TAX HIGHLIGHTS

11 January 2016

Table of contents

Permanent establishment
The Indian company constitutes dependent agent permanent establishment of the US television company The taxpayer is a US based company and is a subsidiary of 'Fox Entertainment Group Inc.'. It holds 100 per cent shares in NGC Network (Mauritius) Holden Ltd, which in turn, holds 99 per cent shares in NGC Network (India) Private Limited (NGC India). All these companies are either subsidiaries/affiliate companies of News Corporation, USA. The taxpayer is the owner of two television channels viz., The National Geographical Channel and Fox International Channel. It is engaged in the business of broadcasting of its channels in various countries including the Indian sub-continent. The taxpayer is eligible for the tax treaty benefit. The taxpayer has appointed NGC India as its distributor to distribute its television channels and also to procure advertisements for telecasting in the channels. Hence, the taxpayer generates two streams of revenues from India, i.e. (a) Fee for giving distribution rights for telecasting of its channels and (b) Advertisement revenues. During the Assessment Year (AY) 2007-08, two agreements entered by the taxpayer with NGC India in respect of advertisement revenues. As per the old agreement, the taxpayer has given commission at 15 per cent to NGC India and retained 85 per cent of the advertisement revenue. As per the new agreement, it has received fixed amount from NGC India for giving contract of procuring advertisements. The taxpayer claimed that both types of income are not taxable in India and accordingly did not offer them in the return of income filed for AY 2007-08. The Assessing Officer (AO) held that the advertisement revenues as well as distribution revenues are taxable in India since NGC India is having a Dependent Agent Permanent Establishment (DAPE) of the taxpayer under the India-U.S. tax treaty. The AO accordingly assessed 25.34 per cent of the advertisement revenues as income of the taxpayer attributable to India, i.e. in the ratio of worldwide profits to worldwide revenue, in accordance with Rule 10B(ii) of the Income-tax Rules, 1962 (the Rules). The Dispute Resolution Panel (DRP) upheld the order of the AO. **The Mumbai Tribunal held as follows:** ***Whether advertisement air time shall fall under the category of goods*** • The advertisement revenue would depend upon the number of advertisements received and also the quantity of air time used. There should not be any dispute that NGC India has acted as an agent of the taxpayer under the old agreement. The 'advertisement air time' is an item that can be identified and abstracted, since the telecasting time limit is predetermined. The right over the advertisement air time may also be capable of being possessed till the time of its expiry. • One of the main characteristics of 'goods' is that it should be capable of being 'consumed' or 'used'. There should not be any doubt that the 'advertisement air time' shall have value or capable of being used/consumed only, if the concerned advertisement material is telecast by the taxpayer herein, i.e., the advertisement air time gets is value only if the taxpayer agrees to telecast the concerned advertisement material. • In the case of 'goods', it gets separated from its manufacturer, and it can be used/consumed by anyone independent of or without any support from the manufacturer. Further, the 'goods' shall be capable of universal use. However, the 'advertisement air time', in the present case, is related to the television channels owned by the taxpayer only. • The advertisement airtime sold by the taxpayer or NGC India shall not have any value with regard to other television channels, meaning thereby, the same cannot be separated from the taxpayer. In the present case the 'advertisement air time' fails to satisfy the test that it is capable of being used/consumed independently, i.e., independent of the taxpayer herein. Hence, through the purchase of advertisement airtime, a person gets a right to get his advertisement material telecasted in the television channels owned by the taxpayer. • The AO correctly held that the 'advertisement air time' cannot fall under the category of 'goods'. It is only a right given to NGC India to procure advertisements. Though the 'right to procure

advertisements' for particular 'airtime' may be capable of being transferred, but the same cannot be consumed/used by the buyer of the right, without the assistance from the taxpayer by way of telecasting the same in the television channels.

Principal and agent relationship

- The nature of the principal-agent relationship was examined by the Delhi High Court in the case of CIT v. Idea Cellular Ltd [2010] 325 ITR 148 (Del). In a principal to the principal relationship in respect of the sale of goods, the manufacturer does not come in the picture in respect of the further sale of goods. The 'advertisement airtime' does not give to anybody the right of universal use and the same is restricted to the channels owned by the taxpayer only.
- Even after the sale of 'advertisement airtime' by the taxpayer, the purchaser gets only a right to enforce the taxpayer herein to telecast the advertisement material of the purchaser, i.e., taxpayer's concurrence to telecast the advertisements and also actual telecasting alone brings value to the 'advertisement airtime'.
- The taxpayer's involvement till the completion of telecasting of advertisement material is essential in order to maintain the value of advertisement airtime. Hence, 'advertisement airtime' cannot be categorised as 'goods' within the legal meaning of the said term. Accordingly, what is being sold by the taxpayer is only the facility of telecasting of advertisements through the advertisement materials given by the clients.
- NGC India cannot be considered to be selling any 'goods' and in effect, it is only canvassing the advertisements for the taxpayer herein. Thus, NGC India provides only agency services to the taxpayer and in turn, the taxpayer is providing advertisement services or telecasting services to the clients. The concept of purchase and sale of goods, cannot be applied to the facts of the present case. Accordingly, it has been held that NGC India is only enabling the taxpayer to procure the advertisements for telecasting them, and hence NGC India cannot be considered as selling advertisement airtime independent of the taxpayer. Accordingly, NGC India cannot be considered to be 'an independent principal/agent' in respect of dealing in advertisement airtime relating to the television channels owned by the taxpayer.
- It is a well settled proposition that the substance shall prevail over the form and hence even if the new agreement states that the relationship between the taxpayer and NGC India is that of 'principal to principal' basis, it has been observed that the relationship between them actually exists on 'principal to agent' basis only.
- Under the old agreement, the taxpayer has paid 15 per cent of the revenue as commission to NGC India and under the new agreement it has sold advertisement airtime for a fixed consideration. In our view, the taxpayer has only changed the method of giving compensation to NGC India or method of generating revenue from the broadcasting of advertisements.

Dependent Agent PE

- On a perusal of the various clauses of the new agreement, it has been observed that NGC India habitually exercises in India an authority to conclude contracts on behalf of the taxpayer and the same is binding on the taxpayer since it has agreed to broadcast the advertisements procured by NGC India.
- Hence, NGC India should be classified as 'dependent agent' of the taxpayer in terms of Article 5(4)(a) of the India-U.S. tax treaty. Accordingly, the taxpayer was having Permanent Establishment (PE) in India through its dependent agent NGC India in terms of Article 5(4)(a) of the treaty, since NGC India has been given full authority to conclude the contracts in India.

NGC Network Asia LLC v. JDIT (ITA No. 7994/Mum/2011) – Taxsutra.com

For further details, please refer to our Flash News dated 18 December 2015 available at this link

Revenue earned from distribution of news, and financial information products are not taxable in India, in the absence of a dependent agent PE and service PE under the India-U.K. tax treaty

The taxpayer is a resident of the U.K. It is engaged in the business of providing worldwide news and financial information products. The taxpayer produces, compiles and distributes news and financial information products through the 'Reuters Global Network' with a vast global communication network. The taxpayer uses the network to receive and transmit information and provide access to the compiled news and edited financial information to distributors in various countries. In India, the taxpayer provides Reuters products to its Indian subsidiary named as Reuters India Private Limited (RIPL) under certain specified agreements. In turn, the RIPL distributes Reuters products to the Indian subscribers independently in its own name. The taxpayer entered into three kinds of contractual agreements with RIPL i.e. license agreement, product distribution agreement and distributor agreement.

Under the distributor agreement, RIPL has been appointed as the distributor to sell designated Reuter products to subscribers in India using the Reuters Global Network. Under the aforesaid agreement, the taxpayer provides RIPL, connection to the Reuters Global Network whereby products are made available to the RIPL, which are then distributed by RIPL to various subscribers in India independently. During the relevant year, the taxpayer had deputed Mr. Simon Cameron Moore, as the News Bureau Chief (NBC) of Mumbai for gathering, writing and distributing the news and overall coverage of news. In terms of the distributor agreement, the taxpayer had received distribution fees which were claimed to be not taxable in India in the absence of a PE. The AO held that the revenue earned by the taxpayer was taxable as Fees for Technical Services (FTS) under Article 13 of the India-U.K. tax treaty. It was held that RIPL constituted to be a dependent agent PE in India under Article 5(5) of the India-U.K. tax treaty and therefore, income was taxable under Section 44D of the Income-tax Act, 1961 (the Act) on a gross basis. The DRP upheld the order of the AO.

The Mumbai Tribunal held as follows:

Agency PE

On referring to the relevant terms of the distribution agreement, it indicates that nowhere has it been specified or that there is any mandate stating that RIPL was habitually exercising its authority to negotiate and conclude contracts on behalf of the taxpayer in the territory of India, which is binding or can bind the taxpayer. It envisages simply delivering of Reuter services for a price which can be further distributed by RIPL for earning its own revenue. There was no clause in the agreement that RIPL will act as an agent on behalf of the taxpayer qua the distribution to subscribers. In fact, RIPL has an independent contract with the subscribers, which is evident from the contract agreement between RIPL and third party subscribers in India. Similarly, when RIPL is supplying news and material to the taxpayer, the same is again on a principal-to-principal basis. The second condition as mentioned in Article 5(4) of the India-U.K. tax treaty is also not fulfilled, because RIPL does not habitually maintain a stock of any goods and merchandise, for which it can be held that it is regularly delivering goods on behalf of the taxpayer. Lastly, it is not habitually securing orders wholly and almost wholly for the taxpayer.

Even under Article 5(5) of the India-U.K. tax treaty, the activities of RIPL cannot be said to be devoted wholly or almost wholly on behalf of the taxpayer as it had entered into contracts with subscribers in India on an independent and on principal-to-principal basis for earning and generating its revenues. In fact, revenue from third party subscribers was far excess than the transaction with the taxpayer. In the present case, it was not that the RIPL was completely or wholly doing any activity for the taxpayer and earning income wholly from the taxpayer only. Thus, the conditions laid down in Article 5(5) of the India-U.K. tax treaty are also not fulfilled.

Service PE

There was no furnishing of services by the NBC to RIPL, which had led to earning a distribution fee to the taxpayer. As per the terms of the agreement, the taxpayer was merely delivering Reuters services to the distributors. The NBC has nothing to do with respect to providing of Reuters services to the distributor. The NBC was only acting as a chief reporter and text correspondent in India in the field of collection and dissemination of news. Thus, it cannot be held that the NBC constitutes a service PE in India for the taxpayer under Article 5(2)(k) of the India-U.K. tax treaty, as it has not furnished any services in India on which the taxpayer has earned a distribution fee.

Reuters Limited v. DCIT (ITA No. 7895/Mum/2011) (Mum) – Taxsutra.com

For further details, please refer to our Flash News dated 16 September 2015 available at this link

Royalty and fees for technical services

Income from EPC related offshore services is neither taxable as fees for technical services nor as business income under the India-Japan tax treaty

The taxpayer, a company, incorporated in and a tax resident of Japan was engaged in the manufacturing of heavy machinery, providing technology oriented products and services. The taxpayer was awarded three Engineering Procurement Construction (EPC) and commissioning contracts by Petronet LNG Limited in India. The contract consideration under these agreements is segregated into an offshore and onshore portion. The onshore portion comprises of onshore supply of equipment and services in India while the offshore portion comprises of the offshore supply of equipment and services from outside India. For the purposes of the execution of this contract the taxpayer set-up a project office in India.

In the return of income, the taxpayer offered the income received from onshore activities to tax in India with a claim of the applicability of the India-Japan tax treaty or the domestic law, whichever is beneficial to it. The taxpayer did not offer to tax the income from offshore supply offshore services by claiming that it did not accrue or arise in India. In support of its contention, the taxpayer relied on the Supreme Court decision in the case of Ishikawajima-Harima Heavy Industries Ltd. v. DIT [2007] 288 ITR 408 (SC). The taxpayer claimed an exemption of income from offshore services from tax by stating that its project office in India had no role to play in respect of the offshore services rendered. The AO as well as the DRP opined that the Supreme Court's decision in the taxpayer's own case was rendered prior to the retrospective amendment carried out to Section 9(1)(vii) of the Act. Also, the amount was liable to be considered as FTS under Article 12 of the India-Japan tax treaty. Resultantly, the gross sum received by the taxpayer towards offshore services was subjected to tax at 10.56 per cent.

The Mumbai Tribunal held as follows:

Taxation under the Act

- The Finance Act, 2010 has substituted the Explanation below Section 9(2) of the Act, whereby the income from FTS shall be deemed to accrue or arise in India to a non-resident whether or not, inter alia, the non-resident has rendered services in India.

- The substitution of this Explanation has diluted the twin conditions formulated by the Supreme Court in the taxpayer's own case, being the rendering of services and the utilisation of such services in India as a pre-requisite for attracting Section 9(1)(vii) of the Act. With this substitution, the rendering of services even outside India would be a good case for bringing the income of non-residents from FTS within the purview of Section 9(1)(vii) of the Act, if such services are utilised in India.

- In view of above, income from offshore services rendered outside India would fall within the domain of Section 9(1)(vii) of the Act.

Taxation under the India-Japan tax treaty

- The Supreme Court in the taxpayer's own case has rendered a positive decision on this aspect by holding that Article 7 of the India-Japan tax treaty is applicable in this case insofar as the income from offshore services is concerned. It has further been held that since the entire service was rendered outside India having nothing to do with the PE, this amount cannot be taxed in India.

- Further, the offshore services are inextricably linked to the supply of goods, so it must be considered in the same manner. In view of the enunciation of law by the Supreme Court in the taxpayer's own case, it becomes vivid that the income from identical services rendered by the taxpayer in respect of the contract under consideration cannot be characterised differently.

- In the AY 2003-04, the jurisdictional High Court noted that the Supreme Court in the taxpayer's own case had held that apart from the non-applicability of Section 9(1)(vii) of the Act, Article 7 of the India-Japan tax treaty is also applicable and hence the income arising on account of offshore services would not be taxable.

- The Supreme Court in the case of CIT v. P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC) held that the provisions of Sections 4 and 5 are subject to the contrary provision, if any, in the India-Japan tax treaty. The crux of the matter is that the provision of the Act or that of the India-Japan tax treaty, whichever is more beneficial to the taxpayer, shall apply.

- Accordingly, it was held that the income from offshore services, albeit chargeable under Section 9(1)(vii) but exempt under the India-Japan tax treaty, cannot be charged to tax in the light of Section 90(2) of the Act.

IHI Corporation v. ADIT [ITA No.7227/Mum/2012] (Mum) – Taxmann.com

For further details, please refer to our Flash News dated 21 December 2015 available at this link

Services in connection with procurement of goods are taxable as FTS under the India-China tax treaty

The applicant is a company registered under the laws of China. The share capital of the applicant is held by Usha International Limited (UIL), having its registered office in India. The applicant has been set-up to carry out the business of import and export and also to provide services relating to the business of household electrical appliances and equipment, household goods and accessories, etc. to the Indian company. The applicant had entered into a Memorandum of Understanding (MOU) with UIL for providing services in connection with the procurement of goods by UIL from vendors in China. Subsequently, the MOU was converted into a service agreement. As per the agreement, the applicant has to render services to UIL in the form of new supplier's development, new products development, market research, price, payment terms, safety/performance/endurance test, review of the quality system, inspection through SGS, interaction with vendors and information sharing with UIL. While making the payment of service fees to the applicant company, UIL had deducted tax at source at the rate of 10 per cent, considering the payment was in the nature of FTS under the India-China tax treaty. The applicant filed an application before the Authority for Advance Rulings (AAR) on the issue of whether service fees received for providing services in connection with procurement of goods are taxable in India.

The AAR referred to the India-China tax treaty and the China-Pakistan tax treaty and observed that it is necessary to point out the distinction between the two. In the India-China tax treaty, the expression used is 'provision of services of managerial, technical or consultancy nature' while in the China-Pakistan tax treaty the expression used is 'provision of the rendering of any managerial, technical or consultancy services'. The AAR observed that the expression 'provision of services' is not defined anywhere in the India-China tax treaty. It is concerned only with the India-China tax treaty. Any other tax treaty either between India and another country or between China and another country cannot influence the scope of the India-China tax treaty. This distinction clearly points out that the scope of 'provision of services' as in the India-China tax treaty is much wider than that of 'provision of the rendering of services' as in the Pakistan-China tax treaty. Based on this distinction, the AAR in the case of Inspectorate (Shanghai) Limited [AAR No.1005 of 2010] held that 'provision of services' will cover the services even when these are not rendered in the other contracting state (i.e. India in this case) as long as these services are used in the other contracting state (i.e. India in this case). The Mumbai Tribunal in the case of Ashapura Minichem v. ADIT [2010] 40 SOT 220 (Mum) held that if at all the contrast with the China-Pakistan tax treaty shows something, this contrast shows that the India-China tax treaty intends to follow the source rule, while the China-Pakistan tax treaty gives up the source rule for FTS.

On a perusal of the list of services provided in the service agreement, it indicates that the applicant is not only identifying the products but also generating new ideas for UIL after conducting market research. It is also evaluating the credit, organisation, finance, production facility, etc. and based on advice in the form of a report to UIL. Such an evaluation can only be given by an expert in the specific area. The applicant is also providing information on new developments in China with regard to technology/product/process upgrade. These are specialised services requiring special skill, acumen and knowledge. These services are definitely in the nature of consultancy services. Accordingly, it has been held that the amount of service fees received by the applicant from UIL for providing consultancy services is taxable in India.

Guangzhou Usha International Ltd. [2015] 62 taxmann.com 96 (AAR)

For further details, please refer to our Flash News dated 15 October 2015 available at this link

Management and procurement services do not make available any technical knowledge, skills, etc. and, therefore, are not taxable as fees for technical services under the India-U.K. tax treaty

The applicant is a company incorporated in the U.K. and is engaged in the development and supply of intrinsic safety explosion protection devices, field bus and industrial networks, etc. The applicant is a wholly owned subsidiary of MTL Instruments Group Ltd., U.K. (MTL U.K.). MTL Instruments Private Limited (MTL India) is an Indian company and a subsidiary of MTL UK. MTL India is engaged in the business of manufacturing industrial control equipment used for process control in hazardous environments. The applicant entered into two service agreements with MTL India for providing management and procurement services.

The management services were provided through one of the employees of the applicant based in the U.K. designated as Group Operations Director (GD) by means of telephone calls, e-mails and occasional visits to India. While sitting in the U.K., GD monitors the financial and operational progress of activities of MTL India. GD also renders services as regards human resource matters of MTL India such as hiring new personnel, setting up individual performance targets, assisting in performance appraisal, etc. GD was also involved in quality and design reviews. As per this agreement, MTL India shall compensate the applicant for providing the management services at cost plus 5 per cent and for this purpose only 50 per cent of the cost (total remuneration of the GD) is allocated by MTL U.K.

The second agreement was entered for the provision of procurement services with a view to reduce cost and to avoid duplication of procurement efforts within the MTL Group. As per the agreement, the applicant had constituted a procurement team in the U.K. to look into the global sourcing requirements of raw materials within the MTL Group including MTL India. The procurement team travels to different countries to visit suppliers and distributors to determine the best price that would be available to MTL group. Their services include setting up the material supply chain, logistic support and providing support to resolve technical issues with supplies from global sources. MTL U.K. was compensated for the procurement services on a cost to cost basis (without any mark-up) and for this purpose, only 30 per cent of the cost of the procurement term was allocated to MTL India.

The AAR held that the consideration received by the applicant for management and procurement services is not taxable in India as per the provisions of the India-U.K. tax treaty since such services do not make available any technical knowledge, skills, etc. The AAR also observed that managerial services are not covered in the definition of FTS in the India-U.K. tax treaty and the same are routine managerial activities and cannot be classified as technical or consultancy services. Further, the AAR observed that procurement services can never be classified as technical or consultancy in nature, and therefore, such services are not FTS under the India-U.K. tax treaty.

