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Article

SC Ruling on MFN Clause in Tax Treaty: A conundrum for the tax deductors in India?

By S. Vasudevan, Bharathi Krishnaprasad and Krishna Laasya V.

The Supreme Court recently passed a judgment, in favour of the Revenue department, interpreting the Most Favoured Nation ('**MFN**') clause present in various Double Taxation Avoidance Agreements ('**DTAAs**'). The article in this issue of Direct Tax Amicus delves into the intricacies of the said decision and in turn, lays emphasis on the plausible ramifications on the benefits claimed by the taxpayers in the past. Discussing the issue of limitation for initiating a tax demand under Section 201 of the Income Tax Act, 1961, the article cites various decisions of Courts and Tribunal, and observe that the opinion on the issue is divided. The authors further opine on the question as to whether tax deductors can be construed as assessees-in-default in cases where lower withholding rate was applied considering the certificate under Section 197. They also explore the possibilities of imposition/non-imposition of interest and penalty in such cases. Observing that the recent Supreme Court decision does not provide any relief for the assessees who have had a reasonable cause for not deducting tax (or the correct amount) in the past, the authors believe that suitable clarification from the government, either through legislative amendments or through circulars, will go a long way in settling these open issues.

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SC Ruling on MFN Clause in Tax Treaty: A conundrum for the tax deductors in India?

Introduction

Recently, the Supreme Court of India passed a judgment interpreting the Most Favoured Nation ('**MFN**') clause present in various Double Taxation Avoidance Agreements ('**DTAAs**'). In essence, an MFN clause is incorporated in DTAAs entered into by India with a country (say second state) by which a promise is made by India to give the same benefit or preferential treatment which India may accord to another country (say third state) in future.

The ruling was delivered in a batch of appeals filed by the tax department against various taxpayers including Steria India, Concentrix Services and Nestle SA. This Article aims to delve into the intricacies of the decision and in turn, lay emphasis on the plausible ramifications on the benefits claimed by taxpayers in the past.

Background of the case

The facts leading up to the dispute before the SC in the lead matters are summarized below -

(i) **Steria India:** The Indian entity was liable to pay certain fee for technical services ('**FTS**') to a tax resident of France. The question was whether the restrictive definition pertaining to FTS as contained in India-UK DTAA due to "make available" condition can be borrowed and read into India-France DTAA by virtue of MFN clause in the later treaty (Clause 7 of the Protocol to India-France DTAA). The Authority of Advance Ruling ('**AAR**') initially ruled that the Protocol cannot be a part of the DTAA and further held that the 'make available' clause as per India-UK DTAA cannot be read into the India-France DTAA unless a notification under Section 90 of the Income Tax Act, 1961 ('**IT Act**') is issued by the Indian Government. Upon challenge by the taxpayer, the decision of the AAR was reversed by the High Court.

(ii) **Concentrix Services Netherlands BV and Optum Global Solutions International BV:** The Dutch entities were recipients of dividend income from the companies in India. India-Netherlands DTAA prescribed a withholding rate of 10% on dividends. Subsequently, India entered into treaty with Slovenia which prescribed a lower withholding rate of 5% on dividends. After entering into treaty with India, Slovenia became member of OECD. The Dutch entities placed reliance on the MFN clause in the Protocol to the India-Netherland DTAA to claim benefit of lower withholding rate of 5% which is agreed to by India with another OECD member, *viz*. Slovenia. When the tax authorities rejected this

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claim, the Dutch entities approached the High Court by way of writ petition. The Delhi High Court allowed the claim of 5% withholding rate for the reason that benefit under the MFN clause should be extended from the date the third state (Slovenia) became a member of the OECD.

(iii) **Nestle SA:** The facts were similar to Concentrix case. The Assessee was a tax resident of Switzerland and sought withholding at the lower tax rate of 5% on dividends received from Indian subsidiary by invoking MFN clause in the Protocol to India-Switzerland DTAA read with the India-Lithuania DTAA. Here again, Lithuania had become an OECD member after entering into tax treaty with India. The Delhi High Court relied on its decision in *Concentrix Services*[1] and held that lower tax withholding certificate at 5% must be issued.

