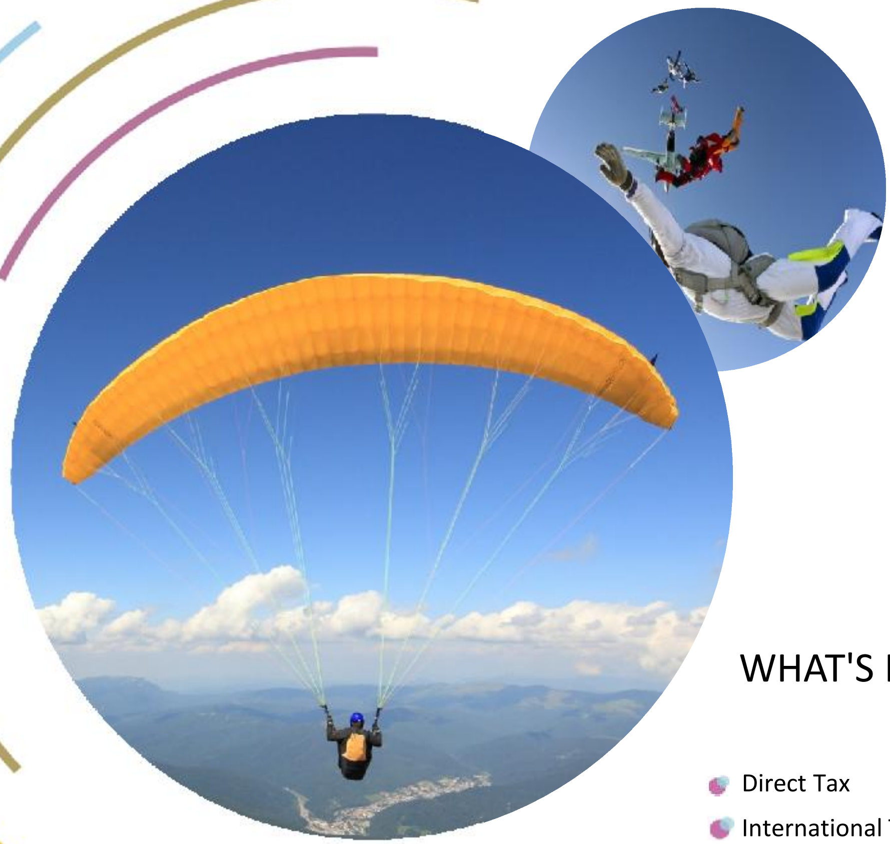
NEWS CRUNCH

June 01- June 30, 2018



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NANGIA ADVISORS LLP

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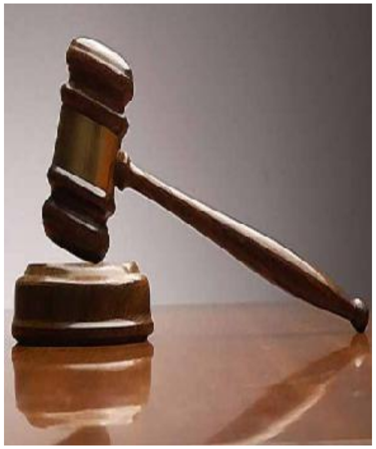
DIRECT TAX

1. AAR: US-parent Co's income from authorised Indian reseller for content delivery solutions not taxable



Brief Facts of the Case:

- Akamai Technologies Inc. ('**Applicant**') is a company incorporated under the laws of USA, and is controlled and managed from the USA.
- Applicant caters to customers who have web based applications/websites on the internet and is into the business of content acceleration and better performance of websites.
- That in the present case, the Applicant entered into a non-excusive Reseller Services Agreement with Akamai Technologies solutions India Private Limited (**'Reseller'**) to provide a global, secure and outsourced infrastructure facility using Akamai network and technology, to the customers.
- Applicant sought ruling on following questions:
  a) Whether payments received by the reseller would be in the nature of FTS?
  b) Whether amounts received would be considered as being FIS under India-US Treaty?
  c) Whether the amounts received are in the nature of Royalty?
  d) Whether there is any presence of a PE of the applicant in India?
  e) Whether payments received would be subject to withholding of tax under the Act?

APPLICANT'S SUBMISSIONS:

- Applicant submitted that the solutions provided are in the form of a standard facility, they are neither specialized nor exclusive and also do not cater to the individual need of the customers. They are provided automatically and on a continuous basis and hence cannot be termed as being FTS
- The Applicant submitted that the arrangement with the reseller does not "make available" any technical knowledge, experience, skill, know how etc., hence cannot be considered as being FIS under the treaty
- The Applicant submitted that the sale is solutions to reseller does not involve transfer of any rights, payments are also not for the use, right, right to use of the reseller or any intellectual property. Since the transaction do not involve provision of royalty, so it won't be considered ab being under the purview of Royalty
- That since, the Applicant does not fall under any of the condition mentioned under article 5 of the article to qualify as a PE, and also the income does not accrue/arise India, it cannot be considered as having a PE in India

DEPARTMENT'S SUBMISSIONS

- That the nature of the Applicant's solution is provision of FTS which accelerates the performance of the websites, and the services rendered are also technical in nature
- That it will be considered as Royalty because it involves transfer of right as Reseller agreement is in the nature of License agreement and it involves use of copyright

- That the income accrue/arise in India as the Reseller works on behalf of the Applicant so it will constitute PE in India

ADVANCE RULING:

- The payment received by the Applicant from Akamai India for the content delivery solutions would not be taxable as FTS

- Payments received by the applicant are also not taxable as FIS under India-US Treaty

- The amount received by the Applicant from Akamai India do not constitute Royalty within the Act and the Treaty. When payments under Reseller Agreement are not towards any IPR/Trademarks, it cannot be covered within the definition of royalty

- The Applicant does not create a PE in India in the facts and circumstances of the case under the treaty