Measurement Technology Ltd. [2015] 376 ITR 461 (AAR)

For further details, please refer to our Flash News dated 13 August 2015 available at this link

Payment for e-learning courses and online information resources is taxable as royalty under the India-Ireland tax treaty

The applicant is an Ireland based company, engaged in the business of providing on demand e-learning course offerings, online information resources, flexible learning technologies and performance support solutions (SkillSoft products). The applicant has entered into a reseller agreement with SkillSoft Software Services India Private Limited (SkillSoft India). Under this agreement, SkillSoft India is a distributor and has the right to license, market, promote, demonstrate and distribute SkillSoft products by providing online access to such products.

SkillSoft India buys the SkillSoft products from the applicant on a principal-to-principal basis and sells the same to Indian end users/customers in its own name. According to the applicant, it has developed copyrighted products by using software and techniques, on several topics which were electronically stored on its server outside India. These SkillSoft products are licensed to Indian end users/customers under the master licence agreement between SkillSoft India and Indian end users. SkillSoft India grants to the Indian end users a non-exclusive, non-transferable license to use and to allow the applicable authorised audience to access and use SkillSoft products. The products consist of two components namely the course content and the software through which the course content is delivered to the end customer. Its e-learning platforms are not instructor driven and have no element of human interaction in the learning programmes. The interaction is restricted to software enabled virtual interaction through text, images and graphics that are utilised to enhance the learning experience.

The issue before the AAR was whether payments received by the applicant on account of e-learning course offerings, online information resources, etc. is taxable as 'royalty' under Article 12(3)(a) of the India-Ireland tax treaty.

The AAR held that e-learning course offerings, online information resources, etc. are software and computer databases created by the applicant, included within the ambit of 'literary work' under Article 12(3)(a) of the India-Ireland tax treaty. Irrespective of the use of words like 'non-exclusive' and 'non-transferable' in the relevant agreements, there is a transfer of certain rights owned by the applicant. In terms of the tax treaty, the consideration paid for the use or a right to use the confidential information in the form of computer software, itself constitutes a royalty. Accordingly, payment for e-learning courses and online information resources is taxable as royalty under the India-Ireland tax treaty.

Skillsoft Ireland Limited [2015] 376 ITR 371 (AAR)

For further details, please refer to our Flash News dated 12 August 2015 available at this link

Business development and marketing related services do not make available technical knowledge, skills, etc., and hence it is not taxable as 'fees for included services' under the India-USA tax treaty

The taxpayer is incorporated in the U.S. It is engaged in providing business development, market services and other support services to its Associated Enterprises (AE's) in India. During the year under consideration, the taxpayer had earned fees from providing these support services. In the income tax return, the entire income was claimed to be taxable exclusively in the U.S.A. and not in India under Article 12(4)(b) of the India-U.S. tax treaty. The AO held that the services rendered by the taxpayer were mostly consultancy services. The AO also observed that the taxpayer was providing technical services to its AEs and also made available technical knowledge to the service recipients. Therefore, it was held that services provided were in the nature of Fees for Included Services (FIS) under the Act and under the India U.S. tax treaty. The DRP not only confirmed the

AO's order on the taxability of FIS but also held that the taxpayer has a DAPE in India. The Indian AEs of the taxpayer act as an agent of the taxpayer in purchasing the products of the taxpayer and distribute the same to various companies. Accordingly, the DRP held that a part of the consideration was taxable as business profits in India.

The Bangalore Tribunal held as follows:

Fees for Included Services

The main condition for invoking the 'make available' clause is that the services should enable the person acquiring the services to apply technology contained therein. The Karnataka High Court in the case of CIT v. De Beers India (P.) Ltd. [2012] 346 ITR 467 (Kar) has approved the same. Unless there is a transfer of technology involved in technical services extended by the U.S. based company, the 'make available' clause is not satisfied. Accordingly, the consideration for such services cannot be taxed under Article 12(4)(b) of the India-U.S. tax treaty.

The lower authorities have been persuaded by normal connotations of the expression 'make available'. However, this expression has specific legal connotations, as held by the Karnataka High Court in the case of De Beers India (P.) Ltd. In the light of the law so laid down by the Karnataka High Court, the consideration for these services cannot be brought to tax under Article 12(4)(b) of the India-U.S. tax treaty as these services do not enable the recipient of the services to utilise the knowledge or know-how on his own in future without the aid of the service provider.

Permanent Establishment

The DAPE exists in India on the grounds that its Indian affiliates, to which the services were rendered, were involved in purchase and sale of similar kind of products of the taxpayer but the taxability was held to be in respect of the FIS rendered to these entities. Even if a PE exists and the taxpayer carries on business through the PE, under Article 7(1) of the India-U.S. tax treaty the profits of the taxpayer may be taxed in the source jurisdiction, but only so much of them that are attributable to (i) PE (ii) sales in the other state of goods or merchandise of the same or similar kind as those sold through that PE (iii) other business activities carried on in the other state of the same or similar kind as those effected through that PE.

In the present case, the PE was in respect of the trading transactions only and hence no part of the earning from the rendering of services to the AEs can be related to the nature of the PE activities. Therefore, consideration for these services cannot be brought to tax in India. Relying on the decision of SET Satellite (Singapore) Pte Ltd v. DDIT [2009] 307 ITR 205 (Bom) it was held that even if there is a DAPE in India, it will have no taxable profits to be taxed in the hands of the taxpayer in the absence of the finding that the DAPE has been paid remuneration less than arm's length remuneration. Accordingly, there was no need to examine the aspect regarding the existence of the DAPE. Accordingly, additions made with respect to income under Article 12(4)(a) of the India-U.S. tax treaty as FIS and with respect to business income under Article 7(1) of the India-U.S. tax treaty were deleted.

ABB Inc. v. DDIT [2015] 69 SOT 537 (Bang)

For further details, please refer to our Flash News dated 16 July 2015 available at this link

Restoration services relating to the transmission of data and telecommunication traffic are not taxable as FTS. Income reasonably attributable to business operations carried out in India in relation to such services shall be taxable as business income

The taxpayer is a company incorporated in Bermuda. The taxpayer had built a submarine fiber optic telecommunication cable to link telecom traffic amongst Western Europe, Middle East, South Asia, South East Asia and the Far East. The capacity in the said cable system had been sold to various landing parties, which are mostly national telecommunication companies belonging to different nations. In India, Videsh Sanchar Nigam Limited (VSNL) was one of the original landing parties in the FLAG cable system. For the purpose of selling the capacity in the cable system to various landing parties, including VSNL, a Capacity Sales Agreement (CSA) was entered into amongst

Landing Parties.

During the year under consideration, the taxpayer had received the payment from VSNL on account of the provision of standby maintenance activities, as provided in the earlier years. Further, during the year under consideration, the taxpayer had entered into an arrangement with certain telecom cable operators to provide restoration of traffic to their customers in the event of a disruption in the traffic on their cable system. Under these arrangements, if there is a disruption in the traffic on a particular segment of the cable operator, the taxpayer provides the alternative telecommunication link route through its own capacity in the cable.

The AO held that receipts from standby maintenance services and restoration services were technical in nature, and, therefore, such services were taxable as FTS under Section 9(1)(vii) of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] held that payment for restoration activities was to be assessed as business income and was taxable in India under Section 9(1)(i) of the Act. The CIT(A) estimated the Indian income from restoration activity at 10 per cent of the global receipts.

The Mumbai Tribunal held as follows:

Taxability of standby maintenance services/charges

Standby charges is a fixed annual charge, which is payable not for providing or rendering services albeit for arranging standby maintenance arrangement, which is required for a situation whenever some repair work on the under-sea cable or terrestrial cable is actually required to be performed or rendered. It is a facility or infrastructure maintained for ready to use for rendering technical services or for repairing services if required. There is no actual rendering of the services qua the standby maintenance charges. Accordingly, following the earlier years' precedence, it was held that the receipt on account of standby maintenance charges was not chargeable as FTS within the scope of Section 9(1)(vii) of the Act.

Taxability of restoration services

In the present case, restoration activity does not fall within the nature of 'managerial' or 'consultancy services' because there was no rendering or managing by direction, regulation, administration or supervision of activities by the taxpayer to VSNL. Further, the taxpayer does not provide any advisory services for arranging of restoration activities to VSNL. The taxpayer already had a cable system network in which it had spare capacity, which was provided to VSNL in the case of disruption in a cable network. When a restoration calling party like VSNL avails the network link in the cable of the taxpayer, no transfer of technology is involved nor have any technical services been rendered.

If any technical equipment developed by a human has been put to operation automatically, then usage of such technology per se cannot be held as the rendering of technical services. Transmission of data or telecommunication traffic through a cable is not rendering of a technical service but the use of a technical device. Such a standard facility for transmission of data and telecommunication traffic by cable operators cannot be termed as the rendering of technical services and, therefore, it was held that consideration received from restoration activities was not taxable as FTS under Section 9(1)(vii) of the Act.

Taxability as business income

A portion of the cable length falls within the territorial waters of India from where it connects to Mumbai and from there it again goes to other countries. In the case of a sale of the capacity, the landing parties become the complete owner of the capacity to the exclusion of the taxpayer as held in earlier years. However, the spare capacity which lies in the cable belongs to the taxpayer, through which it had provided the restoration network to VSNL.

All the business operations of the taxpayer related with restoration services were not carried out in India. Therefore, reasonable attribution of income from such operations has to be done. In such a situation, Explanation 1A to Section 9(1)(i) of the Act provides that, in case of a business of which all operations are not carried out in India, then the income of the business shall be deemed to accrue or arise in India only such part of the income, which can be reasonably attributable to the operations carried out in India. The Tribunal upheld the method of attribution of the tax department, however, the AO was directed to determine the income of the taxpayer which is to be taxed in India after apportioning the revenue on the basis of length of the cable in the territorial waters in India on the segments on which restoration has been provided.

Flag Telecom Group Limited v. DCIT [2015] 38 ITR(T) 665 (Mum)

For further details, please refer to our Flash News dated 26 June 2015 available at this link

Limitation of benefit clause

Since the taxpayer has bonafide business activities in the UAE, the benefit of the India-UAE tax treaty cannot be denied by applying the Limitation of Benefit clause

During the year under consideration, the taxpayer claimed the benefit under the India-UAE tax treaty for its freight income received on account of its shipping business. The taxpayer had registered its vessel with the UAE government to conduct its shipping business for three years. The vessel was owned by a company located in the Marshall Islands with which India does not have a tax treaty. The taxpayer's total five shares were held by two Switzerland based companies. The taxpayer also submitted a letter of commercial licence and tax residence certificate received from the UAE tax authorities. The AO denied the tax treaty benefit on account of the fact that the taxpayer had registered in UAE to get the benefit of the India-UAE tax treaty, and it is neither paying any freight in India nor UAE. The AO invoked the provisions of Article 29 of the India-UAE tax treaty and declined the tax treaty benefits to the taxpayer. The CIT(A) held that the taxpayer was eligible to claim the tax treaty benefit.

The Rajkot Tribunal held as follows:

Article 29 of the India-UAE tax treaty was introduced by the virtue of a protocol. Under the original India-UAE tax treaty provisions there was considerable controversy on whether, the actual taxability of income in the UAE was a condition precedent for availing the treaty benefits in India. This issue was particularly relevant as not all the residents, whether individual or corporate, were necessarily taxable entities under the UAE law. The UAE, as a tax jurisdiction, had the right to tax these residents, but the rights were not exercised by introducing a law to tax them. While dealing with the issue as to whether or not the UAE tax residents will be eligible for tax treaty protection in respect of their income sourced in India, the Mumbai Tribunal in the case of ADIT v. Green Emirate Travels [2006] 100 ITD 203 (Mum) observed that being 'liable to tax' in the contracting state does not necessarily imply that the person should actually be liable to tax in that Contracting state. Vide protocol dated 26 March 2007, the definition of the expression ‘resident' was revised and the requirement of an actual liability to tax for the residents of UAE was consciously removed from the definition of the ‘resident of a contracting state'. The Delhi High Court, in the case of Emirates Shipping Line FZE v. ADIT [2012] 349 ITR 493 (Del) held that under the amended article, the requirement of liability to tax has been done away with. Therefore, it is not open to the AO to decline the tax treaty protection to a UAE tax resident in respect of India-sourced income, on the ground that the UAE tax resident has not actually been taxed in respect of his income in the UAE.

The amendment of the tax treaty definition for a ‘resident in a contracting state’, however, did come with a built-in check to ensure that this provision is not abused by incorporating Special Purpose Vehicles (SPVs) in the UAE only to seek undue benefits in India. On a plain reading of Article 29 of the India-UAE tax treaty, it indicates that this article seeks to decline the tax treaty benefits in a case in which the main purpose or one of the main purposes of the creation of an entity is to obtain the benefits of the tax treaty which would otherwise not be available. As long as such entities have bonafide business activities, the provisions of Article 29 of the India-UAE tax treaty cannot be pressed into service at all by a tax jurisdiction.

The present case is post-amendment vide protocol (Notification No. 282 of 2007, dated 26 March 2007) which gives residuary taxation rights to the residence jurisdiction. Article 8 of India-Switzerland tax treaty does not cover income from operation of ships in international traffic and restricts itself to income operation of aircraft in international traffic. Therefore, whether a Swiss tax resident earns India sourced income from operations of ships in international traffic in India or whether a UAE tax resident earns Indian sourced income from operations of ships in international traffic, the income is not taxable in India; in the former case, because of the provisions of Article 22(1) of the India-Switzerland tax treaty, and in the latter case, because of the provisions of Article 8 of the India-UAE tax treaty.

In this case, the condition precedent for invoking Article 29 of the India-UAE tax treaty has not been fulfilled. When tax treaty protection in respect of income of such a nature was anyway available, though, under a different kind of provision of the India-Switzerland tax treaty, the taxpayer cannot be said to have been created for the purposes of availing the India-UAE tax treaty benefits. Accordingly, the AO was in error in invoking the provisions of Article 29 of the India-UAE tax treaty. The shareholder meetings have taken place in the UAE. It has been observed that the taxpayer is not merely a paper company and has actually carried out material business operations from the UAE. Whether the taxpayer is given a perpetual licence to carry on business in the UAE or whether the licence is renewed every year, does not affect the fact that the taxpayer was carrying on business in the relevant previous year. Once there is reasonable evidence to suggest that the affairs of the company are conducted from UAE, and there is no material to controvert the same or to establish that the company is controlled or managed from outside the UAE, the CIT(A) was indeed justified in reversing the action of the AO and consequently granting the benefits of the India-UAE tax treaty.

ITO v. MUR Shipping DMC Co, UAE [2015] 62 taxmann.com 319 (RJT)

For further details, please refer to our Flash News dated 5 November 2015 available at this link

The limitation of relief clause under the India-Singapore tax treaty is not applicable to income which is offered to tax on an accrual basis in Singapore

GAC Shipping India Pvt Ltd (the taxpayer), filed a return of income in India in respect of MT Alabra, which is owned by Alabra Shipping Pte Ltd of Singapore, a freight beneficiary, as an agent of such a Singapore company under Section 172(3) of the Act. The taxpayer claimed the benefit of India-Singapore tax treaty and treated such freight income as exempt from tax in India. The taxpayer remitted the funds to the freight beneficiary's account with 'The Bank of Nova Scotia in the U.K'. The AO observed that the taxpayer remitted freight to a country other than Singapore and the remittance to Singapore is a *sine qua non* for availing the benefits of the India-Singapore tax treaty. The AO on the basis of the Limitation of Benefit (LOB) clause in Article 24 of the India-Singapore tax treaty declined the tax treaty benefit. Aggrieved by the order of the AO, the taxpayer filed an appeal before the CIT(A). The taxpayer contended that the freight receipts were taxable in Singapore as the taxpayer was a tax resident of Singapore. The taxpayer produced a certificate from the Singapore Inland Revenue Service as well as from the Independent Public Accountant in Singapore. The taxpayer contended that provisions of Article 8 of the India-Singapore tax treaty will apply and, accordingly, the freight receipts cannot be brought to tax in India. The CIT(A) upheld the order of the AO.

The Rajkot Tribunal held as follows:

Since the taxpayer seeks a benefit of tax treaty protection, in terms of its shipping income covered by Article 8 of the India-Singapore tax treaty, the only LOB provision which comes into play is the provision set out in Article 24 of the India-Singapore tax treaty. While the India-Singapore tax treaty does contain certain other significant LOB clauses, such LOB clauses are relevant only for the purposes of the tax treaty protection related to Article of the Protocol to the India-Singapore tax treaty. On perusal of Article 24(1) of the tax treaty, it indicates that LOB clauses come into play when:

- Income sourced in a contracting state is exempt from tax in that source state or is subject to tax at a reduced rate in that source state;
- The said income is subject to tax by reference to the amount remitted to, or received in, the other contracting state, rather than with reference to the full amount of such income

In such a situation, the tax treaty protection will be restricted to the amount which is taxed in the other Contracting state.

In the case of Singapore, the tax treaty protection must remain confined to the amount which is actually subject to tax. Any other approach could result in a situation in which income, which is not a subject matter of taxation in the residence jurisdiction, will anyway, be available for tax treaty protection in the source country. Therefore, the scope of the LOB provision in Article 24 of the India-Singapore tax treaty needs to be appreciated. There was no dispute about the fact that the business was carried on by the taxpayer in Singapore and that the taxpayer was a tax resident of Singapore. By a letter dated 31 December 2013, the Inland Revenue Authority of Singapore confirmed that, in the case of Alabra Shipping Pte Ltd, ‘freight income has been regarded as a Singapore sourced income and brought to tax on an accrual basis (and not a remittance basis) in the year of assessment’.

The taxpayer had also filed a confirmation from its public accountant that the freight earned from the port in India had been included in the global income offered to tax by the company in Singapore. On these facts, the provisions of Article 24 of the India-Singapore tax treaty cannot be put into service as these can only be triggered when the twin conditions of treaty protection, by low or no taxability, in the source jurisdiction and taxability on receipt basis, in the residence jurisdiction, are fulfilled. There is nothing on the record which suggests that the freight receipts were taxable only on a receipt basis in Singapore. On the contrary, there was reasonable evidence to demonstrate that such income was taxable on an accrual basis, in the hands of the taxpayer.

In order to come out of the mischief of Article 24 of the India-Singapore tax treaty, the onus is on the taxpayer to show that the amount is remitted to, or received in Singapore; but then such an onus is confined to the cases in which income is taxable in Singapore on a limited receipt basis rather than on a comprehensive accrual basis. However, in a case where it can be demonstrated that the related income is taxable in Singapore on an accrual basis and not on a remittance basis, such an onus does not get triggered. It has been observed that the only reason for declining the India-Singapore tax treaty benefits was the applicability of Article 24 of the India-Singapore tax treaty and that there is no other dispute on the claim of the tax treaty protection of shipping income under Article 8(1) of the India-Singapore tax treaty which provides that, ‘Profits derived by an enterprise of a contracting state from the operation of ships or aircrafts in international traffic shall be taxable only in that state’. Accordingly, the entire freight income of the taxpayer, which was only from the operation of ships in international traffic, was taxable only in Singapore. The AO was thus in error in bringing the same to tax in India.