Decision of the SC

India entering into a DTAA and Protocol with another state does not automatically confer enforceability before the Indian Courts. The enforceability of the said DTAAs and Protocols arise only after a notification is issued by the Central Government in exercise of Section 90(1) of the IT Act. If the preferential treatment accorded by India in a DTAA with a third state is to be claimed by virtue of MFN clause contained in any other treaty, a separate notification must be issued by the Indian Government. The benefits of the MFN clause can be extended only if the third state is a member of the OECD on the date on which the DTAA with the third state was entered into. Thus, the SC concurred with the view of the tax department and held that the concerned DTAA has to be legislatively brought into the law through a separate statute or *vide* a notification. If not done so, the said DTAA and Protocol would not be legally enforceable.

Implications of the SC Judgment on tax deductors

Apart from the direct impact on the taxpayers who were parties to the dispute before the SC, the above ruling will have wide ranging ramifications on cases where MFN benefit under various tax treaties have been claimed in the past.

The payers located in India, who have deducted and deposited withholding tax at lower rates by taking into account the MFN benefit, may face tax demands under Section 201 of the IT Act. Section 201(1) provides that where a person who is required to deduct a sum in accordance with the provisions of the IT Act does not deduct, then such a person shall be deemed as an assessee-in-default and the tax not so deducted shall be recovered from such person along with applicable interest.

Section 201(3) puts forth limitation of 7 years in passing an order under Section 201(1) with respect to an assessee-in-default for failure to deduct the tax from a person resident in India. However, there is no express provision prescribing any time limit for passing such orders in cases where the payee happens to be a non-resident. Hence, the question that arises for consideration is whether proceedings under Section 201 against the resident

[1] TS-286-HC-2021(DEL).

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payers can be initiated for an indefinite past period for non-deduction or lower deduction of taxes from payments made to non-residents?

This particular issue has come up before various courts and tribunals on multiple occasions. However, the opinion of courts on the issue is divided to say the least.

The Delhi High Court in *Bharti Airtel Ltd.* v. *Union of India*[2], ITAT Mumbai in *Tata Power Co. Ltd.* v. *Income tax Officer*[3], ITAT Bangalore in *Mphasis Ltd.* v. *Deputy Director of Income tax*[4] have held that the limitation period prescribed in Section 201(3) is equally applicable for payments made to non-residents as well.

However, the Bombay High Court in *DIT* v. *Mahindra & Mahindra Ltd*[5] has held that where no time limit is prescribed for taking an action under the statute, the action can be taken only within a reasonable time by harmoniously considering the scheme of the Act. Relying on the said decision, the Allahabad High Court in *Mass Awash* v. *CIT*[6] held that reasonable time cannot be uniformly prescribed for all cases, as it depends on host of factors. In that case, initiation of proceedings even after a lapse of 10 years was considered valid as there was reasonable explanation for delay. Similarly, Telangana High Court in *Dr. Reddys Laboratories Limited* v. *DCIT*[7] held that even though there is no limitation prescribed in the statute, the order under Section 201(1) must be made within a reasonable period, which will depend on the facts and circumstances of the case. The Court also held that a limitation period of 7 years as prescribed by the statute will be a useful guide to determine what would be a reasonable period in case of payments made to non-residents.

On a perusal of the aforementioned decisions, it is evident that a set of decisions cater to the line of thought that the time period prescribed under Section 201(3) must strictly apply to payments made to non-residents as well. However, there are other decisions that provide that since it may be administratively difficult to recover tax from the non-residents, proceedings must be concluded within a reasonable period.

Considering the divergent rulings, the battle between taxpayer and department on the issue of limitation is likely to continue unless settled by a legislative amendment incorporating a specific limitation period or by another decision of the Supreme Court.

