Tax alert: Bombay High Court rules that foreign associated enterprise entitled to claim refund on reduced royalty income pursuant to APA signed by its Indian counterpart

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The Bombay High Court has ruled that pursuant to APA conclusion, the India AE raised an invoice on the foreign entity, the foreign entity repaid the excess royalty income to its Indian AE, and hence, was eligible to claim refund of the tax paid on such excess royalty income which was offered to tax.

In a nutshell

The Bombay High Court has held that the foreign taxpayer is eligible to a refund of excess income tax paid on the royalty income received by it, pursuant to a raised invoice as a result of the conclusion of an APA, by its Indian AE, and dismissed the contention of the tax department

The Court noted that contention of the revenue on application of Section 92(3), second proviso to 92C(4) and 92CE(2), of Income-tax Act 1961 [ITA] would not be applicable in the given case. The Court also upheld the taxpayer's contention that income subject to tax shall be the 'real income' arising to the foreign entity

The Court also held that there was no substantial question of law with respect to the existence of a Permanent Establishment for the foreign taxpayer in India and hence, the receipt of royalty income shall be subject to tax as per the treaty rates.

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Background

- The Taxpayer Respondent[1], is a US-based company and a world leader engaged in the business of gem grading/certification.
- The subject ruling relates to Assessment Year (AY) 2011-12 (as well as the years till 2016-17) wherein the Taxpayer Respondent was subject to assessment by the income-tax authorities. The Taxpayer Respondent had offered royalty income received of INR 68,53,46,239 from its Indian Associated Enterprise (AE) - GIA India Laboratory Private Limited ('GIA India') to tax. The Taxpayer Respondent's case was picked up for scrutiny, and the Assessing Officer had made certain upward additions to the income.
- On the other hand, GIA India, had filed an APA application with the Central Board of Direct Taxes (CBDT) in India, on 22 March 2013, with respect to the transaction of royalty payment to the Taxpayer Respondent. The term of the APA application initially filed covered Financial Years 2013-14 to 2017-18. Further, a rollback application was filed on30 March 2015, covering financial years 2009-10 to 2012-13. The APA was signed on 7 May 2018 and the arm's length price for the royalty payment was negotiated to INR 49,08,99,461, for AY 2011-12. One of the terms of the APA conclusion was that the Taxpayer Respondent shall repatriate the excess royalty income ie, INR 19,44,46,788, in the present case, to GIA India.
- GIA India, complying with the terms of the APA, had raised the invoice on the Taxpayer Respondent for the excess royalty it had received as income for the years covered under the APA and subsequently, the Taxpayer Respondent had duly repatriated the sums due to GIA India.
- GIA India had also filed a modified return pursuant to the APA wherein it had claimed deduction for the reduced royalty amount, as per the APA. In parallel, as its litigation proceedings were ongoing and was at the ITAT stage, the Taxpayer Respondent had raised additional grounds before the ITAT contending that the excess royalty income refunded could not be regarded as its income and hence, it should not be assessed on the same. Similar grounds were raised for other AYs which were also in litigation before the ITAT.
- The ITAT had vide its order dated 30 April 2021 had appreciated the claim of the Taxpayer Respondent and held that and the amounts repaid by it to GIA India were directed to be reduced from the total income of Taxpayer Respondent, subject to verification of whether these amounts were paid back.

Contentions of the Revenue

- The Revenue had challenged that the order of the ITAT was misplaced to the extent that it allowed the Taxpayer Respondent's claim with respect to the refund arising on the royalty income repaid to GIA India. The Revenue had primarily relied on Section 92(3) of ITA 1961 to state that the income of the Taxpayer Respondent, as per the extent Indian Transfer Pricing provisions, cannot be reduced as it would result in a contravention of the provision of Section 92 of ITA 1961.
- The Revenue also contended that the APA mechanism cannot be used as a vehicle to achieve indirectly what the statute prohibits directly. A non-resident AE could never, in law *[in view of Section 92(3)]* have entered into an APA for the purpose of seeking a downward revision of its income.
- The Revenue also highlighted that there is no provision in the law which provides for the non-resident entity, to reduce its income, pursuant to an APA. The current Section 169 of ITA 2025 operates prospectively with effect from 1 April 2026 and the Taxpayer Respondent cannot take shelter under this provision retrospectively. The Revenue had also placed reliance on the provisions of Section 92CE(3)

[1] M/s. Gemological Institute of America Inc – involving appeals in ITA 945/2022, 2306/2022, 73/2023, 779/2023, 21874/2022, 72/2023, 2331/2022, 553/2023

wherein primary adjustment was defined as determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be.

