiary and interaction between such employee and parent company as communication channel/ exchange of information not more than preparatory & auxiliary activities, that qualifies for exemption under Article 5 of India-Korea tax treaty from definition and scope of PE

Brief Facts of the Case:

- Samsung Electronics Co. Ltd. ("Assessee") is a company incorporated in Republic of Korea and is engaged in the business of manufacturing and sales of televisions, home appliances etc.
- The Assessee provided technical assistance to it Subsidiary Company in India, Samsung India Electronics Pvt. Ltd. ("SIEL"), for which it received Fees for Technical Services ("FTS"). However, the Assessee did not declare such FTS in its Original Return of Income for the Assessment Years ("AYs") under consideration.
- Pursuant to survey conducted by the Income Tax department on the premises of SIEL and statements recorded of various expatriate and Indian employees,

a notice was issued to the Assessee u/s 148 of the Income Tax Act, 1961 ("The Act"). In response to the notice, the Assessee filed its return of income wherein, it declared its income from FTS.

- The Assessing Officer ("AO") passed draft Assessment Order holding Assessee to constitute PE in India, both as Fixed Place PE, Service PE, Agency PE and even holding Indian subsidiary as PE of the Assessee in India. While holding so, Ld. AO also placed reliance on decision of Hon'ble Delhi High Court in the case of Centrica India Offshore (P.) Ltd. vs. CIT [2014] [364 ITR 336] (Del)

- Assessee objected before the Dispute Resolution Panel against the draft Assessment Order, wherein, partial relief was given to Assessee and it was deemed to constitute only deemed Fixed Place PE in India. DRP rejected AO's contention of constitution of Service PE, Agency PE and treating Indian subsidiary as PE in case of Assessee.

- The AO passed final Assessment Order treating SIEL as deemed fixed place PE of the Assessee, holding that seconded employees of Assessee, working with SIEL, were carrying out Assessee's business in India through SIEL's business premises.

- Aggrieved, both Assessee and the Department filed appeals before the Income Tax Appellate Tribunal ("ITAT" or "Tribunal").

Contentions of Assessee

- At the outset, in its appeal before the ITAT, the Assessee challenged legal validity of reassessment proceedings initiated by the Income tax department.

- On merits of the case, the Assessee contended that it did not constitute PE in India.

- The Assessee contended that it operated in a highly globalized and competitive business environment where it is essential for group companies spread across the globe to communicate with each other in order to sustain its supply chain management.

- It further contended that none of the statements of the employees recorded in the survey reveal that the key decisions with regard to the products, pricing, launching etc. are taken by the assessee but such decisions are well within the realm of the Indian subsidiary.

- It submitted that the market survey conducted by the employees was in relation to the business of the subsidiary to understand the business of the Indian customers and provide India specific information to Global Business Management ("GBM") of the parent company which in turn then carries out research and development to develop India specific products.

- All the communication between the employees of the assessee in Korea and the seconded expatriate employees in India relate only to the business of the Indian subsidiary and the seconded employees were discharging their duties as employees of the subsidiary.

- Payment of salary of expatriate employees by Assessee in Korea and receiving its reimbursement from SIEL was merely for the purpose of administrative convenience.

Contentions of Revenue

- The Revenue argued that there are details available to show the salaries are not paid to the employees of SIEL after the payment has been received from India but the salaries are paid as if such expats were Assessee's own employees and then a debit note in respect of such salaries is raised by Assessee which depicts that the employees are in fact the employees of the Korean entity, being the beneficiary of payments received from SIEL.

- The Revenue contended that the expatriate employees are working in furtherance of the business interests of the Korean entity and their work description does not fit in the description of preparatory or auxiliary in nature and as such there is no employer to employer relationship between the Korean parent and Indian subsidiary.

Hon'ble ITAT's Judgment

- On the legality of reassessment proceedings, the ITAT rejected the Assessee's contentions and held that if a transaction is not reported in Return of Income prior to issuance of notice u/s 148, but is reported in the return of income pursuant to this notice, then validity of such reassessment proceedings stand confirmed and it would be deemed that some income has escaped assessment, even though income tax liability on such income is already discharged by way of taxes deducted by the relevant payer.

- However, on the issue of constitution of PE, Hon'ble ITAT decided the issue in favour of the taxpayer holding that:

  a) ITAT upheld findings of the DRP that the Assessee could not be held to constitute PE in India on account of its subsidiary or Service PE or Agency PE.

