How a clerical error led to substantial tax litigation

By: Ravi S. Raghavan, Partner, Tax and Private Client Group, and Prerna Seerwani, Associate, Majmudar & Partners, India

The Gujarat High Court (the "**HC**"), in a recent ruling (the "HC Ruling"), dismissed the Indian tax department's (the "**ITD**") appeal against a Tribunal Ruling allowing the taxpayer to rely on a beneficial double taxation avoidance agreement provision previously denied by the ITD due to a mere clerical error in Forms 15CA and 15CB.

Background

Star Rays, an Indian partnership firm engaged in the diamonds business, (the "**Taxpayer**") had a customer services agreement with the Gemmological Institute of America ("**GIA US**") for testing and certification of diamonds. GIA US had a laboratory in Hong Kong named GIA Hong Kong Laboratory Limited ("**GIA HK**").

The Taxpayer sent certain diamonds to Hong Kong for certification by GIA US and made payments for services to GIA US' offshore bank account in Hong Kong. The Taxpayer did not withhold tax on the payments because of the services not being taxable under Article 12 of the Double Taxation Avoidance Agreement between India and the USA (the "**US DTAA**"). Importantly, in the Form 15CA (which is a self-declaration for payment by a resident to a non-resident) and Form 15CB (which is a certificate issued by a chartered accountant certifying the payment and applicable taxes), the beneficiary's name was erroneously mentioned as GIA HK instead of GIA US.

The ITD denied the Taxpayer the benefit of the US DTAA, arguing that as the payment was made in Hong Kong Dollars to GIA US' offshore bank account in Hong Kong and GIA HK was named as the beneficiary in Forms 15CA and 15CB, the services were rendered by the Taxpayer to GIA HK and not GIA US. Accordingly, as the services were in the nature of technical services, the Taxpayer was obliged to withhold tax on the payments made to GIA HK, and because the Taxpayer failed to withhold tax, it was an assessee-in-default and liable to pay applicable penalties and interest.

The HC ruling

The HC took note of the Tribunal Ruling and held that:

- the invoices for payment of fees were issued by GIA USA;
- the remittances were into the offshore bank account of GIA USA;
- GIA HK had no relationship to the account into which the remittances were made; and
- there was evidence in the accounts reflecting payments received in Hong Kong Dollars in the offshore bank account of GIA USA.

The HC concluded that the Taxpayer's case was protected under the US DTAA as mere rendering of services cannot be characterized as FTS, unless the person utilising the services

Raheja Chambers, 2nd floor, Free Press Journal Road, Nariman Point, Mumbai 400 021, India
Tel: +91 22 6123-7272; Fax: 6123-7252; E-mail: mailbox@majmudarindia.com
Other Office – Bangalore | Integrated Network Offices – Chennai, Hyderabad and New Delhi
www.majmudarindia.com

is able to make use of the technical knowledge. Although the argument that GIA HK (instead of GIA US) was mentioned in Forms 15CA and 15CB was brought by the ITD before the HC, the HC did not go into the merits of that argument. Consequently, the appeal was dismissed as lacking any substantial question of law.

Our comments

In many M&A transactions, we have seen considerable time being devoted on the representations, warranties, tax valuation and indemnity sections (which are of course very important), but when it comes to post-closing compliance obligations everyone's attention wanes. In this case, the Taxpayer's clerical mistake led to tax litigation which went on for almost eight (8) years. Considering the increased scrutiny by the ITD and its endeavor to deny tax treaty benefits, a taxpayer must exercise caution and ensure proper preparation of tax and foreign exchange filings free of any clerical mistakes, so as not to give the ITD any scope to initiate an enquiry.

Raheja Chambers, 2nd floor, Free Press Journal Road, Nariman Point, Mumbai 400 021, India
Tel: +91 22 6123-7272; Fax: 6123-7252; E-mail: mailbox@majmudarindia.com
Other Office – Bangalore | Integrated Network Offices – Chennai, Hyderabad and New Delhi
www.majmudarindia.com