Alabra Shipping Pte Ltd./Singapore GAC Shipping India Pvt. Ltd (As agents) v. ITO [2015] 62 taxmann.com 185 (RJT)

For further details, please refer to our Flash News dated 20 October 2015 available at this link

Indirect transfer

CBDT clarifies that dividend declared and paid by a foreign company outside India would not be taxable under the indirect transfer provisions of the Income-tax Act

A number of representations have been received by the Central Board of Direct Taxes (CBDT) stating that the purpose of introduction of Explanation 5 to Section 9(1)(i) of the Act was to clarify the legislative intent regarding the taxation of income accruing or arising through transfer of a capital asset situate in India. Apprehensions have been expressed about the applicability of the Explanation to the transactions not resulting in any transfer, directly or indirectly of assets situated in India. It has been pointed out that such an extended application of the provisions of the Explanation may result in taxation of dividend income declared by a foreign company outside India. This may cause unintended double taxation and would be contrary to the generally accepted principles of source rule as well as the object and purpose of the amendment.

Further, the Memorandum to the Finance Bill, 2012 provides that the amendment of Section 9(1)(i) of the Act by providing Explanation 5 was to reiterate the legislative intent in respect of taxability of gains having economic nexus with India irrespective of the mode of realisation of such gains. Thus, the amendment sought to clarify the source rule of taxation in respect of income arising from the indirect transfer of assets situated in India. Viewed in this context, Explanation 5 would be applicable in relation to deeming any income arising outside India from any transaction in respect of any share or interest in a foreign company or entity, which has the effect of transferring, directly or indirectly, the underlying assets located in India, as income accruing or arising in India.

Declaration of dividend by a foreign company outside India does not have the effect of the transfer of any underlying assets located in India. Therefore, CBDT clarified that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would not be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 to Section 9(1)(i) of the Act.

CBDT Circular No. 4/2015, dated 26 March 2015 – Taxsutra.com

For further details, please refer to our Flash News dated 27 March 2015 available at this link

Gift of shares

Gift received by a company is a capital receipt not taxable under the Income-tax Act

The taxpayer is a private limited company engaged in the business of investment. During the year under consideration [Financial Year (FY) 2008-09], the taxpayer received a gift of INR1618.6 million from four private companies which were shareholders of Reliance Industries Ltd. (RIL). The taxpayer claimed that the amounts had been received directly from RIL on account of the dividend receivable by the said four concerns against their shareholding in RIL. All the four concerns passed resolutions in the meeting of Board of Directors for making the said gifts and similarly the taxpayer also passed a resolution by the Board of Directors for receiving the gifts. It is on the directions of the four concerns that their dividends were directly credited to the bank account of the taxpayer. All the four donor concerns are also authorised by the Memorandum of Association (MoA) and Articles of Association (AoA) for making such gifts, and the taxpayer is authorised as well for receiving such gifts. Since the identity of the donor companies, their source of funds for gifts and the nature of transaction are clearly established, the taxpayer claimed that these receipts are not taxable because these are capital receipts and any such gift is not taxable.

The AO held that these receipts cannot be categorised as gifts or transactions which are specifically exempt from taxation and further held that these cannot be categorised as dividend income in the hands of the taxpayer. The AO held that a gift received by the taxpayer was chargeable to tax as income from other source in the hands of the taxpayer. The AO further held that amount of gift should be added to the book profit under Section 115JB of the Act. The CIT(A) passed an order in favour of the taxpayer.

The Mumbai Tribunal held as follows:

Under the Act, each and every receipt is not taxable. Where other receipts not in the nature of income are intended to be taxed, the legislature has to specifically make provisions for taxability of such receipts in the statute itself. The gift received by the taxpayer is a voluntary payment made by the donors to the taxpayer. Neither the taxpayer has any legal right to claim the gift from the donor nor do the donors have any legal or contractual obligations to give a gift to the taxpayer.

As per Section 14 (classification of heads of income) of the Act, the income of the taxpayer shall be chargeable to tax only if it falls under any of the heads of income specified therein. A gift received is not in the nature of salary; house property; business receipt; capital gains and income from other source.

The provisions of Section 56(2)(v)(vi), (vii) and (viia) of the Act specifically covers the instances of gift which are taxable under the provisions of the Act. However, all other gifts received by the taxpayer other than those covered in these sections are not chargeable to tax being a capital receipt in nature. In the present case, the identity of all the four concerns, which have made gifts to the taxpayer, was given along with their name, PAN, address and other details. Therefore, the identity of these concerns was proved.

The gifts have been received on account of dividend by the donor companies from RIL. Further, RIL has also paid dividend distribution tax and therefore, such money received by the taxpayer is not unaccounted money. Relying on the decision of D.P. World Pvt. Ltd. and Redington (India) Limited v. JCIT [2014] 49 taxmann.com 146 (Chennai) it has been held that companies are competent to make and receive gifts, and natural love and affection are not a necessary requirement. The only requirement for a company is to make gifts as per the respective MoA and AoA, which authorise the company for the same. In the present case, the taxpayer and the donor companies are authorised for receiving and making gifts respectively by their MoA and AoA. The position regarding the competency of corporate entities to make and receive gifts has also been upheld in various cases.

It is also clear from the Transfer of Property Act that companies can receive and make gifts and there is no requirement of any natural love and affection for making or receiving a gift by companies. Even the Act by way of Section 56(2)(viia) and 56(2)(viib) of the Act provides that gifts of certain kind of shares are taxable in the hands of a certain category of companies. Section 122 of the Transfer of Property Act provides for making a gift and permits transfer of moveable or immovable property but without any consideration. Further, the term living person includes a company or association or body of individuals, whether incorporated or not.

The provisions of Gift-tax Act, even though repealed, clearly recognised the company, a juridical person as a donor and made it an assessable entity under the Act. Three elements are essential in determining whether or not a gift has been made i.e. a) delivery, b) donative intent, and c) acceptance by the donee. In the present case, all the three essentials have duly been fulfilled by the taxpayer as well as all the four donors of the gift. Thus in the instant case, the gift received by the taxpayer is in the nature of capital receipt duly supported by documentary evidence and hence cannot be deemed as revenue receipt liable to tax. Even the legislative history shows that gifts received by companies other than certain kind of shares by a certain category of companies mentioned under Section 56(2)(viia) and (viib) are not taxable under the Act or any other Act.

Unexplained cash credit

Provisions of Section 68 of the Act are applicable only if the taxpayer either offers no explanation or his/her explanation is unsatisfactory as to the nature and source of such cash credits. In such cases, it is for the taxpayer to prove the identity of the person from whom the money is received and his source of payment and the genuineness of the transaction. In the present case, the identity of the donors has been proved and the source/capacity has been provided. The suspicion of the AO that the transaction of the gift is dubious and to bring into books, any unaccounted money is contrary to the facts on record.

Taxability as deemed dividend

With regard to the taxability of gift under Section 2(22)(e) of the Act, it has been observed that since there was no common shareholding between the taxpayer and the other four companies who have made gifts, the addition cannot be made under Section 2(22)(e) of the Act.

Taxability under the MAT provisions

The Explanation to Section 115JB of the Act is applicable only if the item of expense or income is debited or credited to the Profit and Loss Account. However, when the item of expense or income is not debited or credited to the Profit and Loss Account, Explanation to Section 115JB of the Act cannot apply and hence no adjustment is required while computing books profits under the provisions of MAT.

In the present case, the gift received from corporate bodies were not credited to the Profit and Loss Account and hence no adjustment is required to the book profit declared by the taxpayer under Section 115JB of the Act.

Accordingly, the amount of gift received by the taxpayer is not taxable as income from other sources or capital gain or deemed dividend. Further, it is not taxable under the provisions of MAT.

DCIT v. KDA Enterprises Pvt. Ltd. [2015] 39 ITR(T) 657 (Mum)

For further details, please refer to our Flash News dated 16 June 2015 available at this link

Section 206AA

Tax is not to be deducted at a higher rate of 20 per cent under Section 206AA of the Income-tax Act when the benefit of tax treaty is available

The taxpayer is engaged in the business of Business Process Outsourcing (BPO). The taxpayer made certain payments to a non-resident on account of royalty and/or FTS. As the benefit of a tax treaty was available to the non-resident, tax was deducted by applying the beneficial rate prescribed under the tax treaty in terms of the provision of Section 90(2) of the Act. The taxpayer filed statements of deduction of tax at source for various quarters of the relevant Financial ear in respect of payments made to non-resident during the period. The AO after processing Tax Deduction at Source (TDS) statement issued intimation under Section 200A of the Act. The AO raised a tax demand on account of the short deduction of tax and interest was also charged on the same. The AO held that if the taxpayer did not furnish PAN, as per the provisions of Section 206AA of the Act, the TDS should have been deducted at the rate of 20 per cent. The CIT(A) decided the matter in favour of the taxpayer and held that payment made to the non-resident recipient was eligible for the tax treaty benefit and by applying the beneficial provisions, the rate of tax to be withheld cannot be more than the tax liability provided in the tax treaty.

Bangalore Tribunal's ruling

Applicability of higher TDS under Section 206AA of the Act

There was no dispute that the benefit of the tax treaty was available to the non-resident recipient. Therefore, the tax liability of the recipient could not be more than the rate prescribed by the tax treaty or the Act, whichever is lower. Reliance was placed on the Pune Tribunal's decision in the case of DDIT v. Serum Institute of India Ltd. (ITA No. 792(Pune) 2013) (Pune). Reliance was placed on the decision of the Karnataka High Court in the case of Bharti Airtel Ltd. v. DCIT (ITA Nos. 158 to 163) (Kar) where it was held that the Act is to be read as an integral code. To deduct tax while making payment to a non-resident, the amount paid must be ascertainable as income chargeable to tax in the hands of the non-resident. TDS is a vicarious liability, and it presupposes the existence of primary liability and hence the TDS provisions need to be read in conformity with the charging provisions i.e. Section 4, 5 and 9 of the Act. The provisions of TDS had to be read along with the machinery provisions of computing the tax liability on the sums in question. Following the aforesaid decisions, the Tribunal held that there was no error in the CIT(A)'s order where it was held that there is no scope for deduction of tax at the rate of 20 per cent as provided under the provisions of Section 206AA of the Act when the benefit of tax treaty is available.

Adjustment under Section 200A of the Act

While making the adjustment under Section 200A of the Act, the AO had ignored the provisions of the tax treaty. The payment in question was made to the non-resident, and the provisions of tax treaty were applicable. Thus, the issue of applying the rate of tax at 20 per cent and ignoring the provisions of tax treaty is a debatable issue and does not fall into the category of any arithmetical error or incorrect claim apparent from any information in the statement, as per the provisions of Section 200A(1) of the Act.

On reference to Explanation to Section 200A(1) of the Act it is clear that in respect of deduction of tax at source where such rate is not in accordance with provisions of the Act, it can be considered as an incorrect claim apparent from the statement. However, in the present case, it was not a simple case of deduction of tax at source by applying the rate only as per the provisions of the Act, when the benefit of tax treaty was available to the recipient of the amount. Therefore, the question of applying the rate of 20 per cent as provided under Section 206AA of the Act is an issue which requires a long drawn reasoning and finding. Hence, it was held that applying the rate of 20 per cent without considering the provisions of the tax treaty and consequent adjustment while framing the intimation under Section 200A is beyond the scope of the said provision.

Bangalore Tribunal – Taxsutra.com

For further details, please refer to our Flash News dated 5 August 2015 available at this link

Section 206AA of the Income-tax Act does not override the beneficial provisions of the tax treaty

The taxpayer is engaged in the business of manufacture and sale of vaccines, and it is a major exporter of vaccines. During the FY 2010-11, the taxpayer made payments to non-residents on account of interest, royalty and FTS. These payments were subject to withholding of tax under Section 195 of the Act. The tax rate provided in the tax treaties was lower than the rate prescribed under the Act, and therefore in terms of the provisions of Section 90(2) of the Act; the tax was deducted at source by applying the beneficial rate prescribed under the relevant tax treaties.

The tax department noted that on account of payment of royalty and fee for technical services in case of some of the non-residents, the recipients did not have Permanent Account Number (PAN). Relying on Section 206AA of the Act, the tax department treated payments to those non-residents who did not furnish the PAN as cases of 'short deduction'. Accordingly, demands were raised on the taxpayer for the short deduction of tax and also for interest under Section 201(1A) of the Act. The CIT(A) held that Section 206AA of the Act would override the other provisions of the Act but not the provisions of Section 90(2) of the Act. Therefore, where the tax treaties provide for a tax rate lower than that prescribed in 206AA of the Act, the provisions of the tax treaties shall prevail and the provisions of Section 206AA of the Act would not be applicable. Accordingly, the CIT(A) deleted the tax demand raised by the tax department.

The Pune Tribunal held as follows:

In the case of non-residents, tax liability in India is liable to be determined in accordance with the provisions of the Act or the tax treaty, whichever is more beneficial to the taxpayer, having regard to the provisions of Section 90(2) of the Act. The Supreme Court in the case of Azadi Bachao Andolan and Others v. UOI [2003] 263 ITR 706 (SC) and Others held that the tax treaties will prevail over the general provisions contained in the Act to the extent they are beneficial to the taxpayer.

The tax treaties provide for the scope of taxation and/or a rate of taxation which was different from the scope/rate prescribed under the Act. For the said reason, the taxpayer deducted tax at source having regard to the provisions of the respective tax treaties where a beneficial rate of taxation is provided. Even the charging Section 4 as well as Section 5 of the Act which deals with the principle of ascertainment of total income under the Act is also subordinate to the principle enshrined in Section 90(2) of the Act as held by the Supreme Court in the case of Azadi Bachao Andolan and Others v. UOI [2003] 263 ITR 706 (SC). Thus, in so far as the applicability of the scope/rate of taxation with respect to the impugned payments made to the non-residents is concerned, no fault can be found with the rate of taxation invoked by the taxpayer based on the tax treaties which prescribed for a beneficial rate of taxation.

It would be incorrect to say that though charging Sections 4 and 5 of the Act (dealing with ascertainment of total income) are subordinate to the principle enshrined in Section 90(2) of the Act, but the provisions of Chapter XVII-B, governing TDS are not subordinate to Section 90(2) of the Act. Section 206AA of the Act is not a charging section but is a part of the procedural provisions dealing with collection and deduction of tax at source. The provisions of Section 195 of the Act which casts a duty on the taxpayer to deduct tax at source on payments to a non-resident cannot be looked upon as a charging provision.

The Supreme Court in the case of CIT v. Eli Lilly & Co. (India) (P.) Ltd. [2009] 312 ITR 225 (SC) observed that the provisions of withholding of tax i.e. Section 195 of the Act would apply only to sums which are otherwise chargeable to tax under the Act. The Supreme Court in the case of GE India Technology Centre Pvt. Ltd. v. CIT [2010] 327 ITR 456 (SC) held that the provisions of tax treaties along with Sections 4, 5, 9, 90 and 91 of the Act are relevant while applying the provisions of TDS. Therefore, in view of the aforesaid schematic interpretation of the Act, Section 206AA of the Act cannot override the charging Sections 4 and 5 of the Act. Section 90(2) of the Act provides that tax treaties override domestic law in cases where the provisions of tax treaties are more beneficial to the taxpayer. Therefore, where the tax has been deducted on the basis of the beneficial provisions of the tax treaties, the provisions of Section 206AA of the Act cannot be invoked by the AO to insist on the tax deduction at 20 per cent, having regard to the overriding nature of the provisions of Section 90(2) of the Act.

DDIT v. Serum Institute of India Limited [2015] 68 SOT 254 (Pune)

For further details, please refer to our Flash News dated 2 April 2015 available at this link

Minimum Alternate Tax

CBDT clarifies that the MAT provisions shall not be applicable to a foreign company (including an FII/FPI)

A Committee on Direct Tax Matters chaired by Justice A.P. Shah was constituted to examine the issue of applicability of Minimum Alternate Tax (MAT) on Foreign Institutional Investors (FIIs)/Foreign Portfolio Investments (FPIs) for the period prior to 1 April 2015. The Committee has submitted its final report to the government on 25 August 2015. The Committee has recommended that Section 115JB of the Act may be amended to clarify the inapplicability of the MAT provisions to FIIs/FPIs, which does not have PE/place of business in India.

In view of such recommendation by the A.P. Shah committee, the CBDT had issued an Instruction No. 9/2015, dated 02 September 2015 clarifying that the government has accepted the recommendation of the Committee on Direct Tax Matters. The Instruction prescribes that Section 115JB of the Act be amended to clarify the inapplicability of MAT to FIIs/FPIs having no PE/place of business in India and decided to carry out the appropriate amendment to this effect.

Subsequently, the government has issued a Press Release, dated 24 September 2015 whereby it has been clarified that with effect from 1 April 2001, the provisions of MAT shall not apply where (a) the foreign company is resident of a country having a tax treaty with India and such foreign company does not have PE within the definition of the term in tax treaty, or (b) the foreign company is a resident of a country which does not have a tax treaty with India and such foreign company is not required to seek registration under Section 592 of the Companies Act 1956 or Section 380 of the Companies Act 2013. Thereafter, the government conveyed its intention of abiding by the decision contained in the aforesaid Press Release to the Supreme Court in the case of Castleton Investment Ltd (Civil Appeal No. 4559/2013). The Supreme Court disposed of the case based on the commitment made by the government.

In view of the decision as reflected in the Press Release dated 24 September 2015 and the commitment made by the government before the Supreme Court, recently, the CBDT has issued an Instruction No. 18/2015, dated 23 December 2015 which prescribes that with effect from 1 April 2001, the MAT provisions shall not be applicable to a foreign company (including an FII/FPI) where:

- The foreign company is a resident of a country with which India has a tax treaty and such foreign company does not have a PE in accordance with the provisions of the relevant tax treaty, or
- The foreign company is a resident of a country with which India does not have a tax treaty and such foreign company is not required to seek registration under section 592 of the Companies Act, 1956 or Section 380 of the Companies Act, 2013.
- An appropriate amendment in the Act shall be made through the Finance Bill, 2016.

In view of the above and the fact that government's commitment to abide by its decision it has been taken into account by the Supreme Court while disposing of the Civil Appeal in the case of Castleton Investment Ltd., the CBDT advised the tax authorities that pending assessments involving applicability of MAT on foreign companies (including FIIs/FPIs) should be completed in accordance with the decision of the government as mentioned in the Instruction.

Instruction No. 18/2015, dated 23 December 2015

Remission of a liability credited to the profit and loss account is liable for MAT under the Income-tax Act

During the AY 2005-06, the taxpayer filed its return of income declaring nil income. Subsequently, a reassessment notice was issued whereby the AO sought to tax an amount of INR4.3 million under MAT, being remission of a liability of ING Vysya Bank Ltd. The taxpayer claimed that this remission of liability was on account of the principal amount of a loan, and therefore, the same is not in the nature of income. The AO rejected the objections of the taxpayer and added the said amount while computing book profits under Section 115JB of the Act. The CIT(A) held that book profits arrived at as per the proviso of Schedule VI of the Companies Act cannot be tinkered with in view of the Supreme Court decision in the case of Apollo Tyres Ltd v. CIT [2002] 255 ITR 274 (SC).

The Bangalore Tribunal held that the decisions relied on by the taxpayer are applicable on the facts where an item of income or expenditure required to be disclosed in the profit and loss account prepared as per the provisions of Schedule VI of the Companies Act but instead of disclosing the said item in the profit and loss account, it was disclosed in the notes to the accounts, then such item of income or expenditure will be treated as part of the profit and loss account for the purpose of computing book profits under Section 115JB of the Act.

In the present case, the taxpayer received a remission of liability under a one-time settlement by ING Vysya Bank, which has been disclosed by the taxpayer in the profit and loss account. This disclosure, in the profit and loss account, is strictly as per the requirement of Schedule VI of the Companies Act and further in conformity with the mandatory Accounting Standard 5. Therefore, any disclosure in the notes to accounts would not require any change in the profit and loss account already prepared as per the schedule of the Companies Act. Once the profit and loss account is prepared as per Schedule VI of the Companies Act, then neither the AO has any power to tinker with it nor the taxpayer is permitted to claim an exclusion or inclusion of any item of income or expenditure as the case may be, for the purpose of computing book profits under Section 115JB of the Act, except the permissible adjustment provided under the Explanation to Section 115JB of the Act itself.

