

# DIRECT TAX

## Judicial Rulings

Offshore services provided by the German entity are connected to PE in India, but exempt from tax in terms of Protocol to India-Germany tax treaty

- Taxpayer, a German entity, was engaged in providing airport management and operation services to its customers in India and had set-up a project office ('PO') in India for the same. Such PO constituted a permanent establishment ('PE') of Taxpayer.
- Taxpayer provided certain consultancy services directly from the Germany (offshore services) which were inextricably connected to the overall services of management of the airport for Indian customers.
- Indian tax authority considered the income from offshore services as Fees for Technical Services ('FTS'), which is not effectively connected to Indian PE. Such offshore income was thus held taxable as FTS in India under the tax treaty as well as under the Indian domestic laws.
- On appeal, hon'ble ITAT agreed with the Taxpayer that though some of the offshore services rendered can be covered in the category of 'managerial or technical or consultancy services', thus falling within the definition of FTS under Article 12 of tax treaty, income from services effectively connected with PE is expressly excluded from taxation as FTS and is taxable as business profits under Article 7 of the tax treaty.
- In this respect, the hon'ble ITAT noted that income from offshore services would ordinarily be attributable to PE. Such services are rendered by the Taxpayer in connection with operation of airport and cannot be rendered from the HO without active involvement of the PE in India

- However, Paragraph 1(b) of the Protocol to India-Germany Tax treaty **provides that income derived from planning, project, construction or research activities and income from technical services exercised in Germany needs to be excluded from being attributed to PE in India.**
- Accordingly, in the present case, the ITAT held that even where the income earned from the offshore services is rendered through the PE in India, due to the Protocol, services in the nature of planning, project, construction or research activities and technical services cannot be attributed to the Indian PE for the purpose of taxability.
- The Hon'ble ITAT directed the Tax Authority to examine the nature of offshore services and applicability of Paragraph 1(b) of the Protocol and exclude income in the nature of planning, project, construction or research activities and technical services covered by the Protocol from being taxed in India.

*[Fraport A.G. Frankfurt Airport Services Worldwide Vs ACIT/ADIT [ITA No. 3257/ Del/ 2014]*

**It is always open for a HC to examine whether the provisions of the tax law dealing with Transfer Pricing have been followed or not and whether there is any perversity in the findings recorded by the ITAT while determining the ALP**

- Taxpayers involved in the appeals were mostly Indian affiliates of multinational groups having international transactions with their respective associated enterprises.
- Taxpayers were subject to TP adjustment based on a TP audit conducted by the Tax Authority. The TP adjustment was made largely by adopting a different set of comparable data as well as by adopting different criteria for selection of comparable data by the Tax Authority as compared to what was used by the taxpayers in their TP documentation.

# DIRECT TAX

## Judicial Rulings

- Most of the taxpayers were successful, partially, or fully, in deleting the TP adjustments in appeals before the Hon'ble ITAT.
- The Tax Authority thereafter filed appeals before the jurisdictional HCs against the order of the ITAT.
- The Karnataka HC in the case of Softbrands India (P) Ltd noted that the existence of a substantial question of law is sine qua non for maintaining an appeal before High Court. It was noted that unless the findings of the ITAT are ex-facie perverse and unsustainable and exhibit a total non-application of mind by the ITAT to the relevant facts of the case and evidence placed on record before the ITAT, the High Court cannot interfere or disturb the findings of the ITAT. The HC had further noted that if it took the path of making such a comparative analysis, it will drag the HCs into a whirlpool of data analysis defeating the very purpose of Section 260A i.e. to adjudicate on the substantial question of law.
- The above decision of Karnataka HC had a bearing on numerous appeals before various HCs on similar transfer pricing issues and a consistent view was taken by the HCs whereby appeals challenging the findings of the ITAT were dismissed on the ground that the issues decided by the ITAT are the question of facts and as perversity is neither pleaded nor argued nor demonstrated, no substantial question of law arises for consideration under Section 260A.
- The Tax Authorities filed appeals in the SC against the HC rulings. It may be noted that the Appellants in the batch of appeals before the SC also included a few taxpayers as well in addition to the Tax Authority.
- The SC rejected the view taken by the Karnataka HC that in TP matters the determination of Arm's length Price (ALP) by the ITAT is final and cannot be subject matter of scrutiny by the HC. While reversing the decision of the Karnataka HC, the SC held as follows:
  - While determining the ALP, the ITAT has to follow the TP provisions that are contained in the Tax law. Any determination of the ALP de hors the relevant TP provisions of the tax law can be considered as perverse and it may be considered as a substantial question of law as perversity itself can be said to be a substantial question of law.
  - Therefore, there cannot be any absolute proposition of law that in all cases where the ITAT has determined the arm's length price the same is final and cannot be the subject matter of scrutiny by the HC in an appeal.
  - When the determination of the ALP is challenged before the HC, it is always open for the HC to consider and examine whether the ALP has been determined while taking into consideration the relevant TP provisions of the tax law.
  - The HC can also examine the question of comparability of companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material/ evidence on record. The HC can also examine whether the comparable transactions have been taken into consideration properly or not, i.e., to the extent non comparable transactions are considered as comparable transactions or not.