In addition, there can also be scenarios where lower withholding has been carried out on the strength of certificate issued under Section 197 of the IT Act. In fact, the High Courts in *Galderma Pharma SA* v. *Income tax Officer*[8], *Cotecna Inspection SA* v. *Income Tax Officer*[9], *Deccan Holdings BV* v. *Income Tax Officer*[10] have held that certificate under Section 197 must be issued for lower rates in view of the MFN clause. While these decisions have also been reversed by the Apex Court, it raises another question as to whether tax deductors can be construed as assessees-in-default in these cases as well i.e., where lower

[2] [2016] 76 taxmann.com 256 (Delhi).
[3] [2019] 111 taxmann.com 238 (Mumbai-Trib).
[4] [2022] 136 taxmann.com 160 (Bangalore-Trib).
[5] [2014] 365 ITR 560.
[6] [2017] 83 taxmann.com 306 (Allahabad)
[7] [2023] 155 taxmann.com 97 (Telangana).
[8] [2022] 138 taxmann.com 44 (Delhi).
[9] [2022] 136 taxmann.com 368 (Delhi).
[10] [2021] 133 taxmann.com 94 (Delhi).

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withholding rate was applied considering the certificate under Section 197 of the IT Act. In our view, it is possible to take a stand that since the assessee relied on the certificate, which was valid at the time of withholding, the assessee cannot be treated as an assessee-in-default for the said period.

Interest

Section 201(1A) provides that the assessee-in-default is liable to pay simple interest computed as per the provisions of the said provision. In this regard, Circular No. 11/2017 issued by the CBDT provides that where any tax was not deducted on the basis of any order passed by the Jurisdictional High Court and subsequently such tax was held to be deductible by the Supreme Court, the Chief Commissioner of Income tax/ Director General of Income tax may grant waiver of interest.

In our view, the benefit of the above Circular can be availed by assessees in circumstances where assessees have been construed as 'assessee-in-default' consequent to judgment in *Nestle SA*, wherever such non-deduction by assessees is backed by a judgment of jurisdictional High Court.

Penalty

Section 271C of the IT Act provides for penalty for failure to deduct tax at source. However, it is a settled position that penalty cannot be imposed on an assessee if he had a reasonable cause for non-deduction of tax at source. In view of the *Nestle SA* judgment, a view may be taken that penalty cannot be imposed on the assessee who has availed lower tax benefits under the MFN clause for the reason such non-deduction was on account of favorable High Court rulings.

Conclusion

Nestle SA judgment has paved way for many ramifications with respect to those assessees who have claimed tax benefits as per the MFN clause. In effect, the *Nestle SA* judgment in its entirety does not provide any relief for the assessees who have had a reasonable cause for not having deducted tax in the past.

However, the issues with respect to levy of interest, imposition of penalty and the period of limitation remain open, which will have to be legally agitated by assessees. Suitable clarification from the government either through legislative amendments or through circulars will go a long way in settling these open issues, rather than waiting for judiciary to settle these issues after a long drawn legal battle.

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Notifications & Circulars

- Trusts, educational institutions, hospitals, etc. – Details in Form 10B/ 10BB, of persons making 'substantial contribution' clarified
- SEZ units – Form of report for claiming deduction under Section 10AA notified; Due date for filing form for AY 2023-24 extended till 31 December 2023
- Concessional tax under Section 115BAA – Delay in filing Form No. 10-IC for AY 2021-22 condoned
- 'Stichting Pensioenfonds ABP' notified as pension fund for exemption under Section 10(23FE)
- Payment by IFSC unit to a non-resident, which is not chargeable to tax, is not required to be reported in Form 15CA
- Rules pertaining to allotment and quoting of PAN amended

Notifications & Circulars

Trusts, educational institutions, hospitals, etc. – Details in Form 10B/ 10BB, of persons making 'substantial contribution' clarified

The audit report in the case of a fund or trust or institution or any university or other educational institution or any hospital or other medical institution, under clause (b) of the 10th proviso to Section 10(23C), or Section 12A(1)(b)(ii) of the Income Tax Act, as the case may be, is required to be furnished in Form No. 10B / Form No. 10BB.