It was not disputed that this amount does not fall within the ambit of any of the clauses of the Explanation to Section 115JB of the Act. Therefore, once this amount has been disclosed in the profit and loss account prepared strictly as per provisions of Schedule VI of the Companies Act, the same cannot be excluded for the purpose of computing book profits under Section 115JB of the Act.

B & B Infotech Ltd v ITO [2015] 63 taxmann.com 122 (Bang)

For further details, please refer to our Flash News dated 19 November 2015 available at this link

Exempt capital gains are to be excluded while computing book profits under the provisions of MAT

The taxpayer is engaged in the business of development and leasing of commercial complexes and rehabilitation of buildings under the slum rehabilitation scheme. The taxpayer was formed by conversion of a partnership firm into a company under the provisions of the Companies Act, 1956. The taxpayer owns a wholly owned subsidiary company in India. The taxpayer held a parcel of land as a capital asset and the said land was attached with development rights/Floor Space Index (FSI). During the AY 2009-10, the taxpayer transferred the development rights/FSI to its wholly owned subsidiary. The said transfer generated a Long-Term Capital Gain (LTCG) and the taxpayer disclosed the same as ‘extraordinary income' in the profit and loss account. The taxpayer claimed that the LTCG is exempt under Section 47(iv) of the Act and hence was not regarded as ‘capital gains' under Section 45 of the Act while computing total income under the normal provisions of the Act. Further, the taxpayer did not offer the LTCG while computing the book profit under Section 115JB of the Act by mentioning in the notes to accounts that it is a capital receipt and that the transaction is not regarded as a transfer under the Act. The company interprets that since it is not in the nature of income, it does not fall within the purview of Section 115JB of the Act. The AO did not agree with the contentions of the taxpayer and accordingly, included the capital gain while computing book profits under the provisions of Section 115JB of the Act. The CIT(A) upheld the order of the AO.

The Mumbai Tribunal's held as follows:

Computation of book profit under Section 115JB of the Act by mentioning in the notes to accounts

The Tribunal observed that for the purpose of making adjustments, it is not necessary that those items should have been specified in Explanation 1 to Section 115JB of the Act since the net profit itself is arrived at by adjusting the effects of notes given in the notes to accounts. The Tribunal observed that the profit and loss account should be read along with the notes to accounts and it should be applied uniformly in all kind of situations and hence due adjustments need to be done for the effect of items disclosed in the notes to accounts. The facts prevailing in the instant case are distinguishable from the facts of the case before the special bench of the Tribunal in the case of Rain Commodities Ltd v. DCIT [2010] 40 SOT 265 (Hyd) (SB). Therefore, it cannot be applied straightly in the instant case. Accordingly, the notes to accounts should be read along with the profit and loss account. Hence, the net profit shown should be adjusted with the items given in the notes to accounts. The profits arising on the sale of a capital asset to its wholly owned subsidiary company should be excluded while computing book profits under Section 115JB of the Act.

Transfer of capital asset is not treated as income under Section 2(24) of the Act

On a perusal of provisions of Section 2(24), Section 2(47), Section 45, Section 47 and Section 10 of the Act it has been observed that the legislature seeks to maintain parity between the computation of total income and book profit, in respect of an exempted category of income. If the said logic is extended further, an item of receipt which does not fall under the definition of 'income' at all and hence falls outside the purview of the computation provisions of the Act cannot also be included while computing book profits under Section 115JB of the Act. Since the said profit does not fall under the definition of 'income' and it does not enter into the computation provisions, there is no question of including the same while computing book profits under Section 115JB of the Act.

Shivalik Venture Pvt. Ltd. v. DCIT [2015] 70 SOT 92 (Mum)

For further details, please refer to our Flash News dated 26 August 2015 available at this link

R&D – Weighted deduction

R&D expenditure certified by DSIR cannot be examined by the tax officer for allowability of such expenditure for the purpose of weighted deduction under Section 35(2AB) of the Income-tax Act

The taxpayer is engaged in the business of software development, manufacturing and trading of networking equipments. During the AY 2009-10, the taxpayer claimed deduction under Section 35(2AB) of the Act in respect of Research & Development (R&D) expenditure. Further, the taxpayer also claimed deduction under Section 35(1)(i) of the Act. The AO disallowed a part of the expenditure claimed by the taxpayer. The DRP held that allowability or otherwise of the expenditure will be governed by the express provisions of the Act. The certificate issued by the prescribed authority cannot overrule the express provision of the Act. The mandate of the prescribed authority is limited to certifying to what extent any activity constituted, or any asset is or was being used, fit, for scientific research. Accordingly, such expenditure cannot be allowed under Section 35 of the Act. Aggrieved by the order of the AO, pursuant to the DRP's direction, the taxpayer filed a writ petition before the High Court.

Karnataka High Court's ruling

Maintainability of a writ petition

The High Court has the discretion to entertain or not to entertain a writ petition. However, availability of alternate remedy would be the normal rule for the High Court to refuse to exercise its jurisdiction under Article 226 of the Constitution of India. It is not an inviolable rule, and the availability of an alternate remedy would not act as a bar for the High Court to exercise the extraordinary power. The self imposed judicial restraint, one of which is that of availability of alternate remedy would be a reason for the court not to issue prerogative writs. Exceptions to this general principles are (i) for enforcement of fundamental rights (ii) violation of principles of natural justice (iii) where the order or proceedings under challenge is attacked or being vitiated on the grounds of such authority acting without jurisdiction and (iv) where constitutional validity of a provision in a statute or the statute itself is under challenge.

When the issue of jurisdiction is under consideration, it cannot be held that writ petition is not maintainable at the threshold. Therefore, subject to the ruling on a weighted deduction under Section 35(2AB) of the Act, the High Court would rule on maintainability of the writ filed by the taxpayer. In the present case, the AO had no jurisdiction to sit in judgment over the report submitted by the prescribed authority under Section 35(2AB) of the Act read with Rule 6(7A)(b) of the Rules. Therefore, it was held that the issue of entertaining writ petition on the grounds of alternate remedy would recede to the background. Accordingly, it was held that writ petition was maintainable and cannot be dismissed on the grounds of the petitioner having an alternate remedy of appeal.

Disallowance under Section 35(2AB) of the Act

As per Rule 6(1B) of the Rules, it would be clear that the prescribed authority for the purpose of Section 35(2AB) of the Act is the Secretary, Department of Scientific and Industrial Research (DSIR). The prescribed authority would examine the claim for grant of approval under Section 35(2AB) of the Act. On reference to the facts of the present case, it indicates that the application had been filed by the taxpayer with the DSIR for the benefit of Section 35(2AB) of the Act and after calling for documents/information from the taxpayer, and on examination and scrutiny of such documents/information furnished by the taxpayer, the DSIR had granted order of approval in favour of the taxpayer. A perusal of Section 35(3) of the Act indicates that where the AO does not accept the claim of the taxpayer made under Section 35(2AB) of the Act, the AO has to refer the matter to the CBDT, which in turn will refer the question to the prescribed authority. The decision of the prescribed authority would be final. Neither the AO nor the CBDT is competent to take any decision on any such controversy relating to report and approval granted by the prescribed authority. It is the prescribed authority alone to take a decision with regard to the correctness of expenditure under Section 35(2AB) of the Act read with Rule 6(7A) of the Rules.

The aforesaid view is also fortified by the Gujarat High Court in the case of DCIT v. Mastek Limited [2013] 263 CTR 671 (Guj) wherein it was held that whenever a question arises as to whether any activity constitutes or any asset is or was being used for scientific research, the CBDT would have to refer the issue to the prescribed authority whose decision would be final. A plain reading of Section 35(2AB) of the Act would clearly indicate that where a company is engaged in the prescribed business, they shall be allowed a deduction of a sum equal to one and a half times of the expenditure so incurred. The word 'shall' used in the relevant provisions would mean that it should be understood in the context in which it is used, and there cannot be the departure in this regard. The said provision would also indicate that such expenditure as approved by the prescribed authority would be allowed as a weighted deduction.

There was no dispute to the fact that the DSIR being the prescribed authority in the instant case had issued the report. When the prescribed authority had certified the extent of expenditure which would be allowable, the AO could not sit in the judgment over such certification made by the prescribed authority. When the taxpayer files the report issued by the prescribed authority under Section 35(2AB) of the Act before the jurisdictional AO and seeks for allowability of such expenditure, the AO should not examine the correctness of the certificate issued by the prescribed authority. The decision of the prescribed authority in this regard would be final, in as much as, the certification of such expenditure is being examined by an expert body. Such exercise has been outsourced by the tax department under the Act itself. Since the prescribed authority possessed the requisite expertise, it would be in a better position to decide as to whether expenditure claimed by the taxpayer under Section 35(2AB) of the Act would fall within the said provision or not.

Tejas Networks Limited v. DCIT [2015] 233 60 Taxman 426 (Kar)

For further details, please refer to our Flash News dated 23 July 2015 available at this link

Head office expenditure

License fees and management charges are not in the nature of head office expenditure and, therefore, cannot be disallowed under Section 44C of the Income-tax Act

The taxpayer is an Indian branch of Lloyd's Register Asia based in the U.K., which is a subsidiary of Lloyd's Register U.K. The main holding company is into the business of survey and inspection of ships, industrial inspection activity and drawing appraisal. Lloyd's Register U.K. entered into a license agreement with all its subsidiaries all over the world, including Lloyd's Register Asia, whereby it had granted license to use the brand ‘Lloyd's Register' i.e. use of trademark and trade name owned by Lloyd's Register U.K. Lloyd's Register U.K. also provides general, technical and marketing support services which have been referred in the license agreement as ‘Intellectual Property Rights'. As per the worldwide policy, the invoices are sent from Lloyd's Register U.K. to Lloyd's Register Asia, which in turn, allocates the royalty attributable to its Indian branch. The Indian branch pays the same to Lloyd’s Register Asia which in turn pays Lloyds Register U.K. Further, the Management Services Agreement was entered into between Lloyd’s Register U.K. and Lloyd’s Register Asia for providing services such as corporate communications, corporate finance and group reporting services, group quality assurance, human resources, information technology, internal audit services, risk management and secretarial services, taxation, treasury services, etc.

During the AY 2005-06, the taxpayer paid management charges and license fees to Lloyd’s Register Asia i.e. its head office, which in turn has been paid to Lloyd’s Register U.K. However, the AO held that both the payments are covered within the definition of head office expenditure as defined in Explanation to Section 44C of the Act. Thus, the AO restricted the management and license fees to 5 per cent of the adjusted total income.

The Mumbai Tribunal held as follows:

On reference to Section 44C of the Act, it indicates that the scope of head office expenditure is in the nature of executive and general administration expenditure incurred by the taxpayer outside India. If the nature of expenditure as enumerated under Section 44C of the Act is compared with the nature of expenditure incurred by the taxpayer's branch, it shows that none of the expenditure under the head license fees, even remotely falls within the category specified in the Explanation to Section 44C of the Act. The payment of license fee is purely for using brand/trademark and other business intangibles, which are in the nature of intellectual property. Such types of expenditure do not fall within the scope of head office expenditure. The general, technical and marketing support services provided to the taxpayer are not in the nature of rent, rates, taxes, repairs, insurance, salary, wages, bonus, commission, etc. Expenditure under the head license fee has nothing to do with these kind and nature of expenditure.

Thus, the entire payment of license fee does not fall within the ambit of Section 44C of the Act as provided in the Explanation to Section 44C of the Act. Therefore, the same cannot be treated as head office expenditure. The nature of head office expenditure under clause (d) of the Explanation covers such other matters connected with executive and general administration as may be prescribed. However, no such illustration has been prescribed by the CBDT, and therefore, the license fee does not fall even under sub clause (d) of the Explanation (iv) to Section 44C of the Act. None of the management services are in the nature of head office expenditure as provided in sub-clause (a) to (d) of the Explanation to Section 44C of the Act.

For computing the deduction of head office expenditure, it is essential that the nature of head office expenditure must fall within the illustration given in the Explanation (iv) to Section 44C of the Act. If any expenditure is beyond the scope of head office expenditure, then it cannot be brought within the ambit of Section 44C of the Act. The Tribunal held that the technical fees were not covered under the head office executive or head office general administration expenditure, as specified in Section 44C of the Act. This aspect has also been clarified in the CBDT Circular. Accordingly, the license fees and management charges do not fall in the nature of head office expenditure under

Section 44C of the Act.

Lloyd's Register Asia (India Branch Office) v. ACIT [2015] 42 ITR(T) 186 (Mum)

For further details, please refer to our Flash News dated 16 June 2015 available at this link

Transfer pricing

The Mumbai Tribunal held that no adjustment on account of Location Savings is required when arm's length price is determined on the basis of appropriate comparables

The taxpayer is engaged in providing contract manufacturing and contract research and development services to its AE. The AEs compensate the taxpayer on a total operating cost plus arm's-length mark-up basis. The taxpayer used Transactional Net Margin method (TNMM) as Most Appropriate Method (MAM) to benchmark the said transactions.

During the course of the Transfer Pricing (TP) assessment and proceeding before the DRP, both the Transfer Pricing Officer (TPO) as well as the DRP contended that the location saving arises as manufacturing activities that were being undertaken in the U.S./European countries are transferred to India which is low-cost jurisdiction and computed location savings based on certain articles appearing in some journal and websites. The location savings so computed was then allocated on an ad-hoc basis by dividing the savings equally between the taxpayer and its AEs.

Tribunal ruling

The Tribunal:

- Observed that the taxpayer as well as the AE operates in a perfectly competitive market and the taxpayer does not have exclusive access to the factors that may result in location specific advantages.
- Relied on Action 8: Guidance on Transfer Pricing Aspects of Intangibles, which is part of Organisation for Economic Co-operation and Development (OECD) and G20 Base Erosion and Profit Shifting (BEPS) project which provides that where local market comparables are available, specific adjustment for location saving is not required.
- Agreed with the taxpayer's submission that reliance placed by the TPO on the United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual) was incorrect, because Chapter 10 of the UN TP Manual is view of the Indian tax administration and not binding on Appellate Authorities.
- relied on the decision of GAP International Sourcing (India) Pvt Ltd v. ACIT (2012) 149 TTJ 437 (Del) and held that comparables selected by the taxpayer being local Indian comparables, additional allocation on account of location savings is not required.
- relied on the Special Bench decision in the case of UCB India (P) Ltd. v. ACIT (2009) 124 TTJ 289 (Mum SB) wherein it was held with respect to requirements of Rule 10(D)(1)(f) that, *"The maintenance of these records is procedural, and non-maintenance of the same is not such that it would affect the determination of Arm's Length Price (ALP)…..".* The Tribunal noted that the Special Bench interpreted use of the words *'if any'* in the provisions as meaning that *"non-submission of records cannot form the basis of making adjustments in the ALP on bald assertions".*
- Observed that the US Tax Court cases relied upon by the TPO to be different from the taxpayer's facts as these case laws were related to fiscal years 1970s and 1980s in which the economic scenario was completely different. Further, in these case laws, taxpayers were not operating in a perfectly competitive market unlike in the case of the taxpayer.
- Held that the TPO has based his computation on a method, which is not ascribed by the provisions of the Act. Thus, the Tribunal deleted the adjustment made on account of location savings.

Watson Pharma Pvt Ltd. v. DCIT [2015] 54 taxmann.com 88 (Mum)

For further details please refer to our Flash News dated 14 January 2015 available at this link

Indian Advance Pricing Agreements - Rollback Rules notified and Pre-Filing Consultation made optional

The Finance (No.2) Act, 2014 introduced the rollback provisions under the Advance Pricing Agreement (APA) program. The rules had been notified on 14 March 2015 setting out the applicability and the requirement for applying rollback. Further, pre-filing consultation which was mandatory has been made optional.

The salient features of the rollback rules are as below:

- The international transaction proposed to be covered under the rollback is to be the same as covered under the main APA.
- The rollback provisions shall be applied for all the rollback years in which the relevant international transaction has been undertaken.
- The manner in which Arm's length price has been determined in relation to an international transaction shall be consistent for all the years covered under the APA including the rollback years.
- The applicant should have filed Return of Income and Form No. 3CEB (Accountants Report) on or before the statutory due date.
- The rollback provision will not be applicable for a particular year where the Income-tax Appellate Tribunal has passed an order disposing off the appeal prior to the date of signing of the APA.
- In case the application of the rollback provisions would result in the reduction of the income offered to tax or increasing the loss as declared in the Return of Income for a particular year, the rollback provision will not be applicable for that year.
- The application for rollback was to be filed on or before 31 March 2015 in the case of applications filed before 01 January 2015 as well as in few cases where APA has been entered into before 1 January 2015. However, the deadline for filing an application for rollback was extended to 30 June 2015.
- Going forward the application for rollback has to be made (Form No. 3CEDA) along with the main APA application (Form No. 3CED).
- An additional fee of five lakh rupees is to be paid along with the rollback application.
- Important procedural aspects for giving effect to the rollback provisions have also been notified.

CBDT Notification No. 23/2015 [F.No.142 /14/2014-TPL] dated 14 March 2015

For further details please refer to our Flash News dated 16 March 2015 available at this link

Delhi High Court upheld the Revenue's stand of characterising AMP expense as an international transaction subject to transfer pricing. Overrules principles laid down in the AMP Special bench ruling by holding aggregation approach appropriate for remunerating AMP functions

In 2013, in the case of LG Electronics India Private Limited v. ACIT (ITA No. 5140/ Del/2011), the Delhi Special Bench of the Tribunal (SB) delivered a ruling on the vexed issue of marketing intangibles. Subsequently, there were various conflicting decisions which led to a need for greater clarity and guidance on the issue that incessantly impacted the industry at large. In this regard, recently, the Delhi High Court (High Court) in the case of Sony Ericsson Mobile Communication India Pvt. Ltd and several other connected matters upheld that advertisement, marketing and sales promotion (AMP) expense constitute an international transaction subject to TP. While the High Court upheld the Revenue's jurisdiction to such transactions, it overturned various other aspects of the SB ruling holding the application of such ratios is erroneous and unacceptable. Among its several findings in the case, the High Court held that distribution and marketing are intertwined functions and can be analysed together as a bundled transaction, and that segregation of non-routine AMP expenditure using the bright line approach is not appropriate. The High Court also held that separate remuneration for the AMP activities may not be required if such compensation is already provided by way of lower purchase price or reduced payment of royalty.

The comparative findings of the SB and High Court have been summarised as below:

Issue	SB ruling	High Court ruling
Whether AMP spend construes an international transaction?	AMP expense is an international transaction.	AMP expense is an international transaction as marketing and distribution function performed towards AE.
Whether Bright Line Test (BLT) is a tool/ method to bifurcate expense into routine versus non-routine?	Bright line expense is a tool to bifurcate AMP expenses into routine and non-routine.	Application of BLT and concept of segregation of no routine AMP expense lacks statutory backing.
Whether AMP expense is a brand building service?	Incurrence of non-routine AMP expense constitutes provision of brand building service to the AE.	Brand building as equivalent substantial attribute of AMP would be largely incorrect.
Whether aggregation of transactions permissible?	Purchase of goods and AMP expense are separate transactions and cannot be aggregated.	AMP function can be looked as closely linked to and a pa of overall marketing and distribution activity, hence ca be aggregated.
Whether set off is permissible?	AMP function is to be separately compensated even if higher profitability is present in the distribution function.	Closely linked transactions s off should be permitted.
Whether economic ownership on intangibles is a reality and relevant for TP purpose?	Concept of economic ownership rejected.	Concept has given due cognizance.
Whether selling and distribution expense constitute AMP expense?	Selling and distribution expense not a part of AMP expenses.	Selling and distribution expense not a part of AMP expenses.

