Tenet Tax & Legal Private Limited

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Reassessment made to tax royalty by invoking 'Force of Attraction Rule' quashed by Delhi HC

Summary – The High Court of Delhi in a recent case of Oracle Systems Corporation., (the Assessee) held that Where during assessment under section 143(3), receipts by assessee-US company was treated as royalty and taxed on gross basis at rate of 15 per cent, but Assessing Officer initiated reassessment contending that, since assessee had a PE in India, said receipt was to be attributed to Indian PE and said amount was to be taxed at 20 per cent, since Assessing Officer had earlier examined entire issue of royalty and its taxability in its entirety and all relevant facts were fully and truly disclosed by assessee, reassessment proceedings was to be quashed

Facts

- The assessee is a company incorporated in USA and into the business of supplying and replication of software. Royalty payments had been received by the assessee from its Indian subsidiary. The receipts from software were treated as 'royalty' and had been taxed at gross basis as per the DTAA at the rate of 15 per cent.
- Later on initiating reassessment, the contention of the Assessing Officer was that, since the assessee had a Permanent Establishment (PE) in India, and the receipts had been treated as 'royalty', the income should be attributed to the Permanent Establishment by virtue of force of attraction Rule under Article 7. Therefore, the receipts were to be taxed as royalty at the rate of 20 per cent.

Held

- When the Assessing Officer has accepted the assessee's contentions that the royalty was to be taxed under Article 12(2)(a)(ii) at the rate of 15 per cent. It has to be presumed that the Assessing Officer's attention was attracted to the entire article 12 of the DTAA. Article 12 itself carves out an exception under clause (6) thereof. Therefore, it cannot be accepted, as is sought to be made out by the revenue, that the Assessing Officer had not applied his mind to this aspect of the matter. The aspect of attribution was too obvious and apparent for the Assessing Officer to have been ignored in the first round/original proceedings. When the Assessing Officer was examining the entire issue of royalty and its taxability the Assessing Officer must have examined article 12 of the DTAA in its entirety, which also contained the exception mentioned in clause (6) thereof.
- When a regular assessment is completed in terms of section 143(3), a presumption can be raised that such an order has been passed upon a proper application of mind. What the Assessing Officer was seeking to do by way of reassessment would amount to a clear change of opinion and that was not permissible. The revenue has been unable to point out as to which material fact had not been disclosed fully or truly. Even the reasons do not specify or indicate as to which material fact had not been disclosed fully or truly by the assessee.

- In the present case, there is not even any allegation as to which material fact had not been disclosed fully or truly by the petitioner/assessee. To the contrary, the reasons recorded indicate that on the basis of very same facts which were before the Assessing Officer at the time of original assessment under section 143(3), the reopening of the assessment has been proposed. No new material fact has been relied upon.
- The impugned notices under section 148 and all proceedings pursuant thereto including the orders disposing of the objections were to be quashed.