- Since no Income arises in the hands of the Applicant in India, there is no requirement to withhold tax under section 195 of the Act

NANGIA'S TAKE

- ***In this interesting ruling, the Hon'ble AAR has made a very fine but important distinction between grant of license of a software vis-à-vis technology solutions. The AAR has*** **held that payment received by the Applicant (a US based technology company) from its India based group company under the non-exclusive Reseller Agreement for sale of applicant's content delivery solutions directly to customers in India, not taxable as FTS/FIS or Royalty under the Act or India-US DTAA;**

- **Accepts Applicant's contention that the Solutions provided by it are in the nature of a 'standard facility' and do not cater to individual requirements of the customer, moreover absent human intervention it cannot be termed as FTS under Explanation 2 to Sec. 9(1)(vii) of the Act, also holds that the Solutions provided do not 'make available' knowledge to the end user so as to fall under definition of FIS under Article 12 of DTAA;**

- **Further holds that** *"when payments under Reseller Agreement are not towards any IPR/Trademarks, it cannot be covered within the definition of royalty***", also observes that Reseller Services Agreement does not contemplate providing any kind of a software "product" to any of its customers or to the Reseller;**

- **Distinguishes Revenue's reliance on ABB FZ ruling which was rendered in the context of use/sharing of specialized knowledge, expertise, etc. by Assessee through its employees, observes in present case there is no use/sharing of knowledge, information, etc. by the Applicant with the Reseller or the end user***."*

2. Mumbai Tribunal holds capital gains earned by Singapore Company from trading in Indian securities as non-taxable in India

Facts of the case

- D.B. International (Asia) Ltd. (“Assessee”) is a tax resident of Singapore and is carrying on its business operation including trading in securities from Singapore.

- There were essentially 2 issues involved in present appeal on account of additions/ adjustments made by Assessing Officer (“AO”), namely:

  a) Issue No. 1: Whether capital loss of Rs. 21.3 crores incurred by Assessee on cancellation of forward foreign exchange contract could be treated as “short term capital loss”, as claimed by the Assessee or as “Income from Other Sources”, as claimed by the Department.

  b) Issue No. 2: Whether short term capital gain of Rs. 455.7 crores could be claimed as ‘exempt’ from income tax in India, as per Article 13(4) read with Article 24 of the India-Singapore tax treaty?

- Specifically in relation to 2nd Issue, the AO denied exemption under Article 13(4), placing reliance on Article 24 of the India-Singapore tax treaty and held that such exemption could not be allowed, since the entire amount of capital gain was not actually remitted to Singapore.

- The Assessee filed objections before the Dispute Resolution Panel (“DRP”) against addition/ adjustment made by AO on both the issues in draft Assessment Order.

- The DRP granted relief to Assessee on both the issues and Department filed appeal before the Tribunal against DRP’s directions.

- In further, appeal before the Tribunal:

ASSESSEE’S CONTENTION:

- **On 1st Issue**, Assessee contended that forward foreign exchange contract was entered into only for hedging against the foreign exchange rate variation in respect of Investment made by the Assessee in India. It was further submitted, since the investments are capital assets, forward foreign exchange contract are in capital field and loss arising on cancellation of such contract is in the nature of ‘capital loss’.

- On 1st Issue, Assessee also placed reliance on orders of Tribunal in its own case for earlier years, where the issue regarding characterization of gain/ loss incurred on forward foreign exchange contract was decided in favour of Assessee, holding it to be in the nature of ‘capital gain/ loss’.

- On **2nd Issue**, Assessee contended that:

  a) It is liable to tax in Singapore on its worldwide income. Therefore, as per Article 13(4) of the DTAA, the capital gain is taxable in Singapore and since the worldwide income is to be taxed in Singapore, the remittance of such income to Singapore is of no relevance for the purpose of claiming benefit under the DTAA.

b. as per article 13(4) of the DTAA capital gains arising from sale of certain asset is only taxable in the country of residence i.e. in Singapore.

c. once such income is not taxable in India under Article 13(4), requirement of remittance to Singapore for applying article 24 becomes irrelevant.

d. once the entire worldwide income of the Assessee is assessed at Singapore, a part of it cannot be taxed in India, as it will amount to Double taxation of the same income.

- The Assessee also relied on decision of coordinate bench of Tribunal in case of *Citicorp Investment bank Singapore Ltd. V/s. DCIT (2017-EII*-59-*ITAT-MUM*-INTL*)*

DEPARTMENT'S CONTENTION:

- **On 1st Issue**, Department contended that forward foreign contract is not a capital asset and should be treated as under "Income from other sources "and hence the loss incurred neither can be set-off nor carried forward.

- **On 2nd Issue**, Department contended that:

  a) Article 24 provides for restriction of exemption mentioned under Article 13(4) in respect of Capital gains to the extent of Income repatriated to country of residence i.e. Singapore.

  b) That, since the capital gain was not repatriated to Singapore under Article 24, it has to be taxed in India, and hence, exemption under Article 13(4) cannot be allowed.

ITAT'S ORDER:

- Tribunal noted DRP's finding that Assessee was a tax resident of Singapore, it did not have a PE in India and its income had to be taxed in India in accordance with provisions of the India-Singapore tax treaty, to the extent that is more beneficial to the Assessee.

- **On 1st Issue**, relying on coordinate benches' decision in earlier years on the same issue, the Tribunal held that the gains arising from forward foreign exchange contract has to be treated as Capital gains. Accordingly, Tribunal decided not to interfere with the decision of DRP and held that gain from the forward foreign exchange contract had to be treated as 'Capital Gains' and the loss arising from such contract had to be treated as 'Capital Loss'.

- **On 2nd Issue**, the Tribunal held that:

  a) Short term capital gain was earned by the Assessee in course of trading of Indian securities from Singapore will fall under Article 13(4) and accordingly the gain derived by the Assessee from the sale of Indian Securities could only be taxed in Singapore.