- To buttress the findings of the ITAT wherein corelative relief was allowed in the hands of the Taxpayer Respondent, the Revenue had also placed heavy reliance on the second proviso to Section 92C(4) which states that the income of the associated enterprise shall not be recomputed based on the arm's length price determined in the hands of the Assessee.
- The Revenue also countered the argument of the Taxpayer Respondent to the extent it related to aspect of only 'real income' being taxed, by relying on the ruling of the coordinate bench in the case of *Kishinchand Chellaram and Others Vs. The Commissioner of Income-Tax Central Bombay*[2], which was subsequently upheld by the Apex Court.

Contentions of the Taxpayer Respondent

- The Taxpayer Respondent argued that the provisions of Section 9(1)(vi) of ITA 1961 as well as the DTAA[3] had clearly established that royalties "paid" shall be subject to tax in India and hence, only the real income in the hands of the Taxpayer Respondent shall be the subject matter of contention.
- The Taxpayer Respondent had also stated the basic premise of Section 92(3) shall be applicable to the same person to whom provisions of Section 92(1) with respect to determination of arm's length price applies. In the given case, provisions of Section 92(1) was applicable in the hands of GIA India and hence, there was no bar on the application of Section 92(3) to the Taxpayer Respondent.
- The Taxpayer Respondent also submitted that the reliance on the second proviso of Section 92C(4) by the revenue was misplaced as this particular proviso does not apply in a case where an APA is agreed and signed. Once an APA is agreed between a taxpayer and the government, the provisions of the APA would override the provisions of the law. It was also argued that the proviso to Section 92C(4) shall apply in the hands of an Assessee who is subject to a process of determination of arm's length price/ a transfer pricing adjustment as per Section 92C(3)[4].
- The Taxpayer Respondent also categorically stated that the provisions of Section 92CE(3), dealing with primary adjustment, shall not be applicable in the present case as the argument was with respect to the determination of income of the Taxpayer Respondent and not GIA India. If at all the provisions of primary adjustment were applicable, they shall be applicable only to GIA India not the Taxpayer Respondent.

High Court judgement

- The Bombay High Court accepted the contentions of the Taxpayer Respondent insofar as it relates to the scope of Section 92(3), second proviso of Section 92C(4) and Section 92CE(3). The Court held that these provisions do not find any application/ merit in the present scenario as the litigation is in the hands of the foreign taxpayer whereas the aforementioned provisions would apply in the hands of GIA India.
- The Court also appreciated the Taxpayer Respondent's contention that the scope of income subject to tax as laid out in the ITA as well as the DTAA was only the amount actually 'paid' to the foreign enterprise and does not include the amount which is repaid/ repatriated.
- The Court also noted that GIA India had claimed deduction for the lower amount of royalty as per its

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[2] 46 ITR 640 and 1955 SCC Online Bom 134
[3] Article 12 of the India – US tax treaty
[4] The Taxpayer Respondent had relied on the ruling of the Karnataka High Court in the case of EYGBS India Pvt Ltd. [(2025) 180 taxmann.com 681]

modified return pursuant to the APA. Further, the Taxpayer Respondent had sought to offer the reduced royalty income to tax. If the corresponding relief is not granted to the Taxpayer Respondent, it would result in double taxation for the same income, which was not appropriate.

- The Court also noted that one of the critical assumptions of the APA between the CBDT and GIA India was that the Taxpayer Respondent shall repatriate the excess royalty income to GIA India. As the critical assumptions form the very base of an APA, once these conditions are satisfied, the provisions of the law would be subsumed by the terms of the APA.
- The Court also appreciated the contentions of the Taxpayer Respondent that only the real income in the hands of the taxpayer shall be subject to tax, which was supported by various judicial precedents in this regard.

Deloitte comments

This is a favourable ruling of the Bombay High Court which lays down the scope of income chargeable to tax for a non-resident entity who is not a party to an APA.

Considering that the revenue could challenge the ruling of the High Court before the Supreme Court, further developments on the matter should be closely tracked, in due course of time.