To remove difficulties faced by trusts in filling details of persons who have made a 'substantial contribution to the trust or institution' as referred to in Section 13(3)(b) of the Act, the CBDT has *vide* Circular No. 17 of 2023 dated 9 October 2023 stated as under:

- Details of persons making substantial contribution may be given with respect to those persons whose total contribution during the previous year exceeds INR 50,000.
- Details of relatives of such person may be provided, if available.
- Details of concerns in which such person has substantial interest may be provided, if available.

SEZ units – Form of report for claiming deduction under Section 10AA notified; Due date for filing form for AY 2023-24 extended till 31 December 2023

Section 10AA provides for deduction to newly established units in Special Economic Zones ('**SEZ**') subject to fulfilling of conditions provided therein. Section 10AA(8) read with Section 10A(5) provides that for deduction to be allowed under Section 10A and Section 10AA, the assessee has to furnish a report of an accountant before the due date prescribed in Section 44AB, specifying that the deduction has been claimed in accordance with this provision.

The CBDT has *vide* Income-tax (Twenty Sixth Amendment) Rules, 2023, dated 19 October 2023 and effective from 29 July 2021, inserted Rule 16D, which provides that for claiming deduction under Section 10AA, the report of the accountant which is required to be furnished under Section 10AA(8) read with Section 10A(5) shall be in Form No. 56F. Form No.56F requires the details about the assessee/ unit located in the SEZ. The said Form also requires a declaration that the particulars of the deduction claimed by the assessee is true and correct to the knowledge of the accountant. Annexure A of Form No. 56F provides for

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furnishing particulars relating to the claim of deduction under Section 10AA.

Further, it may be noted that the CBDT has issued Circular No. 18 of 2023, dated 20 October 2023 to remove difficulties faced by taxpayers and other stakeholders in timely filing of report of the accountant as required under Section 10AA(8) read with Section 10A(5) of the Act on account of notification of relevant Form No. 56F only on 19 October 2023. *Vide* the Circular, the CBDT has now extended the due date of filing the said report from the specified date under Section 44AB to 31 December 2023 for the Assessment Year 2023-24.

Concessional tax under Section 115BAA – Delay in filing Form No. 10-IC for AY 2021-22 condoned

Form No. 10-IC is required to be filed by a domestic company if it chooses to exercise the option of paying tax at concessional rate of 22% under Section 115BAA of the Income Tax Act.

To remove difficulties faced by taxpayers in not being able to file Form No. 10-IC for Assessment Year 2021-22 within the due date or extended due date, the CBDT *vide* Circular No. 19 of 2023 dated 23 October 2023 has directed the said delay to be condoned in cases where the following conditions are satisfied:

- The return of income for the relevant assessment year has been filed on or before the due date specified under Section 139(1);
- The assessee has opted for taxation under Section 115BAA in the Form of Return of Income ITR-6; and
- Form No. 10-IC is filed electronically on or before 31 January 2024 or 3 months from the end of the month in which this Circular is issued, whichever is later.

'Stichting Pensioenfonds ABP' notified as pension fund for exemption under Section 10(23FE)

Section 10(23FE) exempts any income of a specified person in the nature of dividend, interest or long-term capital gain that arises from an investment made by it in India, provided it satisfies the conditions thereunder. Explanation 1 to Section 10(23FE) provides for the meaning of 'specified persons'. According to sub-clause (iv) of clause (c) of the Explanation 1 to Section 10(23FE), 'specified persons' includes a pension fund which is specified by the Central Government by Notification in the Official Gazette.

Accordingly, the CBDT has, *vide* Notification No. 89 of 2023 dated 13 October 2023, notified Stichting Pensioenfonds ABP ('assessee') as a specified person for the said clause in respect of eligible investment made by it in India on or after the date of publication of this notification in the Official Gazette but on or before the 31st day of March, 2024 (hereinafter referred to as the 'said investments'), subject to the fulfilment of the following conditions, namely:

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- The assessee shall file returns of income for all previous years, falling within the period from when investment was made till the investment is liquidated, on or before the due date of filing the return of income under Section 139(1) of the Act.
- The assessee shall furnish along with the return a certificate from the accountant in Form No. 10BBC in respect of compliance with the provisions of Section 10(23FE).
- The assessee shall intimate the details in respect of each investment made by it in India during the quarter within one month from the end of the quarter in Form No. 10BBB.
- The assessee shall maintain a segmented account of income and expenditure in respect of investment which qualify for exemption.
- The assessee shall continue to be regulated under the laws of the Government of the Netherlands.
- The assessee shall be responsible for investing the assets for meeting statutory obligations and defined plans established for providing retirement, social security, employment, disability, death benefits or any similar compensation to the participants or beneficiaries of such funds or plans, as the case may be.
- The earnings and assets of the assessee should be used only for specified purposes only.
- The assessee shall not have any loans or borrowings for investments in India; and
- The assessee shall not participate in the day-to-day operations of the investee.

Further, the Notification provides that violation of any of the conditions mentioned above will render the assessee ineligible to claim exemption under Section 10(23FE).

Payment by IFSC unit to a non-resident, which is not chargeable to tax, is not required to be reported in Form 15CA

Section 195 provides for deduction of tax at source in respect of payments made to non-residents. Section 195(6) provides that any person making a payment to the non-resident, whether or not the payment is chargeable under the Act, shall furnish the information relating to such payment in accordance with Rule 37BB of the Rules. Rule 37BB(2) provides that information on payments made to non-residents, which are not chargeable to tax under the Act, shall be furnished in Form No. 15CA. Rule 37BB(3) provides for exceptions to Rule 37BB(2), to not furnish the details of certain transaction in Form No. 15CA.

The CBDT has *vide* Notification No. 89 of 2023 dated 16 October 2023 amended Rule 37BB, to provide as under:

- If remittance is made by a Unit of an International Financial Services Centre referred to in Section 80LA(1A), then such remittance is not required to be furnished in Form No. 15CA.
- Director General of Income-tax (Systems) or the Principal Director General of Income-tax (Systems) can specify the

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procedure to be followed when Form No. 15CA is furnished electronically under digital signature.

- Director General of Income-tax (Systems) or the Principal Director General of Income-tax (Systems) can specify the procedures, formats and standards to be followed in electronically furnishing Form No. 15CA.
- Form No. 15CB shall be furnished and verified electronically as specified by Director General of Income-tax (Systems) or the Principal Director General of Income-tax (Systems).
- Form No. 15CD, an e-form for furnishing quarterly statement by a unit of an International Financial Services Centre as required under Section 80LA(1A), has been inserted. A quarterly statement for each quarter of the financial year to be furnished with respect of all remittances covered under 37BB(1) to (3) in Form No. 15CD.
- Director General of Income-tax (Systems) or the Principal Director General of Income-tax (Systems) shall prescribe the procedure for furnishing and verification of Form No. 15CA, Form No. 15CB, Form No. 15CC and Form No. 15CD.

Rules pertaining to allotment and quoting of PAN amended

Section 139A of the Income Tax Act lists down conditions and transactions, which require a taxpayer to apply for the allotment of Permanent Account Number ('**PAN**') and in which the tax authorities may allot a PAN.

- Rule 114B specifies transactions in relation to which PAN is required to be quoted in all documents for the purposes of Section 139A(5)(c).
- Rule 114BA stipulates that application for allotment of PAN should be made, if the person is entering into transactions falling under Section 139A(1)(vii).
- Rule 114BB stipulates that a person must quote PAN or Aadhaar number if any of the transactions mentioned in Section 139A(6A) is entered into.

The CBDT has, *vide* Notification No. 88 of 2023 dated 10 October 2023, amended Rule 114B, 114BA and 114BB of the Rules:

Rule 114B of the Income Tax Rules:

- The second proviso to Rule 114B, which required any person who does not have a PAN and who enters into any transaction specified in the Rule to make a declaration in Form No. 60, has now been restricted to any person, not being a company or a firm.
- A proviso has been added requiring a foreign company who (a) does not have any income chargeable to tax in India; and (b) does not have a PAN, enters into any mentioned transaction in an IFSC banking unit, to make a declaration in Form No. 60.