Since Indian subsidiary SIEL is duly confirming to the rules and regulations of India, performing its own functions and is paying taxes on its own income for functions performed, risks undertaken and assets deployed and also complying with Indian Transfer Pricing Regulations, it cannot be considered a PE of the Assessee.

b) In respect of Service PE, the ITAT confirmed findings of the DRP that Service PE of Assessee could not be constituted in India in absence of the Service PE clause in India-Korea DTAA.

c) In respect of Fixed Place PE and constituting PE in India, on allegation that Assessee was carrying out its business in India through expatriate employees at premises of Indian subsidiary, the ITAT held that seamless information exchange between the employees of the Assessee and the expat employees related to the models/designs to the liking of the Indian consumers, plans and strategies relating to the sale of the products etc. and all such activities are clearly within the ambit of the Indian subsidiary.

d) The Tribunal agreed with the Assessee's contention that none of the statements of the employees show that the any activity of the GBM has ever been conducted in India or that the market survey that is conducted in India has nothing to do with the business of the Indian subsidiary and it is solely for the benefit of the assessee.

e) The expatriate employees were only discharging the duties of the subsidiary company towards the holding company. Whatever the benefits that are derived by the Indian subsidiary by such communication are offered to tax in India.

f) Thus, based on the above observation ITAT held that there is

neither any business conducted by the assessee in India through the expatriated employees nor any income is derived by them though the activities of the employees and consequently, there is no PE in India.

NANGIA'S TAKE

- ***This is a welcome judgment of the ITAT, wherein Hon'ble ITAT has held that merely because there is some exchange of information between employees of Indian subsidiary and parent company and neither the Indian subsidiary nor such employees could be deemed to constitute PE of foreign company on account of such interaction/ exchange of information. The Hon'ble Delhi Tribunal held that such exchange of information could at best be considered to be 'preparatory & auxiliary activities', specifically excluded from scope of PE under India-Korea DTAA and many other similarly worded DTAAs.***

- ***This decision also lays down another important principle that even in case of secondment of employees, Service PE of foreign entity could not be constituted in context of DTAAs not having specific Service PE clause. However, in DTAAs where there is a specific Service PE clause, it is still a matter of consideration whether such activities are capable of constituting a Service PE, specifically in light of earlier decisions of the Hon'ble Authority for Advance Rulings and the Hon'ble Delhi High Court in case of Centrica India (supra).***

2. India Signs Agreement for the Avoidance of Double Taxation with Hong Kong

Facts of the case

Recently, India concluded an Agreement for the Avoidance of Double Taxation with the Government of Hong Kong Special Administrative Region of the People's Republic of China ("India'Hong Kong DTAA"). It was a long standing expectation of the foreign companies in Asia-pacific region, having headquarter/ offices in Hong Kong and transacting into business with India from such offices.

The Agreement on Avoidance of Double Taxation is expected to stimulate the flow of investment, technology and personnel from India to Hong-Kong and vice- versa as well as improve transparency in tax matters and help curb tax evasion and avoidance.

The salient features of the agreement include the following:

- With execution of tax treaty, more clarity will come in respect of Hong Kong entities having business transactions in India and having risk of constituting Business Connection/ "Permanent Establishment ("PE") in India. With more streamlined definition of PE under India-Hong Kong DTAA, protection from constitution of PE shall be available to Hong Kong companies performing only preparatory or auxiliary activities in India or performing certain activities in India less than prescribed threshold limit under the DTAA.

- The treaty covers a wider definition of Agency PE including a person who (1) habitually secures orders in India wholly or almost wholly for an enterprise or its associated enterprise or (2) maintains a stock of goods in India from which it regularly delivers goods on behalf of an enterprise to be regarded as an agency PE of the enterprise in addition to a person having and habitually exercising an authority to conclude contracts in the name of an enterprise in India.

- While the Income Tax rates on Royalty and Fees for Technical Services is kept at maximum 10% (similar to rate under Indian domestic tax law excluding Surcharge and Health & Education Cess), the treaty provides a concessional rate of tax in respect of interest income derived from India which will be subject to 10%, subject to satisfying beneficial ownership test as compared to the tax rate of 20% as provided under domestic tax laws. Further, the tax rates provided under DTAA also relieves Hong Kong entities from liability of Surcharge and Health & Education Cess, as applicable under domestic income tax provisions.