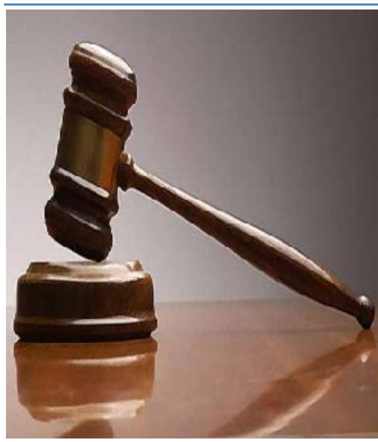
  b) the overriding nature of Article 13(4) of the DTAA makes the capital gain taxable only in the country of residence of the Assessee i.e. Singapore and Department's reliance on Article 24 in respect of 'exempt income' is misplaced.

  c) Thus, ITAT ruled in Assessee's favour, dismissing Department's Appeal. Accordingly, held that the decision of DRP is appropriate and capital gains to Singaporean company for trading in securities will not be liable to tax in India.

NANGIA'S TAKE:

In this welcome decision, the Hon'ble Mumbai Tribunal has rejected a very narrow interpretation of Article 24 adopted by the Department while denying the treaty benefits to a taxpayer. The Hon'ble Tribunal has also held that specific Article 13(4) will have an overriding effect over the general Article 24, which is required in a completely different context, but could not be relied upon to deny a relief, specifically allowed to a Taxpayer under specific Article.

3. Ahmedabad ITAT: Mere TRC non-furnishing cannot disentitle treaty benefits; Explains Section 90(4) interplay vis-à-vis treaty override u/s. 90(2); at the same time Taxpayer must submit supporting documents to substantiate tax residency in country, whose tax treaty benefits are sought



Brief Facts of the Case:

- Ahmedabad ITAT rules that mere non-furnishing of Tax Residency Certificate ('TRC') cannot per se be treated as a trigger to disentitle the treaty benefits. At the same time, the Tribunal has also ruled that in order to claim the treaty benefits, the Taxpayer must submit sufficient supporting documents to substantiate tax residency in country, whose tax treaty benefits are sought.

BRIEF FACTS:

- The Assessee had made certain payments to a US based entity by the name of Teems Electric Inc. ("TEI" or "the US entity"), in consideration for the services rendered by TEI's personnel for installation and commissioning of certain equipment purchased by the Assessee.

- That the Assessee paid installation / commissioning charges to a US entity without deducting TDS on the ground that absent 'make available, payment doesn't constitute Fees for Included Services under Article 12 of India-US DTAA.

- That, the AO rejected Assessee's contention that the services do not satisfy the "Make available test' in Article 12(4)(b) of India-US DTAA, and held that services rendered by non-resident company fall within the clauses 4(a) as well as 4(b) of Article 12 of India-USA tax treaty. Accordingly, AO treated Assessee as a defaulter under section 195 of the Act.

- On appeal made by Assessee, CIT(A) not only confirmed the order of the AO but also raised new issues against the Assessee, viz. denial of tax treaty benefits to US payee due to absence of a tax residency certificate ('TRC') and also holding US payee entity to constitute Permanent Establishment ("PE") in India.

- In further appeal before the Tribunal, though the Tribunal remitted the appeal back to file of CIT(A) for fresh determination on eligibility of US entity for treaty benefits, existence of its PE in India and overall taxability of payments made by Assessee to US entity, the Tribunal laid down some important principles regarding requirement of a TRC for claiming tax treaty benefits.

ASSESSEE'S CONTENTIONS:

- That, the provision of the Act, in a situation covered by the Treaty, cannot put the Assessee to any greater burden than the burden placed by the treaty.

- That the fees paid to the US entity per se do not constitute FTS because:

  a) Installation/ commissioning is directly linked to purchase of equipment
  b) There was no transfer of technology
  c) The entire installation charges were capitalized

- That, section 90(4) do not start with a obstante clause Vis-à-vis section 90(2), and therefore cannot be construed as a rider to section 90(2).

DEPARTMENT'S CONTENTIONS:

- That, non-furnishing of the TRC under section 90(4) itself, on a standalone basis can be reason enough for declining the treaty protection.

- That, furnishing of the TRC is a condition precedent for invoking the treaty protection under section 90(2)

ITAT's ORDER:

- That, once the Assessee furnishes the tax residency certificate (TRC) in the prescribed format, the Assessing officer is denuded of the powers to requisition further details in support of the claim of the Assessee for the related treaty benefits.

- That, 90(4) in the absence of a non-obstante clause, cannot be read as a limitation to the treaty superiority under section 90(2).

- That, an eligible Assessee cannot be declined the treaty protection under section 90(2) on the ground that the said Assessee has not been able to furnish TRC in prescribed format. i.e. an eligible Assessee cannot be declined treaty protection under section 90(2) simplicitor on the ground that he has not complied with the provisions of section 90(4).

- That, Section 90(4) has to be seen as a beneficial provision to a non-resident taxpayer holding TRC in favor of its claim for treaty benefits, instead of non-availability of TRC to be seen as a barrier against claim of treaty benefits.

- Nonetheless, even if the TRC is not available, Assessee has to satisfy his eligibility for treaty protection through other supporting documentations, which has to be something more than Assessee's own filing before tax/ regulatory authorities of the home country.

- ITAT remanded the matter back to CIT(A) on the fundamental aspect of treaty entitlement and also for fresh adjudication of issues on merits.

NANGIA'S TAKE:

In a very important ruling, the Ahmedabad Tribunal has very importantly held that mere non-furnishing of Tax Residency Certificate ('TRC') cannot per se be treated as a trigger to disentitle the treaty benefits, and held that non-obstante clause 90(2), often referred to as 'Treaty override' section has to be preferred over section 90(4).