Sony Ericsson Mobile Communication India Pvt. Ltd v. CIT [2015] 55 taxmann.com 240 (Delhi)

For further details please refer to our Flash News dated 18 March 2015 available at this link

Two enterprises treated as Associated Enterprises without satisfaction of the deeming fiction set out under Section 92A(2) of the Act

The taxpayer had received service charges/commission charges for making purchase of textile, yarns, etc. on behalf of Kaybee Exim Pte Limited, Singapore (Kaybee, Singapore). During the course of assessment proceedings, the AO observed that the taxpayer and Kaybee, Singapore had a common director, who was also the shareholder of the taxpayer and held key position i.e. Chief Operating Officer (COO) in the management of Kaybee, Singapore. Based on the common directorship and participation in management of both the enterprises, the AO held that the taxpayer and Kaybee Singapore are AEs. The CIT(A) confirmed the action of the AO.

Tribunal ruling

- Tribunal observed that the language of Section 92A(1) is unambiguous and does not leave any scope for importing any meaning to expression 'AE'. While addressing as to whether the meaning of expression 'AE' as per Section 92A(1) had to be read in conjunction with clauses (a) to (m) of Section 92A(2), the Tribunal held that if the condition provided in clause (a) and (b) of Section 92A(1) are independently satisfied, then the two enterprises for the purpose of Section 92B to 92E of the Act will be treated as AEs. Tribunal further observed that, sub-section (1) does not begin with subjective clause i.e. subject to sub-section (2).
- Tribunal held that since the said companies had a common director who was also a major shareholder of the taxpayer company and held a key position in the management of the other enterprise, the condition of participation in management or control or capital as prescribed under Section 92A(1) was satisfied. Therefore, the said companies qualified as AEs as per the provisions of Section 92(A) of the Act.

Kaybee Private Limited v. ITO [2015] 57 taxmann.com 449 (Mum)

For further details please refer to our Flash News dated 5 June 2015 available at this link

OECD releases final reports on BEPS Action Plans

The OECD on 5 October 2015 issued a final package of reports in connection with its action plan to address BEPS, together with a plan for follow-up work by 2020 and a timetable for implementation from 2016.

The OECD's BEPS action plan, launched in July 2013 and endorsed by the G20 countries, included 15 key areas for identifying and curbing aggressive tax planning and practices and modernizing the international tax system. The OECD delivered interim reports with respect to seven of the 15 action items in September 2014, and these 2014 reports have been consolidated with the remaining 2015 deliverables to produce a final set of recommendations for addressing BEPS.

With respect to TP aspects, the two reports were issued:

- **Consolidated Report on Actions 8, 9 and 10 – Guidance on intangibles, allocation of risk and capital and subsequent recharacterisation and special measures, LVIGS and CCAs etc.**

  Actions 8, 9, and 10 of the BEPS Action Plan includes the development of rules to prevent BEPS: (i) by moving intangibles among group members; (ii) by transferring risks among, or allocating excessive capital to, group members, which will involve adopting TP rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital and to require **alignment of returns with value creation**; and (iii) by engaging in transactions which would not, or would only very rarely, occur between third parties.

- **Action 13 - Guidance on three-tier TP documentation**

  The OECD suggests a three-tiered approach to documentation that includes preparing a master file, local file and Country-by-Country (CbyC) report. The master file is intended to provide a 'blueprint' of the Multi National Enterprise (MNE) group containing standardized information relevant for the MNE group. The local file provides additional detail on the operations and transactions relevant to that jurisdiction and the economic analyses of the intercompany transactions. The CbyC report contains summary data by jurisdiction including revenue, income, taxes, and indicators of economic activity.

The OECD recommends that i) the CbyC report be required for MNE groups with annual consolidated group revenue of more than €750 million; ii) will begin for MNE's fiscal year beginning on or after January 1, 2016; iii) will be filed by the ultimate parent company of the MNE in its jurisdiction (or by a surrogate parent entity); and iv) is due one year after the fiscal year end of the parent company. The master file and local file will be filed locally with the tax jurisdictions requiring the reports.

There is still ambiguity to certain items especially as it relates to the CbyC report and even to some extent the master file that may have many MNEs interpreting the guidance differently. Many countries have already adopted or are poised to adopt changes to their international tax systems based on the OECD's BEPS recommendations.

These reports will be examined by the Government of India, and the required legislative or administrative actions will be decided soon. The actions taken by the Governments across the world on these reports will certainly have enormous impact on the way businesses conduct themselves and international taxation.

Source: - http://www.oecd.org

For further details please refer to our Flash News dated 8 October 2015 available at this link

CBDT rolls out final rules for 'Range' concept and multiple year data prescribed under TP regulations

On 19 October 2015, the CBDT released the final rules for the use of range and multiple year data. The key highlights/amendments of the Rules are as under:

Use of Multiple year data

The data to be used for comparability analysis was required to be data related to the 'financial year' in which the international transaction or the Specified Domestic Transaction (SDT) was entered into or data relating to a period not more than two years prior to such a FY. The term 'financial year' has been replaced by the term 'current year' in order to avoid disputes arising from the use of the term 'financial year'. The amendment will be applicable for only those international transactions or SDTs, entered into on or after 1 April 2014. The following are the important factors that needs consideration while using multiple year data:

- Applicable only in case the MAM used for determination of ALP is TNMM, Resale Price Method (RPM) or Cost Plus Method (CPLM)

- Comparability to be conducted based on a) data relating to the Current Year or b) data relating to the FY immediately preceding the Current Year, if the data relating to the Current Year is not available at the time of furnishing the return of income

- If the Current Year data becomes available, during assessment proceedings, the same to be considered irrespective of the fact that such Current Year data was not available at the time of furnishing of return of income.

New Rule 10 CA - Determination of the ALP where the application of the MAM results in more than one price.

In cases where the application of any of the methods results in more than one price, the ALP shall be computed as follows:

- A dataset shall be constructed by placing the prices/data in an ascending order.

- If a comparable has been identified on the basis of data relating to:
  a) **Current year**, then the data for the immediately preceding two FYs can be considered,

provided the comparable has undertaken the same or similar comparable uncontrolled transaction in those preceding two years.

b) **FY immediately preceding the current year**, then the data for the immediately preceding two years can be considered provided the comparable has undertaken the same or similar comparable uncontrolled transaction in that preceding year.

- Enterprises may not be considered as comparables, if they have not undertaken comparable uncontrolled transaction in the Current Year, even if, such an enterprise had undertaken comparable uncontrolled transaction in either or both of the FYs immediately preceding the Current Year.

- The price in respect of comparable uncontrolled transactions shall be determined using the weighted average of the prices/data points for a) the Current Year and preceding two FYs; or b) two FYs immediately preceding the Current Year; with weights being assigned to specific parameters (sales, costs, assets etc.) depending on the MAM selected.

Range concept

The concept of Range for determination of ALP shall apply, subject to certain conditions as under:

- Applicable only in case the MAM used for determination of ALP is Comparable Uncontrolled Price (CUP), RPM, CPLM and TNMM

- A minimum of 6 comparables/data points would be required. In case, the number of comparables/data points is less than 6, arithmetic mean (AM) will continue to apply along with benefit of 3 per cent tolerance band (1 per cent for wholesale traders)

- A dataset shall be constructed by placing the prices/data points in an ascending order. The data points lying within the thirty-fifth percentile to sixty-fifth percentile of the data set of series, arranged as above, would constitute the arm's length range

- Arm's length test
  - If the price at which the international transaction or SDT is undertaken is within the thirty-fifth percentile to sixty-fifth percentile of the dataset, the transaction shall be deemed to be at the ALP.

  - If the price at which the international transaction or the SDT is undertaken is outside the arm's length range (thirty-fifth percentile to sixty-fifth percentile of the dataset), the ALP of the transaction shall be taken to be the median of the dataset.

CBDT Notification No. 83/2015 dated 19 October 2015

For further details please refer to our Flash News dated 21 October 2015 available at this link

The Delhi High Court held that AMP expenses incurred by Maruti Suzuki India do not constitute an international transaction. It also held the use of a bright line approach inappropriate for determining the existence of an international transaction and for making an adjustment

The taxpayer is engaged in manufacturing of passenger cars in India and is a subsidiary of Suzuki Motor Corporation, Japan (SMC). During the AY 2005-06, the TPO made an adjustment to the total income on account of the AMP expenditure incurred by the company by application of the BLT. Revenue contended that as the taxpayer undertakes sale of products under the brand name 'Maruti-Suzuki', excess AMP expense incurred by the company vis-à-vis the comparables, is promoting the brand Suzuki which is legally owned by SMC.

High Court's ruling

Earlier this year, the Delhi High Court in the case of Sony Ericsson Mobile Communications Pvt. Ltd. v. CIT (2015) 374 ITR 118 (Delhi) had held that AMP expenses constituted an international transaction in case of marketing and distribution functions. Taking a contrary stand based on the specific facts of the taxpayer, and distinguishing the Sony Ericsson High Court ruling, the High Court rejected the Revenue's contention that after the aforesaid Sony Ericsson ruling, the existence of an international transaction in the case of the taxpayer cannot be questioned.

The findings of the High Court have been briefly given below:

- **BLT is not permitted under the law -** BLT applied by the Revenue authorities is not permissible under the Indian TP regulations. AMP expense cannot constitute an international transaction merely by application of BLT, especially when its application has been struck down by the High Court in the Sony Ericsson ruling.
- **Onus is on the Revenue to demonstrate the existence of international transaction -** The onus to demonstrate that an AMP expense incurred by a taxpayer constitutes an international transaction would rest upon the Revenue authorities without application of BLT. Neither the substantive, nor the machinery provisions of the Indian TP regulations permit undertaking an adjustment by the application of BLT, in the manner applied by the Revenue authorities.
- **Lack of statutory guidance on the approach -** Even in a case where an AMP expense incurred by the assessee is held to be an international transaction, there is no machinery provision under the TP regulations to enable the Revenue authorities to determine the compensation entitled to an Indian entity and a clear statutory guidance is required on the approach to be adopted for such determination.
- **Benefit to the related party is only incidental -** In the subject case, based on an intercompany agreement, SMC had granted a permission to the taxpayer to use the co-brand 'Maruti-Suzuki'. Neither did the co-brand belong to SMC nor did it have the right to use the co-brand in India or outside. The High Court noted that as SMC is not entitled to use the co-brand, the benefit does not arise. High Court held that the benefit of additional AMP spend flowing to SMC is merely based on presumption of the Revenue authorities.
- **No adjustment warranted if transactions are held to be at ALP -** The High Court relied upon Sony Ericsson ruling that if, on application of the TNMM, an Indian entity has operating margins higher than that of the comparable companies, no separate adjustment on account of AMP expense is warranted. Based on the same, the High Court observed that, since the net operating margin of the taxpayer is higher vis-à-vis comparable companies, there is no question of TP adjustment on AMP expense.
- **Erstwhile ruling in the case of Maruti Suzuki is not binding -** The erstwhile ruling in the case of Maruti Suzuki is no longer binding in light of the observations of the Supreme Court in the same case.

Maruti Suzuki India Limited v. CIT [2015] 64 taxmann.com 150 (Delhi)

For further details please refer to our Flash News dated 16 December 2015 available at this link

Base Erosion and Profit Shifting

OECD launched an Action Plan on BEPS in July 2013. OECD had identified 15 specific actions considered necessary to prevent BEPS, out of which the first set of recommendations, have been released in September 2014.

OECD on 5 October 2015 issued final reports in connection with all its Action Plan to address BEPS, together with a plan for follow-up work and a timetable for implementation. Earlier reports have been consolidated with the remaining 2015 deliverables to produce a coherent set of recommendations for addressing BEPS. Many countries are poised to adopt changes to their international tax systems based on the OECD recommendations.

Action 1 - Addressing the tax challenges of the Digital Economy

Action 1 is aimed at addressing BEPS issues in the Digital Economy (DE). The DE presents some key features that may exacerbate BEPS concerns – mobility (intangibles, users and business functions), reliance on data, network effects, multi-sided business models, monopoly and volatility. The final report on DE asserts that DE business models facilitate the artificial shifting of income, avoidance of direct tax nexus and the avoidance of Value Added Tax (VAT).

The report recommends an application of principles as per the International VAT/Goods and Services Tax (GST) Guidelines and the introduction of the appropriate collection mechanism. Apparently, the effective model for the collection of VAT could be the vendor collection model where the offshore vendor registers and pays the tax in the consumer jurisdiction.

The report further develops alternative options addressed in its 2014 work: (1) significant economic presence nexus; (2) withholding taxes on digital income from goods or services ordered online; and (3) 'equalization levy'. These measures could be imposed through domestic legislation and are not recommended as an international standard. However, the report states that countries may wish to impose these measures to address DE BEPS concerns that those countries believe are not adequately addressed by the OECD's recommendations or as a 'stop-gap' measure until the OECD's recommendations are fully implemented.

The report states that the character of many forms of DE income, including cloud computing, is not addressed in the existing commentary to the OECD Model Treaty (royalties, technical services or business profits). The Working Party is mandated to clarify the characterization of such income under the current tax treaty rules, and its work is to be completed with the full participation of associate member countries in the BEPS process.

The report concludes that work under the other BEPS Actions addresses many of the DE BEPS concerns, but also sets out additional measures countries may consider. The report states that the Task Force on the DE (TFDE) will continue its work by monitoring new DE business models and the effectiveness of BEPS measures with the objective of issuing a report on its work by 2020.

Action 2 – Neutralize the effects of hybrid mismatch arrangements

The aim of Action 2 is to develop model treaty provisions and recommendations for the design of domestic rules to neutralise mismatches arising from the use of hybrid instruments and entities. The final report recommends the introduction of hybrid mismatch rules and certain other domestic provisions to counter hybrid arrangements, together with a proposed change to the model treaty to ensure hybrid entities are not used to obtain treaty benefits unduly.

The hybrid mismatch rules apply to arrangements involving a hybrid financial instrument (including a hybrid transfer) or hybrid entity (including a reverse hybrid) that cause a mismatch in tax outcomes. The rules operate to deny a tax deduction for payments made under such arrangements that are also deductible in another jurisdiction, prevent exemption for payments that are deductible for the payer and deny a deduction for a payment that is not included in the ordinary income of the recipient. The hybrid mismatch rules also apply to deny a deduction for payments made by a dual-resident entity where the payment would otherwise be deductible in both jurisdictions and to the extent it is not set-off against dual inclusion income. In addition, the rules allow a jurisdiction to deny a deduction for a payment in circumstances where a hybrid mismatch that arises between two other jurisdictions is 'imported' into that jurisdiction, but only to the extent that the hybrid mismatch is not neutralised by one of the other jurisdictions.

The final report recognises the importance of consistency and co-ordination in the implementation and application of the hybrid mismatch rules to ensure the rules are effective (but do not lead to double taxation) and to minimise compliance and administrative costs. Therefore, in addition to the detailed guidance and examples, it sets out a common set of design principles and defined terms, and calls for countries to exchange information relevant to the administration of the rules and to co-ordinate on the timing of the implementation of the rules. The report says that the rules should generally apply to all payments made under hybrid mismatch arrangements after the date of implementation without grandfathering of the existing arrangements.

Other recommended domestic provisions include the denial of a dividend exemption for payments that are tax deductible for the payer, as well as measures to prevent hybrid transfers being used to duplicate withholding tax credits and to treat reverse hybrids as resident taxpayers where income is not brought into charge to tax in the investor jurisdiction.

The proposed change to the model treaty involves only allowing income that is derived by or through an entity which is treated as fiscally transparent in the contracting state, to be considered as income of a resident of a contracting state for the purposes of the treaty to the extent that it is treated as income of the resident for tax purposes in that state. The report also says that countries that intend to implement the domestic provisions should consider amending their tax treaties that include an exemption method for dividends in order to eliminate double taxation to, instead, apply a credit method, either as a general rule or with respect to tax-deductible dividends.

Action 3 – Designing Effective Controlled Foreign Company Rules

The objective of Action 3 is to address BEPS by designing effective Controlled Foreign Company (CFC) rules. By taxing the income of non-resident subsidiaries in the hands of the resident shareholders, robust CFC rules can prevent groups from establishing low-taxed non-resident affiliates to which they shift income which is often subject to indefinite deferral. The final report sets out recommendations for six building blocks: (1) rules for defining a CFC (including definition of control); (2) CFC exemptions and threshold requirements; (3) definition of CFC income; (4) rules for computing income; (5) rules for attributing income; and (6) rules to prevent or eliminate double taxation. Most significantly, regarding the definition of CFC income, the final report significantly revamped this income issue, makes an affirmative recommendation regarding income attribution and provides modified income attribution options.

CFC rules should broadly define entities that are within the scope of the CFC definition so that, in addition to including corporate entities, CFC rules could also apply to certain transparent entities (partnerships, trusts) and PEs if those entities earn income that raises BEPS concerns and those concerns are not addressed in another way.

The CFC rules should apply both a legal and an economic control test (generally set at more than 50 per cent, although countries could, if they so choose, achieve broader policy goals by setting a lower threshold) so that satisfaction of either test results in control.

CFC rules should include a tax rate exemption that would allow companies that are subject to an effective tax rate that is sufficiently similar to the tax rate applied in the parent jurisdiction not to be subject to CFC taxation.

Possible approaches to defining CFC income that should be attributed to controlling shareholders are identified. However, defined CFC income should be computed using the rules of the parent jurisdiction for determining income.

Income should be attributed only to shareholders having a minimum threshold of control, and the amount of income to be attributed to each shareholder or controlling person should be calculated by reference to both their proportion of ownership and their actual period of ownership or influence.

The final report also recommends that exemption should be granted in CFC rules for dividend income and gains on disposition of CFC shares if the income of CFC has previously been subject to CFC taxation.

Action 4 – Limit base erosion via interest deductions and other financial payments

Action 4 seeks to develop recommendations in the design of rules limiting the deductibility of interest and other economically equivalent payments made to third parties and related parties. In its final report, the OECD recommends a combination approach where a fixed ratio rule is the default rule and a group ratio rule applying at a country's election. Furthermore, the OECD supplements the best practice approach with additional optional elements and targeted rules.

Fixed ratio rule limits the entity's net deductions for interest and interest equivalent to a percentage of pre-tax earnings before interest, depreciation and amortisation i.e. (EBITDA). Recommended range of 10 to 30 per cent. Group ratio rule permits the entity with net interest expense above a country's fixed ratio to deduct interest upto its group level ratio-third party interest EBIDTA ratio. Under equity escape rule an entity level comparison is done of equity and assets to those held by its group. Further other options are also suggested which include a de minimise threshold, public benefit exemption, carry forward or carry back of disallowed interest expense and/or unused interest capacity and other targeted anti-avoidance rules.

Action 5 – Counter harmful tax practices more effectively, taking into account transparency and substance

The goal of Action 5 is to identify preferential regimes, introduce compulsory spontaneous information exchange on rulings related to preferential regimes and require substantial activity for any preferential regime including IP regimes.

The Forum on Harmful Tax Practices (FHTP) will continue its work in reviewing preferential regimes (currently 43 regimes have been identified of which 16 are IP regimes).

For IP regimes, the report agrees on the so-called 'nexus' approach which seeks to directly link IP regime benefits to the claimant company's contribution to the development of the IP in question, measured by reference to the related R&D expenditure as a proportion of total R&D expenditure, with expenditure acting as a proxy for activity. The proposal is based on a formula: eligible IP income for the IP regime = (qualifying expenditure incurred to develop the IP asset divided by overall expenditure incurred to develop the IP asset) x overall income from that IP asset. Qualifying expenditures must be directly connected to the IP asset and will in principle not include interest payments, building costs, acquisition costs and related party outsourcing with an up-lift of 30 percent for qualifying expenditures.