- Definition and scope of "Royalties" under India-Hong Kong DTAA is narrower than the wide definition of "royalty" under Indian domestic income tax laws. However, definition and scope of "Fees for Technical Services" under India-Hong Kong DTAA is similar to that under Indian domestic tax laws.

- The Hong Kong Tax treaty does not provide any tax exemption for gains derived by a Hong Kong resident from disposal of shares in either an Indian company or a company of which the assets are mainly comprised of Indian immovable property. Furthermore, even under residuary clause it has been prescribed that, the gains derived from alienation of any property not specifically referred to in the Treaty (Article 14) may also be taxed in India in accordance with its domestic tax laws.

- In specific Article 8 dealing with taxability of income from Shipping and Air Transport business in international traffic, there is a departure from similar provisions under many other international tax treaties. In other tax treaties, generally, profits from international shipping are usually taxed only in the state of residence of such shipping company (i.e. exempt from tax in the state of source). However, under the India-Hong Kong DTAA, profits derived by a Hong Kong resident in India from the operation of ships in international traffic may also be taxed in India, although there will be a 50% reduction on the tax imposed.

- The India-Hong Kong DTAA also contains anti-abuse provisions in Article 28 - Miscellaneous Rules, however the same has been made subject to domestic anti-avoidance/ anti-abuse provisions.

NANGIA'S TAKE

- ***The Signing of treaty is a welcome step towards encouraging direct investment, exchange of information between Hong Kong and India while aiming at creating a transparent Taxation regime. A positive outcome of the treaty may be that companies relying on Mauritius or Singapore route will may consider Direct Investment into India in order to avail the Treaty benefits. However, no relief has been provided to non-residents deriving capital gains from India.***

- ***Nevertheless, the treaty opens a gateway to expanding trade and investment relations between India and Hong Kong.***

INTERNATIONAL TAX UPDATES

3. Multilateral BEPS Convention will enter into force on 1 July following Slovenia's ratification

Entry into force follows from the deposit of instrument of ratification with OECD, by 5 jurisdictions viz. Slovenia, Austria, the Isle of Man, Jersey and Poland. Commenting on the development, OECD Secretary-General Angel Gurría said that *"The entry into force of this Multilateral Convention marks a turning point in the implementation of OECD/G20 efforts to adapt international tax rules to the 21stCentury. We are translating commitments into concrete legal provisions in more than 1,200 tax treaties worldwide"*.

OECD press release further states that MLI which was negotiated by more than 100 countries and jurisdictions under a mandate from G20 Finance Ministers and Central Bank Governors, will modify existing bilateral tax treaties to swiftly implement the tax treaty measures developed in the course of the OECD/G20 BEPS Project. The press release also highlights that *"The Convention also strengthens provisions to resolve treaty disputes, including through mandatory binding arbitration, which has been taken up by 28 signatories"*.

Source: http://www.oecd.org/tax/milestone-in-beps-implementation-multilateral-beps-convention-will-enter-into-force-on-1-july-following-slovenia-s-ratification.htm

4. OECD releases additional guidance on the attribution of profits to a Permanent Establishment ('PE') under BEPS Action 7

Considering the stakeholders' comments received on the discussion drafts issued in 2016 and 2017, OECD has released the additional guidance on the attribution of profits to a PE under BEPS Action 7. The additional guidance sets out high-level general principles for the attribution of profits to PEs arising under Article 5(5), and includes examples of a commissionaire structure for the sale of goods, an online advertising sales structure, and a procurement structure. The report also includes additional guidance related to PEs created as a result of the changes to Article 5(4), and provides an example on the attribution of profits to PEs arising from the anti-fragmentation rule included in Article 5(4.1).

Source: http://www.oecd.org/tax/transfer-pricing/oecd-releases-additional-guidance-on-the-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm

5. South Korean Regulators to Release Crypto Tax Framework by June

South Korea's Ministry of Strategy and Finance will reportedly release a taxation framework for cryptocurrencies by the end of June, local news outlet Fuji News Network (FNN) reported March 25.

A spokesperson for the Ministry of Strategy and Finance said that although they "do not have a specific time frame," they are "thinking about announcing a virtual money tax in the first half of the year," and FNN adds that any taxation would only start next year.