At the same time, the Tribunal has also held that even if TRC is not available, there has to be reasonable evidence about tax residence and consequent entitlement of treaty benefits to the US entity, holds that the onus is on Assessee to give sufficient and reasonable evidence of satisfying the requirements of Article 4 (Residence) so as to be entitled for treaty protection.

4. Delhi ITAT special bench holds that Nokia’s subsidiary doesn’t constitute the PE of Nokia Networks

Facts of the case

- Nokia Networks OY (‘assessee’), a finish company was engaged in the manufacturing of GSM equipments to be used in fixed and mobile phone networks and trading of telecommunication of hardware and software.

- The assessee sold its products to Indian customers outside India on principal to principal basis under an independent buyer-seller agreement. It established a Liaison office (‘LO’) in India to support the assessee in carrying out the installation and other related activities.

- Subsequently, the assessee had set up a wholly owned subsidiary, Nokia India Private Limited (‘NIPL’) and all the contracts for installation were either assigned or separately entered by the NIPL with the customers.

- Further, NIPL entered into two more contracts, one being a technical support agreement with the Indian telecom operators and other being a marketing support agreement with the assessee.

- During the course of the assessment proceedings, the assessing officer held that the LO and NIPL constituted permanent establishment (‘PE’) of the assessee in India. Also, it held that the assessee supported NIPL in carrying out installation activities and therefore, there is constitution of installation PE.

70% of the equipment revenue was attributed to the sale of hardware whereas remaining 30% was attributed to supply of software and taxed as royalty.

- The issue came up for consideration before the special bench of Income Tax Appellate Tribunal, Delhi (‘ITAT’). It held NIPL as the PE of the assessee in India since the assessee virtually projected itself in India through NIPL and common personnel. It further noted that NIPL undertook certain activities on behalf of the assessee such as network planning, negotiation in connection with sale of equipment and signing and supply and installation contract.

- It further held that the LO does not constitute PE of the assessee in India and no part of income from the offshore sales taken place outside India should be taxed in India.

- Aggrieved, both the assessee and IT department filed an appeal before the Delhi High Court which ruled in favour of the assessee with respect to the grounds related to off shore supply and constitution of LO as PE. Also, it remitted the issue of constitution of NIPL as PE or business connection to ITAT for deciding the matter afresh based on proper appreciations of facts on record.

Assessee’s contentions

- It contended that NIPL did not provide any business connection while undertaking the sale transaction as it was not involved by any means in selling the goods outside India. The contract entered before the constitution of NIPL were concluded in the capacity of the country manager of LO.

- With respect to the issue constitution of PE, it contended that examination should be done from the point of view of DAPE only as constitution of fixed place PE should require the satisfaction of disposal test which was missing in the case of the assessee.

- Also, it contested that the basic condition specified in article 5(5) of the tax treaty, which is subject to the activities being in the nature of preparatory or auxiliary, for the constitution of DAPE could not be satisfied as the assessee was not involved in negotiating or signing contracts on behalf of the assessee.

- No business of the assessee was carried out through the expatriates rendering technical support. All expatriates were working as the employees of NIPL under its complete control and supervision.

Revenue's contention

- The assessee was carrying out negotiations, network planning and marketing of its business through the fixed place in the form of NIPL.

- It argued that the employees of the assessee were seconded to NIPL which indicated that the assessee's presence in all the activities of NIPL. Also that the employees working for the assessee and NIPL were same which constituted service PE, fixed place PE and DAPE of the assessee in India. It further contended that these seconded employees constituted installation PE in India.

- Provisions of the facilities like telephone, fax, vehicles by NIPL to the employees of the assessee further evidenced the constitution of fixed place PE basis the existence of a place at the disposal of the assessee.

- Also, there was a contention that NIPL was dependent on the assessee as its ownership could not be diluted.

ITAT's Judgement

- The majority members of the ITAT ruled in favor of the assessee holding that no PE of the assessee gets constituted in India. While holding the same, it made the following observations:

- The special bench has examined the concept of fixed place PE in light of Article 5 of India-Finland DTAA and propositions laid down by SC in Formula One ruling and E-Funds and international lax commentaries.

- According to the Supreme Court the 'disposal test' is paramount which needs to be seen while analyzing fixed place PE under Article 5(1). Key sequitur and proposition which is culled out from the SC judgment is as under.

    i. Firstly, the fixed place should be where the commercial and economic activity of the enterprise is carried out;
    ii. Secondly, such a fix place acts as a virtual projection of the foreign enterprise;
    iii. Thirdly, PE must have three characteristics, stability, productivity and dependence; and
    iv. Lastly, fixed place of the business must be at the disposal of the foreign enterprise through which it conducts business.

- ITAT special bench examined various kinds of contracts/ activities undertaken by assessee and the facts and material on record, specifically with reference to the following activities which have been identified by HC while remanding the matter back to the Tribunal.

    i. Signing of contracts;
    ii. Network planning;
    iii. Negotiation of off-shore contract in India.

❖ **Whether NIPL is a fixed place PE of Nokia Networks OY?**

ITAT rules that providing telephone or fax or conveyance services can never be equated with fixed place. ITAT states that Revenue could not bring any further material support or evidence that any physical place was made available which can be said to be at the disposal of the assessee for carrying out its off-shore supply contract in India. Hence, ITAT holds that the test laid down by SC does not get satisfied in this case as nothing has been brought on record by Revenue that any physical space was made available which can be said to be at the disposal of assessee for assessee's own business of supply and sale of equipment

❖ **Whether NIPL constitutes dependent agency PE?**

ITAT observes that there is no material fact on record that NIPL has negotiated or concluded any contract of supply of equipment on behalf of the assessee which binds the assessee. Further, ITAT observes that the title of the goods supplied is directly passed on to the customers in India and NIPL neither undertakes any negotiation process nor assist in delivery of goods. Further, ITAT observes that the NIPL neither has any authority to conclude contracts for supply nor any of the orders has been booked by NIPL which can be said to be binding upon the assessee.