As a transitional arrangement, the report concludes that no new entrants will be permitted in any existing IP regime not consistent with the nexus approach after 30 June 2016. The report notes that a framework covering all rulings has been agreed.

Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

The objectives of Action 6 are to: (i) develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances (i.e. treaty abuse and treaty shopping cases); (ii) clarify that tax treaties are not intended to be used to generate 'double non-taxation' and (iii) identify tax policy considerations for jurisdictions to consider before entering into treaties. The final report recommends a three-pronged approach to address treaty shopping arrangements i.e. clarification in treaty title and preamble to the effect that the Contracting States intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, inclusion of a specific anti-abuse rule based on LOB provisions (in line with such clauses in US tax treaties) and addition to tax treaties of a more general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test or PPT rule).

The report further recommends 'minimum standard' to counter treaty shopping whereby countries will include one of the following types of rules, viz. Combined approach of both a PPT and LOB rule in tax treaties; PPT rule alone in tax treaties; or an LOB in tax treaties supplemented by domestic anti-conduit financing legislation.

The final report includes draft provisions for both a U.S.-style LOB and for a 'simplified' LOB, both of which are based on the 2014 deliverable and subsequent discussion drafts. The simplified LOB is expected to be paired with the PPT. Further work will be done on both the detailed and simplified LOB and Commentary during the first part of 2016, in light of changes to the U.S. model LOB, which is expected to be finalized by the end of 2015.

The guidance on the PPT generally incorporates the guidance from the 2014 deliverable and the subsequent discussion drafts. The final report also confirms the specific changes recommended in the 2014 deliverable, including a provision to deny treaty benefits when payments are made to a low-taxed PE in a third jurisdiction, a minimum holding period to receive dividend withholding relief, a provision to prevent avoidance of the real property holding company provision, and a modification to the dual residence tie-breaker for entities.

Action 7 – Prevent the artificial avoidance of PE status

The aim of Action 7 is to develop changes to the definition of PE to prevent abuses of that threshold, including through the use of commissionaire arrangements and the specific activity exemptions to avoid PE status where core activities are involved. The report recommends an expanded scope of what is proposed to constitute a PE, focusing on the negotiation and final conclusion of contracts. An important addition to Article 5(5) is the phrase ‘habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise’. Further, Article 5(4) is modified to ensure exceptions included in PE creation are restricted to activities that are 'preparatory and auxiliary' in nature.

A new anti-fragmentation rule seeks to deny the preparatory and auxiliary exception if the foreign enterprise or a related enterprise carries on related activities in the same jurisdiction and those activities, taken as a whole, go beyond preparatory and auxiliary. New rules to avoid the splitting of contracts are aimed at construction activities carried out by more than one foreign entity, each for a period of less than the threshold for construction activities (generally 12 months). Rather than changing the wording of paragraph 3, the OECD aims to deal with this under the new PPT rule to be introduced following Action 6.

Action 11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it

The BEPS Action Plan states that improving the availability and analysis of data on BEPS is critical, including monitoring the implementation of the Action Plan.

The Final report proposes six indicators which, when taken together, may provide general indications of BEPS, particularly when measured over time. The report also suggests potential future indicators based on new data that will be available by way of Actions 5, 12, and 13 that could provide further insights into the scale and economic impact of BEPS. While this report does not suggest any changes to countries’ local legislation, it does outline a number of best practices in the areas of data collection and analysis, and offers some specific recommendations for better measurement in the future.

Action 12 – Require taxpayers to disclose their aggressive tax planning arrangements

The goal of Action 12 is to design mandatory disclosure rules for perceived aggressive or abusive tax planning. The final report provides a modular framework that enables countries without mandatory disclosure rules to design a regime that fits their need to obtain early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations seek to achieve the certain key objectives i.e. (1) To provide tax authorities with early information on potentially aggressive or abusive tax planning schemes, which may not be achieved through disclosure mechanisms already in place (2) To act as a deterrent for aggressive tax avoidance behavior, since a taxpayer is less likely to enter into a tax planning scheme knowing that the tax outcomes need to be disclosed and may subsequently be challenged by the tax administration (3) To identify abusive tax avoidance schemes, specific information about their taxpayers (users) and promoters.

The report sets out the basic elements of disclosure regime and alternate options that may be adopted by individual countries based on their existing legislations on various parameters [i.e., who has to report (user or promoter), what has to be reported (threshold requirements), when information should be reported etc.

Such rules should include specific and generic hallmarks, such as a confidentiality clause and contingent fees, to determine whether a scheme is deemed aggressive and, therefore, reportable. Sanctions, especially pecuniary penalties, for non-compliance are also recommended.

Action 14 – Make dispute resolution mechanisms more effective

The aim of Action 14 is to improve the effectiveness of the Mutual Agreement Procedure (MAP) in resolving treaty-related disputes. . The final report reflects a commitment by all countries to adhere to a minimum standard for the resolution of treaty related disputes, and establish and submit to a monitoring mechanism to ensure that the commitments embodied in the minimum standard are fulfilled. In addition, the final report identifies best practices which are complementary to the minimum standard, but are not part of it. Finally, the final report notes that while currently there is no consensus among all OECD and G-20 Countries on the adoption of mandatory binding arbitration, a significant group of countries has committed to adopt and implement mandatory binding arbitration.

Detailed terms of reference and an assessment methodology to monitor the implementation of the minimum standard will be developed in the context of the OECD/G20 BEPS project in 2016.

The following countries declared a commitment to provide for mandatory binding arbitration in their bilateral treaties: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

Action 15 – Develop a Multilateral Instrument

The purpose of Action 15 is to streamline the implementation of tax treaty-related BEPS measures through a multilateral instrument (MLI) to amend existing bilateral tax treaties. The OECD issued a report on 18 September 2014 in which it concluded that a MLI is desirable and feasible and would be negotiated through an international conference open to G20 countries, OECD members and other interested countries. On 6 February 2015, the OECD published a mandate with respect to the process for developing the MLI. On 27 May 2015, an ad hoc group was established to develop the MLI. The ad hoc group was open to all interested countries on an equal footing. The ad hoc group has agreed on a number of procedural issues so that the substantive work can begin on 5-6 November 2015. The work will continue throughout 2016 to conclude the multilateral instrument, and it is expected to be open for signature by December 2016. The OECD's final report reiterates the conclusions and mandates contained in its earlier publications on Action 15.

To date, there are 90 countries participating in the development of the MLI. Participation in the development of the MLI is voluntary and does not entail any commitments to sign the instrument once it has been finalised. MLI would not terminate the pre-existing network of bilateral treaties.

Final reports on BEPS Action Plans

For further details please refer to our Flash News dated 8 October 2015 available at this link

Other direct tax developments

CBDT amends rules relating to furnishing of information in respect of payments made to the non-resident

The CBDT has issued Notification No. 93/2015, F.No.133/41/2015-TPL, dated 16 December, 2015 to amend Rule 37BB of the Rules for the furnishing of information in respect of payments made to the non-resident. The amendments to the Rules are summarised as follows:

- The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum chargeable under the provisions of the Act, shall furnish the following, namely:
  - The information in Part A of Form No. 15CA shall be furnished if the amount of payment or the aggregate of such payment made during the AY does not exceed INR 5,00,000.
  - For payments other than the payments referred above, the information shall be furnished:
    - in Part B of Form No.15CA after obtaining:
      i) a certificate from the AO under Section 197; or
      ii) order from the AO under sub-section (2) or sub-section (3) of Section 195;
    - in Part C of Form No.15CA after obtaining a CA certificate in Form No. 15CB.

CA certificate in Form No. 15CB will be required to be furnished only in respect of such payments made to non-residents that are chargeable to tax and the amount of payment during the year exceeds INR 5,00,000.

- The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum that is not chargeable under the Act, shall furnish information in Part D of Form 15CA.

- No information is required to be furnished for any sum which is not chargeable under the provisions of the Act, if:
  - the remittance is made by an individual and it does not require prior approval of Reserve Bank of India (RBI) as per the provisions of Section 5 of the Foreign Exchange Management Act, 1999 or
  - the remittance is of the nature prescribed in the specified list.

- The list of payments of specified nature mentioned in Rule 37BB of the Rules, which do not require submission of Forms 15CA and 15CB, has been expanded from 28 to 33 to include advance payment against imports, payment towards imports-settlement of invoice, intermediary trade, imports below INR 5,00,000 (for use by ECD offices) and imports by diplomatic missions.

- The amended Rule 37BB of the Rules prescribes to continue submission of Form 15CA electronically and introduces the optional usage of the digital signature in accordance with procedure, formats and standards to be provided by the Principal Director General of Income-tax (Systems) [PDGI (Systems)].

- The certificate in Form 15CB shall be furnished and verified electronically in accordance with the procedures, formats and standards to be provided by the PDGI (Systems).

- The authorised dealer shall furnish a quarterly statement for each quarter of the FY in Form 15CC to the PDGI (Systems) or the person authorised by the PDGI (Systems) electronically under digital signature within fifteen days from the end of the quarter of the FY to which such statement relates in accordance with the procedures, formats and standards to be prescribed by the PDGI (Systems).

- The amended Rules will come into effect from 1 April 2016.

CBDT Notification No. 93/2015, F.No.133/41/2015-TPL, dated 16 December, 2015

For further details please refer to our Flash News dated 18 December 2015 available at this link

The CBDT Press Release on phasing out plan of deductions under the Income-tax Act

The Finance Minister in his Budget Speech of 2015 stated that the rate of corporate tax will be reduced from 30 per cent to 25 per cent over the next four years along with the corresponding phasing out of exemptions and deductions available under the Act. Accordingly, the CBDT has issued a Press Release, wherein it is stated that it is a step towards the simplification of tax laws, which is expected to bring about transparency and clarity. The government proposes to implement this decision in the following manner:

- Profit-linked, investment-linked and area-based deductions will be phased out for both corporate and non-corporate taxpayers.
- The provisions having a sunset date will not be modified to advance the sunset date. Similarly, the sunset dates provided in the Act will not be extended.
- In the case of tax incentives with no terminal date, a sunset date of 31 March 2017 will be provided either for the commencement of the activity or for claiming a benefit, depending upon the structure of the relevant provisions of the Act.
- There will be no weighted deduction with effect from 1 April 2017.

The details of the phasing out plan to be implemented are as under:

- Section 32 of the Act - Depreciation under the Act is available up to 100 per cent in respect of certain block of assets. The highest rate of depreciation under the Act is proposed to be reduced to 60 per cent, to be made applicable from 1 April 2017, to all the assets (whether old or new) falling in the relevant block of assets.

- Section 35AD of the Act - This provision of the Act provides for 100 per cent deduction of capital expenditure (other than expenditure on land, goodwill and financial assets) incurred by certain specified businesses such as laying and operating a cross country natural gas or crude or petroleum oil pipeline network, building hotel (two star and above), a warehousing facility for sugar, etc. However, in the case of a cold chain facility, a warehousing facility for storage of agricultural produce, an affordable housing project, production of fertilizer, etc., a weighted deduction of 150 per cent of capital expenditure is allowed. It is proposed that no weighted deduction will be allowed on any specified business with effect from 1 April 2017.
- Section 35AC of the Act - No deduction under Section 35AC of the Act will be available from FY 2017-18 (AY 2018-19).
- Section 35 of the Act - This provision of the Act provides for deduction of expenditure incurred on scientific research. It allows for both capital and revenue expenditure and also allows for the weighted deduction of donations made to certain institutions/associations/companies for scientific research. It is proposed to provide that –
  - Deduction under Section 35(1)(ii), (iia), (iii) and 35 (2AA) of the Act is proposed to be restricted to 100 per cent from FY 2017-18, and
  - Deduction under Section 35(2AB) of the Act is proposed to be limited to 100 per cent from FY 2017-18 as against 200 per cent available up to 31 March 2017 under the Act.
- There are certain tax incentives which at present do not have any sunset date for commencement of an activity. It is proposed to provide a sunset date of 31 March 2017 for commencement of an activity in the following cases:
  - Development, operation and maintenance of an infrastructure facility [Section 80-IA(4)(i) of the Act].
  - Development of a Special Economic Zone (SEZ) (Section 80-IAB of the Act).
  - Export of articles or things or services by a unit located in a SEZ (Section 10AA of the Act).
  - Commercial production of natural gas in blocks licenced under CBM-IV and NELP VIII. [Section 80-IB(9)(iv)&(v) of the Act].
  - Commercial production of mineral oil from blocks licenced under a contract awarded up to 31 March 2011. [Section 80-IB(9)(ii) of the Act].
- No weighted deduction is proposed to be provided under Section 35CCC and 35CCD from 1 April 2017. However, a deduction up to 100 per cent of expenditure referred to therein shall be available.

CBDT Press Release, dated 20 November 2015

For further details please refer to our Flash News dated 23 November 2015 available at this link

Consideration for the sale of capacity in the undersea cable system is not considered as royalty but as business income. The sale was concluded outside India on a principal to principal basis and, therefore, such business income is not taxable in India

The taxpayer, a company, incorporated in Bermuda, was set up to build a high capacity 'submarine fibre optic telecommunication link cable system' i.e. undersea cable for providing telecommunication link. Such a telecommunication cable was known as ‘Fibre Optic link around the Global Cable System’ (Flag Cable System). The taxpayer had entered into a Memorandum of Understanding (MOU) with various parties which were mostly national telecommunication companies belonging to different nations, for the purpose of planning and implementing of the ‘Submarine Fabric Optic Telecommunication Link Cable System’ linking Western Europe (starting from the U.K.), Middle East, South Asia, South East Asia and Far East (ending in Japan). The taxpayer has been termed as ‘founding party’, whereas the other parties to the MOU have been termed as ‘landing parties’.

Most part of the cable has been laid down on the sea bed and for the purpose of connection in the terrestrial land, the cable comes ashore in certain countries, connecting with the domestic telecommunication system, which has been termed as ‘landing stations’. In India, Videsh Sanchar Nigam Limited (VSNL) was one of the original landing parties to the MOU in the cable system and part of the consortium to the Flag Cable System. For the purpose of selling the capacity in the cable system, the parties entered into a Cable Sales Agreement (CSA). On 31 March 1995, the CSA was entered into between the taxpayer and VSNL, which was further amended on 29 April 1998, by which time VSNL had bought the capacity in the said cable system. The CSA provided for the ownership rights in the Flag Cable System with all the rights and obligations in the capacity being sold. VSNL can transfer, assign or sell the capacity.

The entire procedure for ownership of capacity in the cable system and all other terms and conditions has been contained in a separate agreement titled as ‘Construction and Maintenance Agreement' (C&MA). As per the terms, once C&MA comes into force, the CSA will come to an end. The C&MA was for a period of 25 years, which coincides with the life of the cable. The taxpayer received USD28.94 million from VSNL towards the sale of capacity in the cable system. The taxpayer also received separate consideration for standby maintenance activities. The taxpayer claimed that the receipt was on account of sale of goods, from a non-resident to a resident which cannot be taxed in India. CSA and C&MA with VSNL have been executed by the taxpayer outside India on a principal to principal basis and the payment for the sale of capacity has also been made outside India. The AO held that the payment was for ‘right to use' the cable, hence, taxable as royalty in India under Section 9(i)(vi) of the Act. Further, the AO held that income from standby maintenance activities, which was separately received, was taxable as FTS, because the maintenance requires highly skilled and technical personnel.

Mumbai Tribunal held as follows:

Sale of capacity in the cable system

As per clauses given in CSA and C&MA, VSNL had all the ownership rights and obligations in respect of the capacity purchased in the cable system. VSNL can transfer capacity to any other signatory or any other international telecommunication entity.

VSNL had all the risks and rewards of ownership which were unaffected by the taxpayer, inasmuch as VSNL not only had the exclusive domain on the rights to use but also right to resale or transfer its interest in the capacity in the cable system to the exclusion of the taxpayer. The taxpayer recognised its revenue from the sale of capacity on the date on which the risks and rewards of ownership have been transferred to the purchaser. It is the capacity alone which is the subject matter of either ‘agreement to sale', ‘agreement for ‘right to use' or ‘indefeasible right to use', ‘agreement for lease' or ‘agreement for service', etc.

Either by looking at the form or looking through the substance, the only picture which emerges is that, parties intended to ‘sell’ and not to give or get ‘right to use’. In the present case, in all the agreements the word ‘capacity’ has been defined in terms of saleable units which can be sold/purchased amongst the parties.

If VSNL had bought 51 Minimum Investment Units (MIUs) in the Flag cable system, which was running across in all the segments, it had not only the exclusive ownership of 51 MIUs, but also the exclusive right to use the said capacity in the manner in which it likes i.e. it could assign or transfer or sale to any other party. In case had there been only right to use to be given, then the ownership right to the exclusion of the taxpayer could not have been given to VSNL. Based on the apparent terms and conditions of the agreement between the parties, there was no assignment of ‘right to use’ but ‘sale of capacity’ in the cable system.

Consideration is not royalty

The taxpayer right from the stage of entering the MOU with the parties, signing of the capacity sales agreement and C&MA agreement, intended to sell the capacity with the transfer of complete ownership, risks and rights. The entire agreement was for the period of 25 years which coincided with the life of the cable. Accordingly, the signatory becomes the owner of the capacity in the cable system after the purchase, that is, VSNL in the instant case. This fact further establishes that there was no payment for simply the use of the capacity. In the case of a 'royalty', agreement, the complete ownership is never transferred to the other party. The concept of transfer of ownership to the exclusion of the other party is denuded in the case of 'royalty'.

If the consideration has been received for transferring the ownership with all rights and obligations then such a consideration cannot be taxed under the head 'royalty'. Thus, the characterisation of the transfer, in the terms of the contract and agreement entered by the parties, is for sale and not for simple use. The payment received by the taxpayer from VSNL was on account of sales and hence constitutes business income and not royalty under Section 9(1)(vi) of the Act.

No business connection in India – business income not taxable

The taxpayer does not have any capital asset or property in India, which has been transferred to VSNL. The sale of capacity in the cable system does not arise through and from the business connection in India, because the sale has been made to VSNL, which is unconnected to the taxpayer. The landing station is owned by the landing parties of the respective countries. The taxpayer was not earning income through any aid or assistance of VSNL as VSNL was not carrying out any business for the taxpayer in India and therefore, in this case, there was no income accruing or arising from a business connection in India.

Neither the landing station nor the capacity in the cable is an asset of the taxpayer in India, hence, there is no income accruing or arising through or from an asset of the taxpayer in India. Regarding source from India, the source of income must lie in India so as to be deemed to be income in India. The source must flow from an asset whereas in this case there is no asset belonging to the taxpayer through or from which the taxpayer is having income.

No income had accrued or arisen in India within the deeming provision of Section 9(1)(i) of the Act, as the sale had concluded outside India on a principal to principal basis. The CBDT Circular No. 23, dated 23 July 1969 would be squarely applicable in the case of the taxpayer for the relevant year. Further, as there is no deemed income accruing or arising to the taxpayer in India within the ambit of Section 9(1)(i) of the Act, there is no attribution of income to operations in India.

Taxability of standby maintenance charges and repair and maintenance charges

The entire cable system is to be operated and maintained by founding signatory in co-ordination with relevant landing party signatory. Flag Network Operation Centre (FNOC) has to provide overall network service surveillance and over all co-ordination of maintenance and repair operations of Flag cable system. The taxpayer has to co-ordinate the deployment of the vessels for repairs and maintenance operation in accordance with the procedure defined.

There was a separate charge for repair and maintenance under the C&MA whereby, the taxpayer was actually required to undertake repair and maintenance. The standby maintenance was a fixed annual charge which was payable, not for providing services but for arranging standby maintenance arrangement which was required for a situation whenever some repair work in the undersea cable or terrestrial cable is actually performed. In relation to the standby maintenance, the payment made by VSNL is not in the nature of 'managerial service' or 'consultancy services'.