The announcement of the future tax plan came after the Finance Ministers' meeting of the G20 that took place earlier this month from March 19-20.

Source: https://cointelegraph.com/news/south-korean-regulators-to-release-crypto-tax-framework-by-june1A4

6. Thailand Inches Closer to Cryptocurrency Taxation

Thailand has moved one step closer to enacting taxes on cryptocurrencies. Investors trading cryptos in the country are expected to face a 7 percent value added tax (VAT) for all trades in addition to a 15 percent tax on capital gains, according to a report by Nikkei Asian Review on Friday.

The move marks the latest effort to regulate cryptocurrencies in Thailand following two royal decree drafts that were previously passed by the Cabinet of Thailand, the executive branch of the country's government.

As reported before, one of the two decree drafts specifically eyed regulation on cryptocurrency taxation in an effort to prevent money laundering and tax avoidance.

After its initial passage, the draft was further reviewed by the Council of State, an advisory body reporting to Thailand's prime minister on legislative matters, before final approval by the Cabinet again on Tuesday last week, according to a local Thailand media outlet, the Bangkok Post.

Source: https://www.coindesk.com/thailand-inches-closer-to-cryptocurrency-taxation/

7. Netherlands and Luxembourg join Ireland as wary of digital tax

Ireland was joined by the Netherlands and Luxembourg, among others, in expressing strong reservations over new plans by the European Commission to tax digital companies. European Council president Donald Tusk said at a press conference at the EU summit in Brussels that their discussion had "confirmed all leaders' desire to work for an effective and fair solution" to the challenge of taxing digital profits. He said the debate would resume in June when a decision would be taken – with unanimity voting meaning it is unlikely to be approved. The US decision to exempt EU steel and aluminium from new tariffs came as great relief to EU leaders as they gathered in Brussels but somewhat undermined the case being made by Ireland over the tax issue.

Taoiseach Leo Varadkar had been ready to cast the commission's new proposals, and what he said was the "targeting" of US businesses, as likely to be perceived as an escalation of that trade war, concerns the Germans have also expressed in recent days.

Source : https://www.irishtimes.com/news/world/europe/netherlands-and-luxembourg-join-ireland-as-wary-of-digital-tax-1.3437129#.WrXCSo5n__4.twitter

TRANSFER PRICING

8. ITAT dismisses Revenue's appeal and held that TP-adjustment on reimbursement of seconded employees' salary is unsustainable

Facts of the case

Blue Scope Steel India (P) Ltd. ("taxpayer") is a subsidiary of Blue Scope Steel Limited, Australia ("AE or "Holding Company"). During Assessment Year ("AY"), the taxpayer was engaged in providing business support services to its AE and feasibility/ technical consultancy services and project management services to third party. During the AY 2007-08 ("year under consideration"), the taxpayer had undertaken transaction of provision of business support services and reimbursement of salary cost expenses with its Holding Company. The transaction in relation to the business support services was benchmarked by the taxpayer using Transactional Net Margin Method on a cost plus markup of 7.5% which is duly accepted by the TPO and in relation to reimbursement of salary cost to its AE, TPO determined the ALP to be NIL.

Further, the AO after giving an opportunity to the taxpayer, confirmed the action of the TPO and made an addition to the total income o account of reimbursement of salary cost. Aggrieved taxpayer filed appeal before the CIT(A).

CIT (A) after considering the material facts and the submissions filed by the taxpayer including the additional evidences filed by the taxpayer and the remand report of the TPO, deleted the adjustment proposed by the TPO. Aggrieved by the order of CIT(A), Revenue filed an appeal before the Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT

1. Taxpayer's Contentions

- Disallowance was made only to the extent of foreign salary component and not on the salary paid in India to the seconded employees.
- TPO accepted the business support income and project management income earned by the taxpayer through the employment of such expats.

2. Revenue's Contentions

- There is no agreement between the taxpayer and its AE relating to secondment of employees;
- The taxpayer and its AE made an arrangement to drain out the money from India;
- No services relating to payroll management services rendered by AE to the taxpayer for which claim was made.

3. ITAT's Ruling

- ITAT after hearing both the parties and pursuing the material documents noted that the expats were the seconded employees of the taxpayer and not of its overseas AE. The expats were responsible for providing Business Support Service as well as project management service to its AE. ITAT further noted that the disallowance was made only on the foreign salary component and not on salary paid in India.