❖ **Whether NIPL is the 'virtual projection' of assessee?**

ITAT rejects Revenue's stand that the Indian subsidiary is a virtual projection of the assessee as employees of assessee company were practically performing all kinds of work, and therefore, it has to be treated as a PE of assessee. ITAT clarifies that "The concept of 'virtual projection' flows from the fixed place itself or with any other parameters of establishment of PE under Article 5. This concept alone is not relevant but has to be seen in relation to fixed place or any other concept of PE.

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❖ **Whether Nokia Networks Oy had any kind of a business connection in India in the form of NIPL?**

At the outset, ITAT clarifies that "Though this issue has become slightly academic in view of our above finding, because even if it is held that assessee had a business connection in India, then also under the treaty provisions, if there is no PE in terms of Article 5, then no income can be attributed to India under Article 7….but, for the sake of completeness, we shall discuss in brief, whether the assessee was having any kind of business connection in India or not". ITAT re-iterates that in the present case, the goods were manufactured outside India and even the sale has taken place outside India and once this fact is established even in those cases where there is a one composite contract supply has to be segregated from installation and only then would question of apportionment arise having regard to expressed language of Section 9(1)(i) of the Act, which makes the income taxable in India to the extent it arises in India.

However, dissenting from majority view, ITAT Member Shri Pramod Kumar gave a separate ruling on the issue of constitution of PE/ existence of a business connection, and held as under:

❖ The assessee and NIPL were carrying out business activities in tandem and NIPL's work cannot be seen on standalone basis. Thus, taking note of interdependence and interconnection between assessee and NIPL, he upholds existence of business connection.

❖ He holds that the fixed place of business and the disposal tests are not relevant for unassociated or indirect PEs

❖ He also rejects assessee's reliance on Formula One ruling to contend that since the conditions precedent for existence of a fixed place PE, i.e. right to disposal, stability and productivity, are not satisfied, there cannot be a PE even if there is a virtual projection of the foreign enterprise by the NIPL.

- He thus holds that 35% of 10.8 % of global profit on sales can be allocated to marketing functions carried out in India. He then rounds off the attribution to 3.75% of sales.

Nangia's take

This is a landmark ruling, though ruled in favor of the assessee, has left the door for future litigation on this matter open.

Owing to the varying ruling on the concept of Fixed place PE and Dependent Agent PE, the litigation on this matter has increased substantially. The tax department invariably alleges a PE of foreign entity, irrespective of the period of existence, extent of existence, extent of activity undertaken and the right to disposal available to the foreign entity.

The dissenting judge's ruling in this case has opened a Pandora box, especially owing to the fact that the well settled position on disposal test have been challenged. Also, mere interdependence and interconnection between the foreign entity and its Indian subsidiary, has been taken as a base for constitution of business connection, which may lead to frivolous litigation on this matter

INTERNATIONAL TAX UPDATES

5. Time to 'definitively address' Ireland's tax haven reputation

Legislation that aims to tackle once and for all the "emerging international view of Ireland as a tax haven," has been introduced in the Dáil. Labour finance spokeswoman Joan Burton said there was a need for a standing commission on taxation to deal with tax loopholes and other controversies. She added that the growing international view and recent academic studies showing Ireland as a tax haven "have to be addressed definitively". Ms Burton was speaking as she introduced the Tax Law Reform and Codification Advisory Committee Bill, which would establish a taxation commission. She claimed that "as a country we are drinking in a last chance saloon with how we participate in international tax justice and progress" and the "vital infrastructure" in the Bill was about this. Ms Burton said one of its first actions could be to look at the unacceptable situation where the banks, which taxpayers bailed out with great sacrifice, "should effectively have a tax holiday with relief from all corporation tax for up to the next 20 years". She said the construction industry and developers were also using tax losses in this way and she highlighted the tax credit for research and development, which was costing "many millions over what it was meant to be when introduced by the Minister".

And she warned that "many of the tax structures that we still have were significant contributors to the last crash".

Source: *https://www.irishtimes.com/news/politics/oireachtas/time-to-definitively-address-ireland-s-tax-haven-reputation-1.3552888*

6. Dividends Soar to Record After Tax Cuts and Bank Stress Tests

S&P 500 Index members are gearing up to pay out $124.1 billion in dividends in the coming months, a new quarterly record according to data compiled by Bloomberg.

The new high was ushered in by a lower corporate tax rate and the results of last week's Federal Reserve stress tests. Dividend declarations made during the second quarter were 12 percent higher than in the prior year, two percentage points greater than the increase from 2016 to 2017.

Financials led the way with a 36 percent year-over-year increase, fulfilling ambitious plans by the big banks to deliver cash to shareholders. Altogether, financial firms will distribute about 95 percent of their profits, the Fed projected, roughly in line with analysts' estimates.

Source: *https://www.bloomberg.com/news/articles/2018-07-03/dividends-soar-to-record-after-tax-cuts-and-bank-stress-tests?utm_source=google&utm_medium=bd&cmpId=google*

7. German tax law permitting loss carry forward following restructuring of failing companies is not State aid, EU court rules

The long-running debate regarding whether German laws that provide for the carryforward of tax losses in the case of restructuring of companies in financial difficulty are State aid has finally come to an end. In a welcome decision, the Court of Justice of the European Union concluded June 28 that the German "restructuring clause" does not constitute illegal State aid. German tax legislation provides that, generally, tax loss carryforwards of a corporation can be offset with future profits taking into account rules on minimum taxation. However, tax loss carry forwards are forfeited upon a harmful change in control.
Under the "restructuring clause," enacted in 2009 as a result of the financial crisis, though, losses are not forfeited if the company in question is in financial difficulty and the change in control takes place to restructure this company. Whether the restructuring clause applies depends on the facts and circumstances of the individual case. Hence, it was common practice to ensure the applicability of the exception by way of a binding ruling from the tax authorities. The June 28 ECJ decision follows the Opinion of Advocate General Wahl. The decisive question is the reference framework, which ought to be used to determine whether the restructuring clause is selective and, thus, constitutes State aid or not. The ECJ concluded that it is not the forfeiture of tax loss carryforwards but the future utilization of tax loss carryforwards which must be used as the reference framework.
As such, the ECJ puts the European Commission in its place and clarifies that the restructuring clause does not constitute State aid. This judgement is welcome from the point of view of Germany and the taxpayer.