In the present case, the standby maintenance charges were in the form of fixed annual charge which was in the nature of reimbursement. Only actual cost incurred had been recovered from VSNL in providing the standby maintenance services. Accordingly, the receipts on account of standby maintenance charges cannot be taxed as FTS, under Section 9(1)(vii) of the Act as there was no rendering of services. However, whenever payment is received on account of actual repair or maintenance carried out, then same would definitely fall within the ambit of FTS chargeable to tax under Section 9(1)(vii) of the Act.

Flag Telecom Group Limited v. DCIT [2015] 38 ITR(T) 665 (Mum)

For further details please refer to our Flash News dated 2 March 2015 available at this link

Adoption of stamp duty valuation under Section 50C applies to compute capital gains and not to determine the written down value of assets

The taxpayer, during the relevant year, sold a part of the assets forming part of the block of assets 'Building', at INR 150,000. The AO during the course of assessment proceedings observed that this transaction attracts Section 50C of the Act and the value adopted by the stamp value authority was INR 230,000. Accordingly, the AO recomputed the opening Written Down Value (WDV) of the relevant block of assets and allowed the depreciation for the current year accordingly, working the same at an amount less than that claimed by the taxpayer. The CIT(A) held that Section 50C only applies for computing 'capital gains' arising to the taxpayer on the transfer of capital assets specified therein and the same would have no implication toward computing the WDV of the relevant block of assets.

The Mumbai Tribunal held as follows:

The tax department relied on the decision of the Special Bench of the Mumbai Tribunal in the case of ITO v. United Marine Academy [2011] 130 ITD 113 (Mum)(SB). However, the Special Bench held that Section 50C of the Act shall apply equally in respect of depreciable assets though used for the purposes of its business by the taxpayer. The deeming provision of Section 50C of the Act is for the limited purpose for computing the capital gains under Section 45 read with Section 48 of the Act on the assets specified under the said section.

The WDV would have to be necessarily computed in terms of Section 43(6) of the Act, and for which Section 50C of the Act has no application. The decision in the case of United Marine Academy shall, therefore, have no application to the facts of the present case. Accordingly, the Tribunal upheld the decision of the CIT(A). The Tribunal observed that the opening WDV could not be altered without first changing the depreciation for the immediately preceding year and, in parallely, the WDV at the close of that year. Accordingly, the tax department's case is wholly untenable in law.

ACIT v. Bhaidas Cursondas and Company [2015] 154 ITD 521 (Mum)

For further details please refer to our Flash News dated 20 March 2015 available at this link

Benefit of carry forward and set-off of business losses for previous years shall be available if 51 per cent of the control and voting power of the company remains unchanged

The taxpayer is a company engaged in the manufacture and sale of storage batteries. Up till AY 2000-01, all the shares of the taxpayer were held by AMCO Batteries Limited (ABL). In the AY 2001-02, the holding of ABL in the taxpayer was reduced to 55 per cent, and the remaining 45 per cent shares were transferred to a subsidiary of ABL, namely AMCO Properties and Investments Limited (APIL). In the AY 2002-03, ABL further transferred 49 per cent of its remaining 55 per cent shares to Tractors and Farm Equipments Limited (TAFE), and consequently, ABL retained only 6 per cent shares while its subsidiary APIL held 45 per cent shares. A similar shareholding continued for the AY 2003-04. The taxpayer filed its return of income for AY 2003-04 offering nil income after setting off losses brought forward from earlier years. On scrutiny assessment, the set-off of losses of the previous years against the income of AY 2003-04 was disallowed invoking Section 79 of the Act. The taxpayer preferred an appeal before the CIT(A) for the denial of set-off of brought forward business loss.

The CIT(A) upheld the order of the AO and held that the taxpayer was not entitled to set-off the brought forward losses, considering the change in the beneficial holding of 51 per cent or more, as provided under Section 79 of the Act. The Tribunal allowed the benefit of set-off of brought forward losses to the taxpayer. The Tribunal held that 51 per cent of the voting power was beneficially held with ABL during the AYs 2002-03 and 2003-04, and would thus be entitled to carry forward and set-off business losses for the previous years.

The Karnataka High Court held as follows:

ABL had complete control over APIL, which is its wholly owned subsidiary. Though the shareholding of ABL reduced to 6 per cent, yet by virtue of it being the 100 per cent holding company of APIL, the voting power of ABL cannot be said to have been reduced to less than 51 per cent, because together, both the companies hold a voting power of 51 per cent. The purpose of Section 79 of the Act would be that the benefit of carry forward and set-off of business losses for previous years should not be misused by any new owner, who may purchase shares of the company, only to get the benefit of set-off of business losses of the previous years. For such purpose, it is provided under the said Section that 51 per cent of the voting power which was beneficially held by a person or persons should continue to be held, only then can such benefit be given to the company.

Though ABL may not have continued to hold 51 per cent shares, Section 79 of the Act speaks of 51 per cent voting power, which ABL continued to have even after transfer of 49 per cent shares to TAFE, as it controlled the voting power of APIL, and together, ABL had 51 per cent voting power. Reliance was also placed on decision in the case of CIT v. Italindia Cotton Private Limited [1988] 174 ITR 160 (SC) where the Supreme Court held that the Section would be applicable only when there is a change in shareholding in the previous year which may result in a change in control of the company and that every such change of shareholding need not fall within the prohibition against the carry forward and set-off of business losses. Meaning thereby, the control of the company remained with ABL as the change in shareholding did not result in a reduction of its voting power to less than 51 per cent.

CIT v. AMCO Power Systems Ltd. [2015] 62 taxmann.com 350 (Kar)

For further details please refer to our Flash News dated 30 October 2015 available at this link

The expression 'month' used in Section 201(1A) of the Income-tax Act refers to a 'month reckoned according to the British calendar'

In the present case, the Supreme Court vide its order dated 7 November 2012 directed that the taxpayer cannot be held as an 'assessee in default', in view of the directions of the High Court, for the period from 20 February 1996 to 15 March 2010. Therefore, the taxpayer was liable to pay interest only from 16 November 2010. Accordingly, the interest under Section 201(1A) of the Act was required to be computed for the period from 16 November 2010 to 14 December 2012. The AO computed a period of 26 months on the basis that there were 24 calendar months in this period and it also included a part of November 2010 and December 2012. The taxpayer had filed a rectification petition against the AO's order of giving effect to the directions of the Supreme Court. The claim of the taxpayer was that since the total period was of 24 months and 28 days, the period for which interest under Section 201(1A) of the Act could be levied was only for 25 months. However, the AO did not agree with the contention of the taxpayer. The CIT(A) upheld the order of the AO.

The Ahmedabad Tribunal held as follows:

Section 201(1A) of the Act indicates that the provision is quite simple and unambiguous in as much as interest is to be charged for 'every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted'. The context in which the expression 'month' is used in the present case is a measurement of the period for which time value of money is to be compensated. If a person ought to have deducted tax on 21 October and he actually does so on 3 November, the period for which the government is deprived of its legitimate taxes is less than a month. However, as per the interpretation canvassed by the AO, this will be a period of two months – i.e. a part of October and also a part of November. Such a result was clearly incongruous.

As for the alternate contention of the tax department, i.e. the period of a month could at best be taken as thirty days and, therefore, the period 7 November 2010 to 14 December 2012 should be constructed as 26 months, it was also devoid of any merits. If that is the principle to be followed, when a person required to deduct tax at source on 21 March, actually deducts the tax at source on 18 March in the subsequent year, the period of delay will have to be taken as 13 months (i.e. 12 X 30= 360 days plus 2 days as part of the month). This approach is also incongruous. There was no dispute about the fact that the expression 'month' is not defined for the purpose of Section 201(1A) of the Act nor there is any direct judicial authority in the context of Section 201 of the Act. Section 3(35) of the General Clauses Act, 1897 defines 'month' as, unless there is anything repugnant in the subject or the context, 'a month reckoned according to the British calendar'.

The expression 'reckoned', in plain English, refers to 'count, compute or calculate'. In substance thus, the mandate of Section 3(35) of the General Clauses Act, 1897 is to count, compute or calculate according to, or as per, the British calendar. It is also important to note that even this definition is not in absolute terms in as much as when 'there is anything repugnant in the subject or the context', this definition can be discarded. The levy of interest under Section 201(1A) of the Act is compensatory in nature and it represents the time value of money attributable to delay in the deduction of tax at source. Thus, what is to be seen is the gap of time between the point of time when tax ought to have been deducted at source vis-à-vis the point of time when the tax was actually deducted, and it is in this context that connotation of expression 'month' is to be examined. In the present case, the period of time from 16 November 2010 to 14 December 2012 was less than 25 months because, on 14 December 2012, the period of 25 months has not elapsed from 16 November, 2010. The period which is elapsed between these two dates is 24 months and 28 days. Therefore, going by the provisions of the General Clauses Act, for such period, interest under Section 201(1A) of the Act could not have been levied for a period of more than 25 months. The expression 'month' refers to 'a month reckoned according to the British calendar'. 'A month as per the British calendar' and 'a month reckoned as per British calendar' are not the same thing and cannot be used interchangeably. While the former refers to a calendar month by itself, the latter refers to a period of time which qualified to be treated as a 'month'. The subtle distinction between the scope of these two expressions cannot be ignored. The interest under Section 201(1A) of the Act could not be charged for more than 25 months. Accordingly, the AO was directed to re-compute the interest under Section 201(1A) of the Act.

Oil & Natural Gas Commission v. ACIT [2015] 62 taxmann.com 133 (Ahd)

For further details please refer to our Flash News dated 9 October 2015 available at this link

Levy of interest under Section 234B of the Income-tax Act is automatic if prescribed conditions are met with, even when a calculation is provided in the form attached with the assessment order – Supreme Court

Whether the levy of interest under Section 234A, 234B and 234C of the Act is mandatory and whether the AO should give a specific direction in his order to levy such interest, has been a subject matter of debate before the courts. The five-judges bench of the Supreme Court in the case of CIT v. Anjum M.H. Ghaswala [2001] 119 Taxman 352 (SC) held that the Settlement Commission does not have the power to reduce or waive off the interest statutorily payable under Sections 234A, 234B and 234C of the Act, except to the extent of granting relief under the circulars issued by the CBDT under Section 119 of the Act. The Supreme Court in the case Karanvir Singh Gossal v. CIT [2012] 25 taxmann.com 213 (SC) relied on the five-judges bench decision in the case of Anjum Ghaswala and held that the levy of interest under Section 234A, 234B and 234C of the Act is mandatory.

The Allahabad High Court in the case of CIT v. Oswal Exports [2015] 57 taxmann.com 259 (All) considered the above-referred decisions of the Supreme Court including the decision of CIT v. Ranchi Club Ltd. [2001] 114 Taxman 414 (SC) and held that if interest is leviable under Sections 234A, 234B or 234C of the Act, then such a levy of interest is mandatory and compensatory in nature, but, in order to levy interest under these sections, the AO is specifically required to mention the specific section of charging interest, failing which, no interest can be levied under those sections.

The Supreme Court in the case of CIT v. Bhagat Construction Co. Pvt. Ltd. (Civil Appeal No. 1169 of 2006) (SC) (the taxpayer) dealt with this controversy. In the present case, the AO did not give any direction in the assessment order for the levy of interest under Section 234B of the Act. The matter went upto the Supreme Court. The decision of the Supreme Court has been summarised as follows:

- The Supreme Court decision in the case of CIT v. Ranchi Club Ltd. [2001] 114 Taxman 414

(SC) is a one-line order which merely states that there was no merit in the appeals, and accordingly the civil appeals were dismissed. Following the Supreme Court's decision in the case of JK Synthetics Ltd. v. Commercial Tax Officer [(1994) 94 STC 422], the High Court in the case of Ranchi Club Ltd. v. CIT [1996] 222 ITR 44 (Patna) had held that the taxpayer is not supposed to pay interest on the amount of tax which may be assessed in a regular assessment under Section 143(3) of the Act or best judgement under Section 144 of the Act as the taxpayer is not supposed to know or anticipate that his return of income would not be accepted. The High Court further held that interest is payable in future only after the dues are finally determined.

- The moment a taxpayer who is liable to pay advance tax has failed to pay such tax or where the advance tax paid by such a taxpayer is less than 90 per cent of the assessed tax, the taxpayer becomes liable to pay simple interest at the rate of one per cent for every month or part of the month. A levy of such interest is automatic when the conditions of Section 234B of the Act are met.
- The facts of the present case are squarely covered by the decision in the case of Kalyan Kumar Ray v. CIT [1992 Supp (2) SCC 424], inasmuch as it is undisputed that Form I.T.N.S.150 contained a calculation of interest payable on the tax assessed. Accordingly, this form must be treated as a part of the assessment order in a wider sense, in which the expression has to be understood in the context of Section 143 of the Act, which is referred to in Explanation 1 to Section 234B of the Act.

CIT v. Bhagat Construction Co. Pvt. Ltd. [2015] 379 CTR 185 (SC)

For further details please refer to our Flash News dated 25 August 2015 available at this link

Tax is to be deducted on entries relating to provision for expenses passed in the books of account

The taxpayer is a wholly owned Indian subsidiary of a U.S. based company. As per the mercantile system of accounting the taxpayer makes provision for certain expenses in the books of accounts. As per the global group accounting policy, each of the entity of the IBM group worldwide has to quantify its expenses every quarter, within three days of the end of every quarter. In respect of expenses for which invoices have been submitted or the payments have become due, the same are accounted for and if TDS related provisions are found to be applicable on these expenses, the same are accounted for. However, in respect of expenses of which only service/work has been performed by the vendors, but for which the invoices have not been furnished or in respect of which the payments have not fallen due, a provision for such expenses is also made in the books of account recognising the liability that has been incurred. Such expense provisions were created on reliable estimates of the payment that was expected to be made on the settlement dates in the future. In the subsequent FYs, the provision entries were reversed and on receipt of invoices in respect of the respective expenses, the same were recorded as liabilities due to the respective parties and taxes were deducted at source and paid to the government in the due course.

During the year under consideration, the taxpayer has debited the expenses to the profit and loss account and the provisions are credited to a provision account and not to the vendor accounts as these have not fallen due for payment. While filing the return of income, the taxpayer disallowed the amounts in the computation of income in terms of Section 40(a)(i) and Section 40(a)(ia) of the Act. The AO held that the above procedure followed by the taxpayer was contrary to the accounting policy because once the expenditure is booked in the profit and loss account, it cannot be reversed. The taxpayer has to deduct tax on the provision so created by the taxpayer in the books of accounts. However, the taxpayer could not produce the details of payment of TDS and therefore, the taxpayer would be treated as an 'assessee in default' under Section 201(1) of the Act in respect of taxes not deducted at source in respect of provision for expenses made in the books of accounts. The AO also levied interest under Section 201(1A) of the Act on taxes not paid to the credit of the Central Government. The CIT(A) upheld the order of the AO.

The Bangalore Tribunal held as follows:

Once there is a disallowance under Section 40(a)(i) and (ia) of the Act, it is not possible to argue that there was no liability under Chapter XVII-B of the Act and, therefore, the provisions of Section 201(1) of the Act will not be attracted. It is clear from the statutory provisions of TDS that the liability to deduct tax at source exists when the amount is credited to a 'suspense account' or any other account by whatever name called, which will also include a 'provision' created in the books of accounts. Thus, it is not possible for the taxpayer to argue that there was no accrual of expenditure in accordance with the mercantile system of account and, therefore, the TDS obligations do not get triggered.

Section 195 of the Act uses the expression 'chargeable to tax'. In the present case, it is neither the case of the taxpayer that payments made to non-residents are not chargeable to tax nor has the taxpayer been able to demonstrate as to how payment made to a non-resident is not chargeable to tax. The taxpayer is a person making payment and the simple obligation cast upon him is to deduct a sum specified by the Act from and out of the payment and remit to the credit of the Central Government. The argument of the taxpayer that TDS provisions operate on income and not on payment is erroneous. Section 194C, 194J and 195 of the Act, which are the sections applicable in the present case, do not use the expression, 'Income'. The above sections use the expression 'Sum' and tax deduction has to be on the 'sum so paid'.

Section 194H and Section194-I of the Act deals with TDS obligation on payment of commission and rental income. These payments by its nature are specific and the entire payment is attributable to commission or rent and, therefore, the commission and rent paid are treated as 'income'. Therefore, the expression income by way of commission or rent is found in these sections. Moreover, as a person responsible for making payment, it is the duty of the taxpayer to deduct tax at source. Section 194C, 194J, 194H and 194-I of the Act do not use the expression 'chargeable to tax'. It has been noted that it is not the case of the taxpayer that the payments are not chargeable to tax in the hands of the payee. The taxpayer deducted tax on the provision made for various expenses in the subsequent FYs when the provision entries were reversed. The taxpayer, therefore, cannot take a plea that the payments in question are not chargeable to tax and, therefore, there was no obligation on its part to deduct tax at source.

IBM India Private Ltd. v. ITO [2015] 154 ITD 497 (Bang)

For further details please refer to our Flash News dated 4 June 2015 available at this link

CBDT clarifies on 'amounts not deductible' under Section 40(a)(i) of the Income-tax Act

Section 40(a)(i) of the Act provides that any interest, royalty, FTS or other sum chargeable under the Act, either payable in India to a non-resident (not being a company) or a foreign company or payable outside India, shall not be allowed as deduction, while computing the business income, if there has been failure in deduction or in payment of tax in respect of such amounts under Chapter XVII-B of the Act dealing with deduction of tax at source. Disallowance regarding 'other sum chargeable' under Section 40(a)(i) of the Act is applicable when the deductor fails to withhold tax under Section 195 of the Act. There were doubts about whether the term 'other sum chargeable' referred to the whole sum being remitted or only to the portion representing the sum chargeable to income-tax under the relevant provisions of the Act.

In this regard, the CBDT has issued Instruction No. 02/2014, dated 26 February 2015 wherein it was clarified that in cases where the tax was deducted at source under Section 195 of the Act, the AO shall determine the appropriate portion of sum chargeable under Section 195(1) the Act. The AO shall ascertain the tax liability on which the deductor shall be deemed to be 'assessee in default' under Section 201 of the Act. It has been clarified that such appropriate portion of the said sum will depend on the facts and circumstances of each case taking into account the nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion.

The disallowance of the amount under Section 40(a)(i) of the Act in the case of a deductor is interlinked with the sum chargeable under the Act as mentioned in Section 195 of the Act for the purposes of TDS. Accordingly, the CBDT has issued a Circular No. 3/2015, dated 12 February

2015 clarifying that for the purpose of making disallowance of 'other sum chargeable' under Section 40(a)(i) of the Act, the appropriate portion of the sum which is chargeable to tax under the Act shall form the basis of such disallowance and shall be the same as determined by the AO having jurisdiction for the purpose of Section 195(1) of the Act in accordance with the CBDT Instruction No. 2/2014, dated 26 February 2014.

CBDT Circular No. 03/2015, dated 12 February 2015

For further details please refer to our Flash News dated 16 February 2015 available at this link

Premium paid on premature redemption of debentures is revenue in nature

The taxpayer paid a premium on redemption of debentures. The AO as well as CIT(A) held that a premium on redemption of debentures was in the nature of capital expenditure since the taxpayer derived the benefit by paying the sum on premature redemption of the debentures. Accordingly, both the AO and the CIT(A) have disallowed the premium paid on redemption of debentures. The Mumbai Tribunal deleted the disallowance made by the lower authorities.