- In relation to this, ITAT noted that the TPO accepted the business support income and project management income earned by the taxpayer from the employment of such expats. Further, ITAT held that "*the action of the TPO is not just and proper when it is accepting the salary paid to such employees in India should not deny the deduction on foreign component of the same"* as the income earned from these expats has been offered to tax and accepted by the TPO.

- At last, ITAT held that since the income earned through these expats had been accepted by the TPO and the local expenditure against the said income had also been allowed, no disallowance could be made with respect to the foreign salary component. ITAT noted that the CIT(A) had given a detailed finding on the above aspects and there was no need to interfere with the findings of the CIT(A) and accordingly the appeal of the revenue was dismissed.

NANGIA'S TAKE

The verdict in the instant case reiterates the fact that if the taxpayer has availed services of employees seconded from its AE and the income earned through services of these expats has been offered to tax, no disallowance can be made with respect to foreign salary component and accordingly, tax authorities cannot make any adjustments without any coherent basis.

Source: Blue Scope Steel India (P) Ltd [TS-143-ITAT-2018(DEL)-TP]

9. ITAT considers segmental profitability using man hour based allocation and relies on APA signed for other years

Facts of the case

Tieto IT Services India Private Limited ("the taxpayer") is engaged in the business of telecom software development and providing software development services to its Associated Enterprises ("AE") as well as Non-AEs. During the Assessment Year ("AY") 2010-11 ("the year under consideration"), the taxpayer has entered into international transactions with its AE. Thus, the Assessing Officer ("AO") made reference under section 92CA(1) of the Income Tax Act to the Transfer Pricing Officer ("TPO") for determining the arm's length price of the international transactions.

Taxpayer followed segmental information pertaining to transactions with AE and Non-AE while determining the arm's length price of the international transactions. However, TPO disregarded the segmental information and considered the operating margin of the taxpayer at an entity level. TPO observed that the basis of cost allocation between AE and non-AE by the taxpayer was based on hours in respect of man power cost and at actuals in respect of administration and other overheads. Further, TPO was of the view that the taxpayer has not followed any scientific method for allocation of expenses and accordingly, segmental account prepared by taxpayer were held to be non-reliable and non-authentic. However, the taxpayer submitted that he had shown sales to the AE and non-AE in preceding and succeeding years and no reference and adjustment was made by the TPO.

It was only in the year under consideration where the AE sales were compared with non-AE sales and the adjustment was made. Taxpayer contended that if segmental profitability was accepted, then the margins of the international transactions would be within the tolerance range of +/- 5%. Taxpayer further stated that the method of allocation of expenses on man-hours spent has been accepted in the Advance Pricing Agreement ("APA") proceedings signed by taxpayer in the later years.

Further, DRP upheld the order of AO/TPO in disregarding segmental result and in considering net margins of taxpayer at the entity level. Aggrieved, the taxpayer filed an appeal before the Pune Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT

ITAT'S Ruling

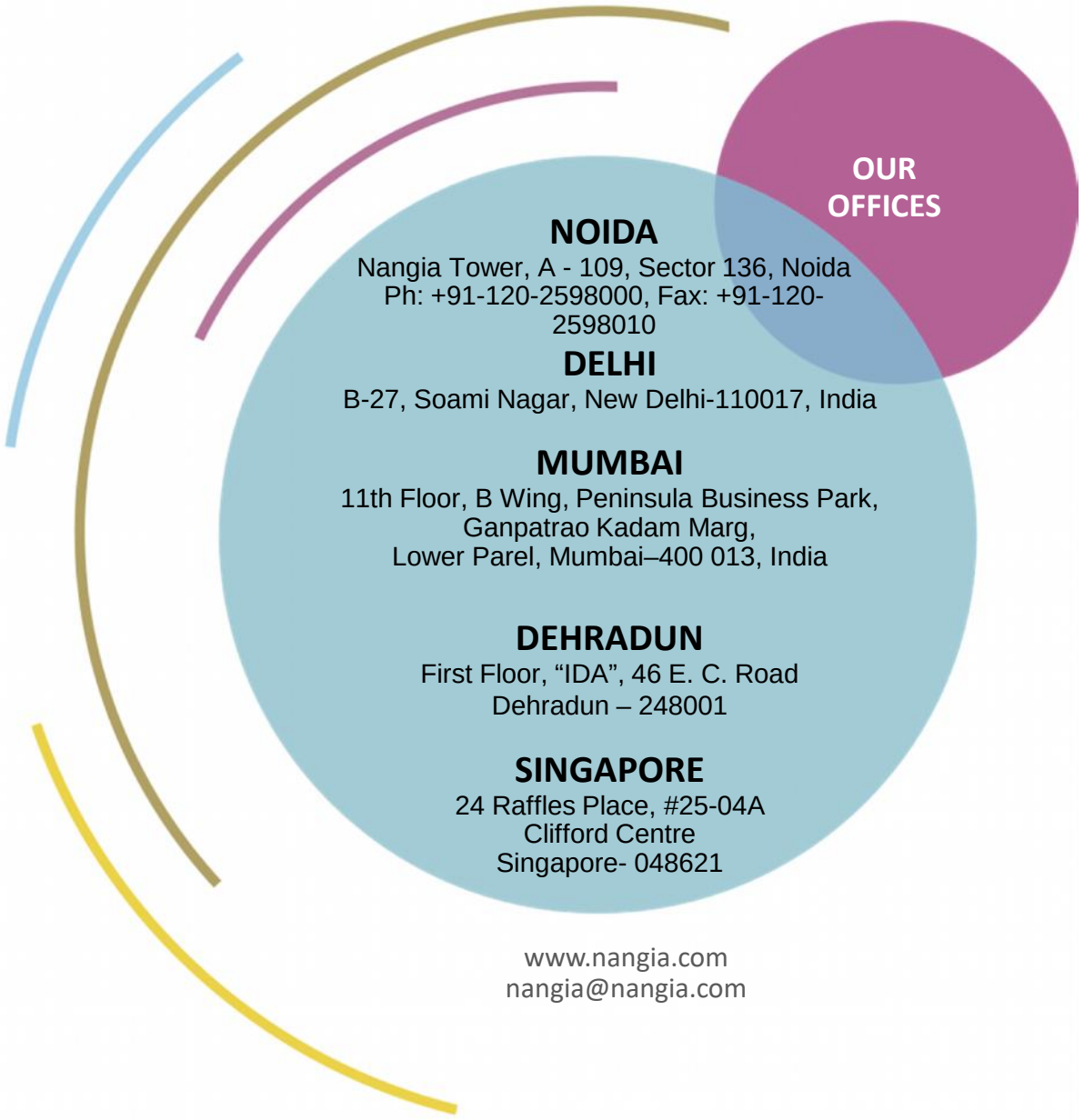
ITAT noted that the international transactions carried out by the taxpayer in year under consideration were similar to the one covered under APA for later years. ITAT further noted that the same transaction was undertaken in the preceding and in the succeeding years and no TP adjustment was made by the TPO and in some years, there is no TPO reference at all. Additionally, ITAT stressed that in all the years, similar segmental profitability statement provided by the taxpayer was accepted by the revenue authorities. In totality of the above facts and circumstances, ITAT held that while benchmarking the international transactions of provision of services to Tieto Group Companies, the segmental details of AE segment need to be applied and not the results at entity level are to be applied. ITAT observed that the taxpayer had applied a systematic manner of allocating the expenses to the AE segment i.e. on the basis of man-hour which is accepted method for allocation of cost. The same method has also been applied under APA agreement signed by the taxpayer. Further, the taxpayer has also explained in details the allocation of other costs either on actual basis or on turnover basis and the same cannot be rejected.

Accordingly, ITAT reverse the order of AO/TPO in applying the margin at entity level and direct the AO to accept the margin shown in segmental profitability of AE segment and the margins shown by the taxpayer is within the +/- 5% range of mean margins of comparable as calculated by the TPO and no adjustment need to be made on account of international transactions undertaken by the taxpayer. Accordingly, the appeal of the Revenue is dismissed.

NANGIA'S TAKE

The verdict in the instant case reiterates the fact if Scientific method/approach is followed by the taxpayer for allocation of expenses and the same methodology of allocation was accepted in the APA then the department cannot reject the allocation key used and make any adjustments thereof without any logical basis.

Source: Tieto IT Services India Private Limited [TS- 155-ITAT-2018(PUN)-TP]



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