Rule 114BA of the Rules:

A proviso has been inserted to provide for non-applicability of Rule 114BA, in a case:

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- where the person, making the deposit or withdrawal of an amount otherwise than by way of cash, or opening a current account not being a cash credit account, is a non-resident;
- the transaction is entered into with an IFSC banking unit; and
- such non-resident does not have any income chargeable to tax in India.

Rule 114BB of the Rules:

A proviso has been inserted to provide for non-applicability of Rule 114BB in a case:

- where the person, making the deposit or withdrawal of an amount otherwise than by way of cash, or opening a current account not being a cash credit account, is a non-resident;
- the transaction is entered into with an IFSC banking unit; and
- such non-resident does not have any income chargeable to tax in India.

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Ratio Decidendi

- Nature of original obligation and nexus of subsequent payment are relevant for characterization of payment as revenue or capital – Supreme Court
- Taxability of app-development, marketing and sales support services, web-hosting services under UAE and Mauritius DTAA – ITAT Delhi
- Subscription fees received from member firms when non-taxable – Delhi HC discusses three tests of mutuality, i.e. commonality of identity, non-profiteering, and obedience to mandate – Delhi High Court
- Borrowed services charges for provision of statistical or qualitative inputs cannot be regarded as FTS – ITAT Mumbai
- Order determining total income and tax payable is a final assessment order – Participation in DRP proceedings does not oust assessee from challenging the validity of such final order – ITAT Delhi

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Ratio Decidendi

Nature of original obligation and nexus of subsequent payment are relevant for characterization of payment as revenue or capital

The Assessee was engaged in the business of telecommunication services and was granted a license under the National Telecom Policy, 1994, (later substituted by the New Telecom Policy, 1999) to establish, maintain, and operate cellular mobile services. The Assessee paid a one-time license fee as 'entry fee' and a further 'variable license fee' @ 15% on the Annual Gross Revenue ('**AGR**').

The Assessee claimed deduction towards the variable licence fee paid under Section 37 of the Income Tax Act, 1961, on the ground that the variable licence fee is made on a revenue sharing basis and is, thus, in the nature of revenue expenditure. The Assessing Officer, however, treated the said expenditure as in the nature of capital and instead allowed deduction under Section 35AAB which permitted the assessee to claim deduction over the license period.

On appeal, the CIT(A) held that the expenditure incurred towards payment of variable licence fee was to operate and maintain the telecom services and thus, was revenue in nature. It was also held that the entry fee paid for establishment and setting-up of business was capital in nature. The same view was upheld by the ITAT and the Delhi High Court.

On appeal before the Supreme Court preferred by the Revenue, the Apex Court held that the expenditure incurred in payment of annual licence fee cannot be segregated into entry fee or variable licence fee without any statutory basis for the same. The variable licence fee is towards right to operate telecommunication services for the reason that failure to pay the same would lead to revocation of the licence as a whole. The variable licence fee and entry fee are made for the same purpose – acquisition of right to carry on the business of operating and rendering telecommunication services. Since this right is in the nature of a capital asset, any payment made towards acquisition of right (lumpsum or annual instalments) would be in the nature of capital disbursement. Nature of payments i.e., classification of entry fee and variable licence fee can be made distinct only when the payments do not have any nexus with the acquisition of capital asset (licence to render telecommunication services). In this case, since there is a nexus, the said distinction will not apply. Accordingly, the Hon'ble SC held that variable licence fee paid by the Assessee is in the nature of capital expenditure and will be eligible to deduction under the provisions of Section 35AAB of the Act. [*Commissioner of Income-tax* v. *Bharti Hexacom Ltd.* – Judgement dated 16 October 2023 in Civil Appeal No. 11128 of 2016, Supreme Court].

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Taxability of app-development, marketing and sales support services, web-hosting services under UAE and Mauritius DTAA

The assessee was engaged in the business of computer software. During the Financial Year relevant to Assessment Year 2017-18, the assessee made various remittances to foreign entities for services like development of a mobile application, market survey and analysis, etc. whereon no tax at source was deducted. These payments pertained to the entities in UAE and Mauritius.