Source: *https://mnetax.com/german-law-allowing-tax-loss-carryforward-following-restructuring-of-companies-in-financial-difficulty-is-not-state-aid-eu-court-rules-28429*

8. UK tax treaty anti tax avoidance changes to apply from 2019

Changes to many of the UK's double tax treaties will come into force next year in order to comply with internationally agreed measures to prevent tax avoidance. This is as a result of the UK depositing its instrument ratifying the multilateral instrument to amend tax treaties (the MLI) with the Organisation for Economic Cooperation and Development (OECD) last week. The MLI is designed to change thousands of double tax treaties without each treaty having to be separately amended. The changes are to implement the OECD's recommendations from its base erosion and profit shifting (BEPS) project to tackle international tax avoidance and relate to hybrid mismatches, treaty abuse, artificial avoidance of permanent establishments and improving dispute resolution. For the UK the MLI enters into force on 1 October, but it will not apply to individual tax treaties until next year at the earliest. It will only enter into force in relation to a particular treaty three months after both parties to the treaty have ratified the MLI and opted for it to apply to the treaty in question. Even then the provisions will take effect from slightly later dates. For withholding purposes, it is from the beginning of the calendar year after the MLI comes into force for each of the parties to the relevant treaty and for other taxes it will generally be the beginning of the next fiscal year – in the UK's case, 1 April for companies and 6 April for individuals. The OECD is developing an online 'matching database' to assist with this process. The UK has said it will provide amended versions of its treaties, showing how they will be affected by the MLI. In order to tackle treaty abuse, the UK has chosen to adopt a principal purpose test in its treaties. This will deny treaty benefits where it is reasonable to conclude, having regard to all the facts and circumstances, that one of the principal purposes of the arrangement was to obtain the benefits of the treaty.

Source: *https://www.out-law.com/en/articles/2018/july/uk-tax-treaty-anti-tax-avoidance-changes-to-apply-from-2019-/*

9. OECD Welcomes Dutch Efforts To Counter BEPS

The OECD has welcomed efforts by the Dutch Government to tackle base erosion and profit shifting but called for the overall tax regime to be simplified, including in area of value-added tax. In its latest Economic Report on the Netherlands, the OECD said that the Government is attempting to change the country's image as a low-tax conduit jurisdiction with extensive proposals to prevent BEPS. "In the past, the Netherlands has been considered to be an important jurisdiction for multinational corporations, which created a reputational issue linked to aggressive tax planning," the report observed. "Dutch tax rules, designed for avoiding double taxation, are used by companies that engage in tax planning, as suggested by high levels of dividend, royalty, and interest payments made via the Netherlands." "The Netherlands has, however, made significant progress to contain base erosion and profit shifting, in line with OECD recommendations," the report continued. "A new policy agenda to tackle tax evasion and avoidance was recently sent to Parliament by the Dutch State Secretary for Finance to overturn the Dutch reputation of leniency towards BEPS by multinationals." In February 2018, the Dutch Government announced a comprehensive package of tax anti-avoidance proposals designed to bring the jurisdiction's rules into line with new European Union anti-avoidance laws and fulfill its obligations under the international BEPS agenda. These include implementing the first and second EU anti-tax avoidance directives in 2019 and 2020, respectively.
These measures are being balanced against other proposals to improve the Netherlands' tax competitiveness, including a gradual reduction in the rate of corporate tax from 25 to 21 percent, with the 20 percent lower rate of corporate tax on profits up to EUR200,000 (USD232,700) to be lowered to 16 percent. The report also noted that the Netherlands has made substantial progress towards implementing the OECD's specific BEPS recommendations.

Source: *https://www.tax-news.com/news/OECD_Welcomes_Dutch_Efforts_To_Counter_BEPS____86857.html*

TRANSFER PRICING

10. ITAT deletes adjustment on Advertisement, Marketing and promotional expenses in the absence of any prior agreement or arrangement with the AE

Facts of the case

- Colgate Palmolive (India) Limited ("the taxpayer") is engaged in the manufacturing and marketing of diversified pharmaceutical products.

- During the assessment year ("AY") 2005-06, the transfer pricing officer ("TPO") observed that the taxpayer paid royalty on the sales effected in India and the Associated Enterprise ("AE") stood benefitted in a major way. Further, the TPO also noted that the Advertisement, Marketing and Promotional expenses ("AMP") incurred by the taxpayer were the driving force for enhancing the AE's brand value in India.

- Thus, such AMP expenses needed to be shared with the overseas AE in the ratio of royalty payment to total payment. In view of the above facts, the TPO proposed an upward adjustment of INR 131.36 Lakhs on account of cost Allocation of AMP expenses debited by the taxpayer.

- Additionally, for the AY 2007-08, the TPO proposed an upward addition of INR 5.69 crores by excluding the duty benefits received by the taxpayer, under *'Served for India Scheme'* for the purpose of computation of margins from R&D activities.

- In this regard, the TPO was of the view that the benefit on account of the duty benefit could not be considered for the purpose of comparison of margins between the taxpayer and the comparable companies.

- Aggrieved by the same, the taxpayer appealed before the Commissioner of Income Tax (Appeal) ("CIT(A)"). The CIT(A), deleted both the aforesaid additions proposed by the TPO. Aggrieved by the deletions, the Revenue filed an appeal before the Income Tax Appellant Tribunal ("the ITAT"/ "the Tribunal").