# DIRECT TAX

## Judicial Rulings

- Accordingly, the Supreme Court quashed and set aside the Karnataka HC order. The matters are remitted back to the concerned HCs to decide and dispose of the respective appeals afresh and examine in each case whether the guidelines laid down under the Act and the Rules are followed while determining the ALP by the ITAT and whether the findings recorded by the ITAT while determining the ALP are perverse or not. The SC has also noted a timeline of nine months from the date of receipt of the present order to the respective HC to complete the exercise.

*SAP Labs India Private Limited vs. ITO, Circle 6, Bangalore [TS-225-SC-2023-TP]*

# FOREIGN TRADE POLICY 2023

Foreign Trade Policy ('FTP') 2015-20 which was to end on 31.03.2020 was extended due to COVID pandemic and volatile geopolitical scenario till 31.03.2023. The Foreign Trade Policy 2023 is being announced to provide the policy continuity and a responsive framework. The policy emphasizes ease of doing business, reduction in transaction costs and e-initiatives, along with initiatives to promote exports, boost manufacturing, and facilitate e-commerce exports.

### Key Highlights:

Ease of Doing Business, Reduction in Transaction Cost and e-Initiatives will be implemented as follows:

- Online and automatic approval without physical interface of various permissions under FTP

- Reduction in processing time and immediate approval of applications under automatic route for exporters and reduction in user charges for MSMEs.
- Revamp of the 'e-Certificate of Origin' platform to provide for self-certification

### Export Promotion Initiatives

- Rationalisation of status holder thresholds to enable more exporters to achieve such status
- Rupee payment to be accepted under FTP Schemes: FTP benefits extended for rupee realisations through special Vostro accounts setup
- Common service providers in Towns of Export Excellence are now entitled for authorization under EPCG schemes.
- Boost merchanting activities from India

### Districts as Export Hubs Initiative

- The Districts as Export Hubs Initiative is a strategy proposed to boost exports through decentralized export promotion.
- The initiative proposes various strategies such as capacity building at district level, Infrastructure and logistics development Intervention.

### E-Commerce Exports

- All FTP benefits to be extended to e-Commerce exports.
- Necessary enablement of IT systems in Department of Commerce, Post, CBIC, to be undertaken in the six months.
- Dak Ghar Niryat Kendras and designated hubs with warehousing facilities will also be operationalized to facilitate cross-border e-commerce and reduce the cost and time involved in logistics
- Designated hubs with warehousing facility to be notified, to help e-commerce aggregators for easy stocking, customs clearance and returns processing.

# **FOREIGN TRADE POLICY (FTP) 2023**

## **Initiative to Boost Manufacturing**

- These initiative includes include the addition of the PMMITRA scheme to the EPCG scheme, exemption for the dairy sector, eligibility for reduced export obligation requirements for green technology products, self-declaration basis for the Apparel and Clothing sector, extension of the self-ratification scheme, and double weightage for Fruits and Vegetables exporters.

## **Special One-time Amnesty Scheme for Default in Export Obligations**

- Government is introducing a special one-time Amnesty Scheme to address non-compliance in Export Obligations
- Government is strongly committed to reducing litigation and fostering trust based relationships to help alleviate issues faced by exporters

## **Emphasis on Streamlining SCOMET Licensing Procedure**

- FTP 2023 emphasizes the licensing process for Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET)
- Recent policy changes introduced such as general authorizations for export of certain SCOMET items to streamline licensing of these items to make export of SCOMET items globally competitive.