During scrutiny, the AO held that the concerned remittances were in the nature of royalty/ fees for technical services ('**FTS**') and thus, the assessee ought to have deducted tax on the same. On an appeal by the assessee, the CIT(A) held that the concerned payments were not chargeable to tax in India and decided in favour of the assessee.

On appeal by the Revenue, the ITAT held as follows:

- ***Payments made to an entity in UAE:***
  - The payment was made for development of an android app with customisation for the assessee.
  - There was no clause for license being given to the assessee under the agreement. The software once developed was to be owned by the assessee. Therefore, the payments do not qualify as royalty.
  - There is no specific clause for FTS in India-UAE DTAA and therefore, the said payment cannot be brought to tax as FTS.
  - It is a settled position that in the absence of a clause in DTAA not dealing with a particular item of income, the payment should not be regarded as residuary income but as business income which is not chargeable to tax in India in the absence of a PE of the Dubai entity in India.
- ***Payment made to another entity in UAE:***
  - The payment was made towards the provision of certain market survey and analysis, new market sizing, competitive benchmarking services provided to the assessee.
  - The ITAT upheld the findings of the CIT(A) that income of the entity from provision of marketing and sales support services rendered to the assessee cannot be included under section 5(1) of the Act as the same does not deem to accrue or arise in India.
  - In the absence of a specific clause on FTS under the India-UAE DTAA, provisions of Article 22 on residuary/ other income cannot be invoked.
- ***Payment made to the entity in Mauritius:***
  - The payment was made towards the provision of Amazon Web Services, Hosting Services, Virtual Private Cloud services, Virtual Machine Services to the Assessee.
  - The ITAT upheld the findings of the CIT(A) that the said payment does not constitute royalty for the reason that

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there is no privilege or right granted to the assessee over the servers and other equipment used to provide cloud hosting services.

- The ITAT also upheld the findings of the CIT(A) that the installation and operation of sophisticated equipment with a view to earn income by allowing customers to avail the benefits of the user of such equipment does not result in provision of a technical service. Further, in the absence of any specific clause on FTS in India-Mauritius DTAA for the year under consideration also, the said payment does not qualify as FTS.

In view of the foregoing, the ITAT held that there is no obligation on the assessee to deduct tax at source under Section 195 of the Act as the payments are not chargeable to tax in India as held by the Supreme Court in *GE India Technology*. [*DCIT* v. *Campus Eai India Pvt. Ltd.* – Order dated 20 October 2023 in ITA No. 355/ Del/ 2021, ITAT Delhi]

Subscription fees received from member firms when non-taxable – Delhi HC discusses three tests of mutuality, i.e. commonality of identity, non-profiteering, and obedience to mandate

The assessee was an association in Switzerland consisting of members that are Chartered Accountant firms situated across the world. During the Financial Years 2008-09 to 2011-12, the assessee was in receipt of certain income in the form of subscription fee from its members. Since the income was a contribution made by the members for their own benefit, the same was not reported in the return of income by the assessee.

During scrutiny, the AO held that the subscription fee received by the assessee was in lieu of the specific services it provided to the member firms and therefore, the same was taxable.

On an appeal, the CIT(A) held that the subscription fee received by the assessee was not in the nature of trade but are exempted as having been covered by the principle of mutuality. The ITAT upheld the findings of the CIT(A), upon perusal of the Articles of the Assessee/Association.

On a further appeal by Revenue, the Delhi High Court relied on *Bankipur Club Ltd*, to state that for the concept of mutuality to govern the assessee, three conditions have to be satisfied, namely: (a) Element of commonality, (b) Element of non-profiteering, and (c) Element of obedience to mandate.

The Court observed that the Article on dissolution of the assessee provided for proportionate distribution of surplus that was left over from the contributions made by the member firms for meeting operating expenses of the assessee. Therefore, the High Court held that the first test of mutuality was satisfied since there was no commercial nexus between the contributions and benefits enjoyed by the member firms.

The Court held that the second test of mutuality, being non-profiteering is also satisfied, since it was evident from the Articles

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of the Assessee that the Assessee was purely formed for the benefit of the members. The object of forming the Assessee was that it acted as a conduit for member firms to share collective information and resources, so that each member enjoyed the benefit of the group as a whole.