ITAT's Ruling

The ITAT observed the following: -

- **Applicability of TP provisions on AMP Expenditure**

The ITAT noted that

- There was no prior arrangement or agreement between the taxpayer and the AE for undertaking any sort of brand building on behalf of the AE;

- The TPO brought nothing substantial on record to demonstrate that the incurrence of AMP expenditure by the taxpayer resulted in brand building exercise or created marketing intangibles for the AE;

- Further, no evidence placed on record by the TPO to establish direct relation between sales growth vis-à-vis AMP expenditure incurred by the taxpayer;

- Emphasis was further placed on the nature of such expenses, which were mainly in the nature of meeting expenses, travelling expenses, hotel expenses etc. which were received and paid by the taxpayer on third party basis;

- Reliance was placed on a number of co-ordinate bench rulings, some of them being rulings in the case of ***Johnson & Johnson Ltd., Maruti Suzuki, Whirlpool of India, Bausch & Lomb etc.***

Consequently, the ITAT opined that no addition could be made on mere assumption of certain facts and thus, deleted the AMP adjustment proposed by the TPO.

- **Application of Bright Line Test**

The ITAT stated that the Bright Line Test is not a recognized methodology and not one of the prescribed methods as envisaged by Rule 10B of the Income Tax Rules, 1962. Additionally, the ITAT observed that the TPO did not carry out any analysis of the impugned expenditure to corroborate his stand.

Consequently, ITAT rejected the computation of AMP adjustment as carried on by the TPO by applying the bright line test.

- **Export Benefits**

The ITAT opined that the export benefits received by taxpayer arose from usual activities and were a part and parcel of the same transaction. Thus, the same can be considered while calculating the operating income of the taxpayer. Further, in the absence of any contrary judgment placed on record by the Revenue, the ITAT deleted the proposed upward addition by the TPO in this regard.

NANGIA'S TAKE

The principles drawn in the current judgement are in line with the prior rulings on the same issue. It further reiterates the fact that transactions pertaining to AMP expenditure incurred by the Indian taxpayers does not automatically lead to brand building by the taxpayers on behalf of the AEs, in the absence of any prior arrangement or any evidence to substantiate the same. Such a judgement is appreciated on part of the taxpayers as it enhances their confidence and ensures that the judgements by the tax authorities are not based on mere whims and fancies.

Source: *Colgate Palmolive (India) Limited vs. ACIT [TS-319-ITAT-2018(Mum)-TP]*

11. ITAT Deletes TP-adjustment on interest-free advances for equity investment

Facts of the case

- Bartronics India Ltd. ("the taxpayer") incorporated in India, is engaged in the business of automatic identification and data capture technology and has a manufacturing facility for producing the smart cards.

- During the year under consideration, the taxpayer raised funds overseas through foreign currency convertible bonds and advanced these funds to its Associated Enterprises ("AE") without charging any interest for the purpose of business expansion of AE.

- These bonds were classified as zero coupon bonds and had coupon rates of 7.25% p.a. and 6.65% p.a. Furthermore, the overseas bond holders were entitled to an option of converting the bonds into equity shares of the taxpayer.

- During the Transfer Pricing ("TP") assessment proceedings, the TP Officer ("TPO") opined that the taxpayer should have charged interest on advances given to the subsidiaries and accordingly proposed an upward TP adjustment.

- The taxpayer, however, contended that it did not incur any interest costs for the funds so raised and notably, the funds were raised with a core intention of forwarding the same to the AEs for facilitating business expansion. Furthermore, the bonds were later on converted into equity shares of the taxpayer thereby implying that the loan was no more outstanding in its books.

- The taxpayer challenged the action of the TPO before the Dispute Resolution Panel ("DRP") but in vain. However, DRP directed the TPO to adopt rate of LIBOR plus 2%. Aggrieved by the order of DRP, the taxpayer filed an appeal before the Hyderabad Income Tax Appellate Tribunal ("ITAT").

Proceedings before ITAT

The ITAT made the following observations:

1. Even though Explanation (1)(c) was introduced vide Finance Act 2012 clarifying that capital financing qualifies as international transaction retrospectively, the liability on those transactions *(which occurred before the aforesaid amendment*) cannot be fastened;

2. The taxpayer did not incur any interest liability and thus there was no need for receiving any interest also and therefore, the transaction had **no 'bearing on the profits, income, losses or assets** of such enterprises, a classification which is required to subject the transaction to further analysis the TP provisions;

3. The amount advanced were shown as 'loans and advances' in books of accounts, however, the taxpayer's intention of borrowing as well as advancing was clearly reflected towards the investment and expansion of business and as such, there was no violation of "Foreign Exchange and Management Act" regulations;

4. Relying on the ruling by coordinate bench in case of ***DLF Hotel Holding Ltd. [TS-418-ITAT-2016(DEL)-TP]***, ITAT opined that "advancing interest free loans must not necessarily be deemed to be an interest earning activity and an activity to capitalize the opportunity cost for investing in new territories".

The ITAT ruled in the favor of the taxpayer and held that "since the funds were raised for the purpose of investment in subsidiaries and on the fact that these funds were interest free and ultimately shares were allotted, thereby no adjustment need to be made on the CUP method even if the transaction is to be considered as the international transaction".

NANGIA'S TAKE

The verdict in the instant case emphasizes upon the applicability of TP provisions where transactions have 'bearing on the profits, income, losses or assets'. Further, it also echoes the fact that the commercial expediency in relation to the transaction should also be given due consideration, along with other factors. Interestingly, ITAT in relation to applicability of amended law has provided a contrary view from the Bangalore ITAT ruling and has held that that liability on transactions cannot be fastened on account of amended law, if the transaction has occurred prior to such amendment. It will be an interesting wait and watch for the taxpayers at this stage.

Source: Bartronics India Ltd [TS-322-ITAT-2018(HYD)-TP]

12. ITAT: Rejects bank quotes average as guarantee ALP; Averages don't always give logical results

Facts of the case

- Britannia Industries Ltd ("the taxpayer"), a public limited company, is primarily engaged in the business of manufacturing and trading of bakery and dairy products.

- During the year under consideration, the taxpayer provided corporate guarantee to its Associated Enterprises ("AEs") and determined its arm's length price ("ALP") at 0.2% based on the average of free quotes obtained from Royal bank of Scotland ("RBS") and Indusind Bank which were 0.25% and 0.15% respectively.

- However, the Transfer Pricing Officer ("TPO") rejected the approach used by the taxpayer and determined the ALP at 3%. Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). DRP imputed a percentage of 150 bps on the basis that interbank lending rate varied between 150 and 2 bps and accordingly directed TPO to adopt 150 bps i.e. 1.5% in place of 3%.

- Being aggrieved by the DRP directions, the taxpayer filed an appeal before Kolkata Income Tax Appellant Tribunal ("ITAT"/ "the Tribunal").

ITAT's Ruling

ITAT made the following observations:

- The interbank lending rate adopted by DRP as benchmark for determination of the ALP is appropriate for fund based transactions, **whereas issuance of corporate guarantee is a non-fund based transaction.**

- Free quote received by taxpayer from RBS Bank (i.e. 0.25%) is based on the transaction similar to the taxpayer;

- The credit rating of an organization, geographical location, local government regulations etc. should be considered for ALP determination and RBS, before giving a free quote to the taxpayer, must have considered the credit rating of the taxpayer and other financial data.

- The average adopted by the taxpayer as ALP is not the right approach as average do not always give logical results.

- In view of the aforesaid observations, ITAT held that the free quote from RBS Bank constitutes the ALP of the international transaction as this quote is the basis on which the transaction has taken place and accordingly directed the TPO to adopt 0.25% as the ALP.

NANGIA'S TAKE

The issue of corporate guarantee is one of the most contentious issues in the battleground of TP litigation. Both taxpayer and tax authorities have been dealing with the issue since long, but a settled position remains awaited. This judgement while provides clarity on the approach of determination of ALP, however, this verdict is a deviation from the prior rulings by ITAT in terms of considering the corporate guarantees outside the ambit of international transaction.

In light of this, it will be an interesting wait and watch for the taxpayers for a settled tax position on the taxability of corporate guarantees.

Source: Britannia Industries Ltd *[TS-359-ITAT-2018(Kol)-TP]*

13. ITAT held that attribution of profits to Indian Branch should be based on FAR Analysis

Facts of the case

Corning SAS India ("the taxpayer"), a branch office of Corning SAS France, primarily engaged in providing sales/administrative support and marketing services for non-ophthalmic products such as optical fibre, optical fibre cables, telecommunication equipments, ceramic substrates, etc. During the assessment year ("AY") 2005-06, the Assessing Officer/ Transfer Pricing Officer ("AO/TPO") observed that the taxpayer entered into distribution, marketing and agency activities and benchmarked the distribution and agency activities on aggregate basis. However, TPO segregated the transactions and aggregated the agency services with the marketing support service.

❖ Further, the tax authorities attributed 50% of the gross profits earned on account of direct sales made by Corning France through its Branch Office/ Permanent Establishment ("BO/PE") ignoring the functions performed, assets utilized, risks undertaken ("FAR analysis") submitted by the taxpayer, stating that BO/PE undertake negligible risks and own no assets. This attribution was in addition to the commission income @ 3 percent earned on direct sales made by the taxpayer to the customers in India.

❖ The intermediate tax authorities were of the view that the taxpayer was deliberately trying to evade taxes and stated that as per the Double Taxation Avoidance Agreement ("DTAA") between India & France ("India-France DTAA"), the indirectly attributable profits of an enterprise are to be taxed in India as per Article 7(1) of the India-France DTAA and para 2 and 3 of the Protocol.

Thereon, aggrieved taxpayer filed an appeal before the Commissioner of Income Tax - (Appeal) ("CIT(A)"). The CIT(A), however, dismissed the appeal of the taxpayer. Consequently, the taxpayer filed an appeal before the Delhi Income Tax Appellant Tribunal ("the ITAT"/ "the Tribunal").

ITAT's Ruling

The ITAT observed the following:

❖ ITAT noted that the AO/TPO rejected commission earned by the taxpayer @ 3% which was accepted by the AO in all other AYs *(preceding as well as succeeding AYs)*, while the same was rejected by the AO in the said AY. Also, in none of the other AYs, any additional profits were attributed by the AO to the taxpayer in respect of direct sales made by Corning SAS France in India, even though the taxpayer had undertaken same functions assumed identical risks and employed similar assets in all the AYs;

❖ ITAT held that Hon'ble Supreme Court ("SC") in case of ***Morgan Stanley [TS-5-SC-2007]*** has held that transfer pricing analysis once undertaken; there would be no further need to attribute profits to PE. ITAT further states that, *"in each case* ***data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case."***

❖ ITAT further observed that the taxpayer received commission on dispatch of goods to customers irrespective of the realization of sales consideration by Corning SAS France and with no utilization of assets. With no substantial functions performed, risks undertaken and assets employed, "no additional profit in addition to the 3% commission income earned is required to be attributed".

❖ ITAT drew ratio laid in case of ***Morgan Stanley (supra)*** held that "*Economic Nexus is an important feature for Attribution of Profits in corporate world"* and on account of absence of the same in the instant case, allowed the taxpayer's appeal.

NANGIA'S TAKE

The verdict in the instant case highlights the importance of economic nexus for the purpose of attribution of profits (attributable to PE) which echoes that transfer pricing analysis once undertaken, taking into account all functions and risk undertaken by the enterprise, would suffice the need of attribution of profits and accordingly, no further profits attribution is required.

Source: Corning SAS- India Branch vs. DDIT [TS-421-ITAT-2018(DEL)-TP]

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