The Court further held that the third test of mutuality, being obedience to the mandate of the association, also stood satisfied since the Articles of Assessee provide for a mechanism to bind all member firms to follow the mandate of the group and it was not the case that just a few member firms excluding others enjoyed the benefit.

The High Court, thus, upheld the order of the ITAT that the receipts of the assessee were exempt from tax being covered under the principle of mutuality. [*CIT* v. *Deloitte Touche Tohmastu* – Judgement dated 18 October 2023 in ITA 399/2022, Delhi High Court]

Borrowed services charges for provision of statistical or qualitative inputs cannot be regarded as FTS

The assessee was a part of Mckinsey group and was incorporated in Singapore. The assessee provided borrowed services to its Indian Associated Enterprise ('**AE**') and received charges for the same. The assessee did not offer this income to tax on the premise that the income was in the nature of business profits and in the absence of a PE, the same was not taxable in India.

During scrutiny, the AO treated the said income as FTS and made additions thereto. On an appeal, the CIT (A) deleted the addition made by the AO.

On an appeal to the ITAT by Revenue, the ITAT referred to Mutual Agreement Procedure ('**MAP**') invoked by AE, whereby the competent authorities of India and USA have accepted that the borrowed service charges cannot constitute FIS under Article 12 of the India-US DTAA. The ITAT held, relying on various rulings, that MAP order should be followed as the provisions of India-Singapore DTAA are similar to the provisions of India-US DTAA and therefore, borrowed services charges cannot be treated as FTS under India-Singapore DTAA.

The ITAT also held that the end product delivered to the client by AE itself is not in the nature of FIS/ FTS. Accordingly, borrowed services from the assessee which are predominantly in the nature of provision of statistical or qualitative inputs cannot by any stretch of imagination be regarded as being in the nature of FTS under Article 12 of the DTAA. Further, in the absence of a PE of the assessee in India, the borrowed service charge received by the assessee would not be taxable in India. [*JCIT* v. *McKinsey & Company Singapore Pte Ltd.* – Order dated 28 September 2023 in ITA No. 2123 to 2125/ Mum/ 2023, ITAT Mumbai]

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Order determining total income and tax payable is a final assessment order – Participation in DRP proceedings does not oust assessee from challenging the validity of such final order

In the Assessee's case who was an 'eligible assessee', the AO passed an order dated 28 June 2022 under Section 143(3) read with Section 144C of the Act along with a demand notice and notice to initiate penalty proceedings against the Assessee. The said order was captioned as *"Assessed u/s 143(3) r.w.s 144C(13) of the Act"*.

Subsequently, on a reference made to the DRP, the DRP issued the directions under Section 144C(5). Based on the directions of the DRP, the AO passed an final assessment order dated 27 April 2023 under Section 143(3) read with 144C(13).

The Assessee preferred an appeal before the ITAT on the ground that the Order dated 27 April 2023 is *non est* in law as the same cannot be construed as a final assessment order since the Revenue had already passed an order in the nature of final assessment order being Order 28 June 2022 itself. The ITAT relied on *Purshottam Das T Patel* wherein it was held that an assessment is said to be complete when an order in writing contains two aspects namely, (i) when the total income of the assessee is assessed and (ii) the tax payable by the assessee is determined. Therefore, the ITAT held that the Order dated 28 June 2022 is nothing but a final assessment order, following which assessments proceedings came to a halt on the very same day.

The ITAT also held that the AO bypassed the mandatory provisions laid down in Section 144C by failing to first forward a draft assessment order and therefore, the Order dated 28 June 2022 is not valid as per Section 144C(1) and that what has been passed is nothing but a final Assessment order. The ITAT also held, relying on *V Mr. T.P. Firm MUAR (SC)*, that subsequent participation of the assessee in DRP proceedings will not act as an estoppel to challenge the validity of the Order passed on 28 June 2022. [*Defsys Solutions Pvt. Ltd.* v. *ACIT* – Order dated 17 October 2023 in ITA No. 1818/Del/2023, ITAT Delhi]

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