The Bombay High Court held as follows:

The Tribunal has correctly held that if the debentures were redeemed by the taxpayer prior to the period for which they were issued and if there was a mutual arrangement for premature redemption thereof, then, the premature redemption premium cannot be said to be a capital expenditure and need not be spread over. This was because the contract was brought to an end due to premature redemption. There was no obligation thereafter on the taxpayer to redeem it. The premium was paid on premature redemption of debentures and the expenditure was incurred in the previous year and was held to be an allowable deduction. The Supreme Court's decision in the case of Madras Industrial Investment Corporation Ltd. v. CIT [1997] 225 ITR 802 (SC) relied upon by the tax department is distinguishable on the facts of the present case. Accordingly, the premium paid on premature redemption of debentures was treated as revenue expenditure.

CIT v. Grindwell Norton Ltd. (ITA No. 694 OF 2012) – Taxsutra.com

For further details please refer to our Flash News dated 5 January 2015 available at this link

Individual taxation

Employees' Provident Fund Organisation issues clarifications on International Workers and Overseas Citizen of India/ Person of Indian Origin card holders

In October 2008, the Government of India (GoI) made fundamental changes in the Employee's Provident Fund Scheme, 1952 (EPFS) and the Employees' Pension Scheme, 1995 (EPS) by bringing International Workers (IWs) under the purview of the Indian social security regime.

In October 2012, the GOI issued a notification to amend the provisions for withdrawal of Provident Fund (PF)/ Pension Fund accumulations in respect of IWs.

In November 2012, the Employees' Provident Fund Organisation (EPFO) issued a circular to its officers for implementation of the aforesaid notification issued by the GoI.

EPFO has now clarified that position on whether Overseas Citizen of India (OCI)/ Person of Indian Origin (PIO) card holders should be treated as IWs. Benefits available to IWs from Social Security Agreement (SSA) and non-SSA countries have also been reiterated by the EPFO.

Key Clarifications

- An employee holding a foreign passport/ other than Indian passport and working for an establishment in India, to which the Employees Provident Fund & Miscellaneous Provisions Act, 1952 (EPF Act) applies, will fall under the category of IWs.

- If an IW has contributed for ten years under EPS, she/ he will be eligible to get a pension benefit under EPS provided:

For employees coming from countries with which India has SSA in force

- These employees would be eligible to avail the benefit of Totalisation

- In case the employees have completed years of eligible service after Totalisation of service in both countries, they would become eligible for a monthly pension. However, if the eligible service is less than ten years, even after including Totalisation period, such IWs will be eligible for a withdrawal benefit (lump sum refund).

For employees coming from countries with which India does not have SSA in force

- Such IWs cannot avail the Totalisation benefit. These employees will qualify to receive a monthly pension if they have completed ten years of service under EPS.

- These employees would not be eligible to receive withdrawal benefit (lump sum refund) under EPS.

Source - www.epfindia.com

For further details, please refer to our Flash News dated 18 February 2015 available at this link.

RBI amends provisions governing issue of shares under an ESOP scheme to a person resident outside India

The RBI vide Notification No. FEMA 344/2015-RB dated 11 June 2015 has amended the Regulation 8 of Foreign Exchange Management (Transfer or Issue of Security by a person Resident outside India) Regulations, 2000 governing the issue of shares under an Employee Stock Option Scheme (ESOP) and/or sweat equity shares to a person resident outside India. The RBI has also issued directions in this regard to the authorised dealer banks via an A.P. (DIR Series) Circular No 4 dated 16 July 2015.

The amendment has been effective from 11 June 2015.

Prior to the amendment:

- An Indian company could issue shares under an ESOP scheme to its employees or employees of its joint venture or wholly owned overseas subsidiary/subsidiaries who are resident outside India, directly or through a trust, provided the scheme had been drawn in accordance with the Securities and Exchange Board of India (SEBI) regulations.
- The face value of the shares to be allotted under the scheme to non-resident employees could not exceed five per cent of the paid-up capital of the issuing company.
- The trust or Indian company had to ensure compliance with the above conditions and adhere to the reporting requirements.

The amendments so made bring about homogeneity in the RBI regulations with reference to the provisions governing the issue of options/sweat equity shares by listed and unlisted companies under the Companies Act, 2013 and the SEBI Guidelines.

The definition of sweat equity and ESOP has been added via the amendment dated 11 June 2015.

- A company can now issue sweat equity shares apart from ESOP to its employees/directors who are resident outside India.

- A company can also issue shares/options to non-resident employees/directors of its holding company.

- A company can issue sweat equity shares/ESOP to non-resident directors of its joint venture or wholly owned overseas subsidiary/subsidiaries.

- Unlisted companies with ESOP schemes that are compliant with the Companies Act, 2013 and allied rules are eligible to issue shares to its non-resident employees/directors.

- The amended regulation does not specify the mode of the issue of shares/options i.e. directly or through a trust.
- The threshold limit of five per cent of the paid-up capital of the issuing company has been done away with.
- The issue of options/shares under a scheme by a company where foreign investment is under the approval route shall require prior approval of the Foreign Investment Promotion Board (FIPB) of the Government of India.
- The issue should be in compliance with the Foreign Direct Investment (FDI) sectorial cap applicable to the company.
- The issue of options/shares to a citizen of Bangladesh/Pakistan under the ESOP scheme of the company shall require prior approval from the FIPB.
- A company issuing options/shares under its ESOP scheme to a non-resident is now required to furnish a return as per the newly prescribed form within 30 days of issue of such options/shares. The company is also required to obtain a certificate from an SEBI-registered merchant banker/chartered accountant indicating the manner of arriving at the price of the shares issued to the resident outside India.

A.P. (DIR Series) Circular No 4 dated 16 July 2015

For further details, please refer to our Flash News dated 20 July 2015 available at this link.

A fraction of a day stayed in India cannot be counted as one complete day while determining of residential status in India

The taxpayer, a salaried employee, filed the return of income claiming his residential status as that of a resident for the Tax Year (TY) 2008-09 and also claimed an income tax refund amounting to INR2,66,000 for the said year (subject to an exemption of salary income under Section 10). The refund claim of the taxpayer was rejected by the AO on the ground that the taxpayer being a resident of India is not eligible to claim an exemption of his income and accordingly, issued an intimation under Section 143(1) of the Act raising a demand of INR2,66,510.

The taxpayer filed a rectification application claiming the status of a non-resident (since his stay in India was less than 182 days) vis-a-vis resident inadvertently reported in the tax return. The AO after examining the number of days of his stay in India concluded that the taxpayer was present in India for 182 days and accordingly, his residential status in India is that of a resident during the year. The application under Section 154 was therefore rejected. Aggrieved by the decision of the AO, an appeal was filed with the CIT(A). The CIT(A) reversed the order of the AO and held that the day on which the taxpayer arrived in India in the night cannot be included as his stay in India for that day.

Tribunal's ruling

On the basis of the flight details, the Tribunal noted that the taxpayer was in India on 25 October 2008 for less than three hours. Thus, that date cannot be treated as a complete day of stay in India and hence should be excluded while computing the number of days. The exclusion, therefore, makes his stay in India less than 182 days (i.e. only 181 days plus 3 hours approximately of 25 October 2008) and accordingly, he will be considered as a non-resident.

The Tribunal relied on the decision in the case of Walkie vs. IRC [1952] wherein it was held that when a person is in India for only a part of a day, the calculation of physical presence in India in respect of such a broken period should be made on an hourly basis. Basis the Tribunal ruling, the taxpayer, was eligible for an exemption being a non-resident, and the appeal of revenue authorities was dismissed.

Shri Sharad Mishra v. ITO (AY 2009-10) (ITA No. 599 of 2012) **(Lucknow)**

For further details, please refer to our Flash News dated 11 August 2015 available at this link.

Foreign Trade Policy

Notification regarding introduction of New Foreign Trade Policy 2015 -2020

The Central Government notified the Foreign Trade Policy 2015-20 and the Handbook of Procedures 2015-20, which is effective from 1 April 2015. The key highlights are under:

- The Schemes viz., Focus Product Scheme, Market Linked Focus Product Scheme, Focus Market Scheme, Agri. Infrastructure Incentive Scrip, Vishesh Krishi and Gram Udyog Yojana, have been merged into a single Scheme viz., Merchandise Export from India Scheme (MEIS) to provide benefits for exporter of goods.

- Served from India Scheme (SFIS) has been replaced with Service Exports from India Scheme (SEIS), which provides for rewards to service providers of notified services, who are providing services from India, regardless of the constitution or profile of the service provider.

- Chapter -3 Incentives (MEIS and SEIS) have been proposed to be extended to units located in SEZs.

- All scrips issued under MEIS and SEIS and the goods imported against these scrips would be fully transferable.

- The nomenclature of Export House, Star Export House, Trading House, Star Trading House, Premier Trading House, the certificate has been changed to One, Two, Three, Four, Five Star Export House.

- Manufacturers who are also Status Holders would be enabled to self-certify their manufactured goods as originating from India with a view to qualify for preferential treatment under different Preferential Trading Agreements etc.

- Reduced Export Obligation for domestic procurement under Export Promotion Capital Goods (EPCG) scheme.

- Some procedural simplifications are provided for procurement and de-bonding of goods by Export Oriented Unit (EOU)/Software Technology Park (STP)/Electronic Hardware Technology Park (EHTP) units.

Notification No. 01/2015-2020, dated 1 April 2015

SFIS Scheme

Only Indian brands are eligible under SFIS Scheme

In a batch of Writ Petitions filed before the Bombay High Court, the petitioners challenged the order passed by the Secretary, Department of Commerce and Industry, holding that the petitioners are not entitled to the duty credit scrip under the SFIS as they were not promoting Indian brands.

The Bombay High Court observed that the intention of the SFIS scheme was to accelerate growth in export of services and to create a powerful and unique 'Served From India brand' instantly recognized and respected the world over. Further, the object would be only by encouraging those entities and conferring benefits & giving incentives to such companies, who create an Indian brand. The brand created should be served from India and must get recognition, respect world over. It is not the soil or piece of land, which is important but the involvement of Indian suppliers, which is predominant.

The High Court further observed that anybody who earns foreign exchange is not entitled to the benefit as this will be contrary to the object and purpose of the SFIS. The entity establishing a foreign brand of service and prior to the entry in India, therefore, will not qualify and cannot be held eligible for the SFIS benefit as the brand of such an entity is already created, existing and established. Such foreign brand does not get recognized and respected the world over as Indian brand. Therefore, disagreeing with the Delhi High Court decision in the case of Yum Restaurant, the Bombay High Court observed that the learned Judge has construed the expression 'Indian Service Providers' narrowly and has not construed it in the backdrop of the policy measures and has read the paragraphs in the policy in isolation. Therefore, the views of the Delhi High Court are not agreeable. It has been held that SFIS scheme is only applicable to Indian brands.

Shri Naman Hotels P Ltd with others [2015-TIOL-2090-HC (Mum)]

Excise duty

Labelling amounts to manufacture

Labelling activity amounts to 'manufacture' irrespective of whether it enhances the marketability of the product or not

In the present case, the taxpayer manufactures Coco Butter and Coco Powder in their Jammu factory and sent the said goods to their other unit located at Taloja. In their Taloja unit, labels were affixed on the packages of the said goods and cleared for export on payment of duty and claimed a rebate of duty paid on the exported goods. The Central Excise authorities took a view that, the labels were already affixed on the boxes at Jammu factory, and, therefore, additional labels affixed at Taloja Unit does not amounts to 'manufacture', as affixing of the additional label does not enhance the marketability (as the goods are already marketable). Accordingly, proceedings were initiated to deny the Central Value Added Tax (CENVAT) credit and consequently denying the rebate claim.

The Mumbai Tribunal based on Chapter note of Central Excise Tariff Act held that, in view of the use of the word "OR" in the provisions, it is clear that the activity of labelling or re-labelling of containers is an independent activity. Similarly, the activity of repacking from bulk packs to retail packs is another activity and also the activity of adoption of any other treatment so as to render the product marketable to the consumer is another activity. All these three activities are independent and separate. Accordingly, it is held that the activity of labelling/re-labelling would amount to "manufacture" being an independent activity and it is not necessary that the activity of labelling must enhance the marketability of the product.

Jindal Drugs Limited v. CCE [2015-TIOL-857-CESTAT-MUM]

Service tax

Swachh Bharat Cess (SBC/ the Cess) notified at the rate of 0.5 per cent on all taxable services with effect from 15 November 2015

With effect for November 15, 2015, SBC at the rate of 0.5 per cent has been notified on all taxable services. The Cess would not be applicable on exempt services/ services covered under negative list.

Other provisions of the Service tax law relating to computation of taxable value, assessment, exemption, payment, penalty, reverse charge, etc. tax would also apply in respect of the SBC.

Notification No. 21/2015-ST and 22/ 2015– ST dated 6 November 2015, Notification No. 23/2015 – ST to 25/2015 – ST all, dated 12 November 2015

Circular reviving the scheme of granting 80 per cent ad hoc refund prescribed earlier under circular issued in 2006

The Central Board of Excise and Customs (CBEC) have revived the refund scheme (prescribed earlier Circular No.828/5/2006-CX dated 20 April 2006). The Circular provides for a scheme of granting 80 per cent adhoc refund of CENVAT credit to service exporters. The scheme applies to the refund claims filed on or before 31 March 2015 under the CENVAT Credit Rules, 2004 (the Credit Rules) which are not 'disposed of'. The refund to be processed on submission of additional documents such as Statutory Auditor certificate (in the case of companies) certifying refund eligibility and an undertaking to repay refund sanctioned with an interest in the event the same is found in-admissible.

Circular No. 187/6/2015-ST, dated 10 November 2015

Buying and selling of lottery tickets do not fall within the meaning of 'service' and not subject to service tax

In the instant case, the constitutional validity of the levy of Service tax on the activity of buying and selling of lottery tickets was challenged. The Sikkim High Court struck down the constitutional validity of the said amending provisions on the basis of the following –

- The activity of buying and selling of lottery tickets does not fall within the meaning of 'service' explained as "*any activity carried out…by a lottery distributor or selling agent in relation to promotion, marketing, organizing, selling of lottery or facilitating in organizing lottery of any kind…";*
- The service tax payment mechanism provided for lottery distributors/ selling agents under Service tax law, is under a subordinate piece of legislation (i.e. Service tax Rules) which only provides an optional composite scheme for payment of tax and does not create a charge of Service tax;
- Lotteries fall within the meaning of 'betting and gambling' as provided in the State List of the Constitution of India and therefore by virtue of the entry "taxes on betting and gambling" in the State List, taxing power lies in the exclusive domain of State Legislature.

M/s Future Gaming & Hotel Services (Private) Limited and Another v. Union of India [2015-VIL-449-SIK-ST]

Managing/running entire hotel business by a company on behalf of the hotel not a 'service'

In the instant case, the issue was whether service tax is leviable on profits retained by the taxpayer in lieu of activities of developing, operating and managing the business of the hotel during the process of acquisition of the hotel by the taxpayer under the *erstwhile* taxable category of 'management consultancy services'.

The Third Member, ruling in favor of the taxpayer (post a split verdict on the applicability of service tax on such activities) held that no service tax is payable on the said activities of running/managing the entire hotels business by the taxpayer on the basis that the taxpayer was not running hotel as a service provider, taxpayer is co-owner of the assets of the hotel. The mere holding of joint discussions and reporting of activities to the hotel did not mean service was being provided. The meaning of the expression 'services in connection with the management of any organization' in terms of the definition of 'management or business consultant' is restricted only to services in relation to consultancy or advisory and not in relation to the actual performance of management.

The Indian Hotels Co. Ltd v. Commissioner of Service Tax, Mumbai [TS-666-Tribunal-2014-ST]

Value Added Tax

Levy of VAT

Penal proceedings against e-commerce firms for sales to customers within the state quashed by High Court

The taxpayer is an online service provider, registered under the Finance Act, 1994, as amended, governing the levy of service tax. The revenue authorities have passed orders levying penalty on the taxpayer on the grounds that the taxpayer has failed to get itself registered as a dealer under the Kerala Value Added Tax Act (KVAT Act), not filing returns and not maintaining true and correct accounts as required under the KVAT Act. Aggrieved by the said orders of penalty, the taxpayer has filed a Writ Petition before the Kerala High Court.

The main contentions of the taxpayer were that they are service providers who merely facilitate transactions of sale and purchase from their online portal. After a customer identifies a product of his choice online, the seller of the particular product is notified and he, in turn, raises an invoice on the customer. Further, depending on the nature of the transaction, the seller of the product pays tax either under the local VAT Act or the Central Sales Tax (CST) Act, and the same is indicated in the invoice issued to the customer. Thus, the taxpayer contends that they had no role in the transaction of sale or purchase.

The Kerala High Court observed that the notices issued to the taxpayer did not provide any reasons as to why the revenue authorities considered the taxpayer as a dealer or why the transactions in question were to be treated as local sales as against inter-state sales. Further, the orders used by the authorities were not supported by any reasons as to whether there was any sale effected by the taxpayer at all.

In view of the above, Kerala High Court observed that the findings in the impugned order reflect a patent non-application of mind by the authorities concerned and therefore quashed the orders imposing a penalty on the taxpayer and allowed the said writ petition.

[Flipkart Internet Private Limited & Another v. State of Kerala & Other [TS-590-HC-2015(KER)-VAT]

High Court rejects distinction between statutory vs. contractual right of sale; Sale of hypothecated goods by Bank's liable to VAT

In the present case, the issue before the Madras High Court was whether a bank, which hold hypothecation of vehicles in its favour would be a dealer within the definition under the Tamil Nadu Value Added Tax Act, 2006 (TN VAT Act), merely because the bank seizes and repossesses the hypothecated vehicle and conducts sale through public auction.

The taxpayer contended that a bank merely facilitates the sale of hypothecated vehicles, and the sale of such hypothecated vehicles was only in its capacity being an agent of the owner of the vehicle. The bank in itself is not competent to transfer the title in the vehicle to the purchaser and hence would not get covered within the definition of the expression ‘dealer' under TN VAT Act.

The Madras High Court noted that even though the ownership of hypothecated goods remains only with the person creating the hypothecation, the hypothecation agreement invariably contains clauses empowering the bank to repossess the vehicle in the event of a default and also to sell the vehicle without even involving the owner of the vehicle. Therefore, banks sell the hypothecated goods only as agents of the owners may not be completely true. Further explanation to the definition of dealer also includes disposal of unclaimed goods and hence, the contention of the taxpayer that seller of goods must be in a position to pass on the title may not stand.

Given the above, the Madras High Court held that since the explanation to definition of dealer also includes sale of unclaimed goods, the distinction between a statutory right of sale and contractual right of sale cannot stand and hence, the auction of sale of sale of repossessed hypothecated vehicles by bank is taxable under TN VAT Act.

HDFC Bank Limited, Chennai vs. the State of Tamil Nadu [TS-479-HC-2015(MAD)-VAT-HDFC]

Non –levy of VAT on implementation of software

In the instant case, the matter involved applicability of VAT on 'software implementation' provided by Infosys Limited (the taxpayer) to a bank. The taxpayer was providing banking software tilted 'Finacle' to banks. The agreements between the taxpayer and the banks provided for the following activities separately:

- Sale of license of Finacle (the same could be customized or otherwise depending upon the requirements of the bank);
- Implementation of the software (the same involved linking of the Finacle with other software of the banks so as to integrate the entire system); and
- Annual maintenance of Finacle (the same included updates and maintenance of Finacle)

The taxpayer was discharging following taxes in respect of the aforesaid transactions:

- VAT on sale of license of Finacle (by treating the same as right to use goods);
- Service tax on implementation of software; and
- VAT and Service tax on annual maintenance of software (by treating the same as works contract)

Karnataka High Court held that that implementation of software activity constitutes 'mere service' through skill and human effort, and there is no right to use goods liable to VAT. The Karnataka High Court further held that, even if some software gets created during implementation, as per the agreement, the ownership vests automatically with the bank and the taxpayer has no copyright/proprietary right over it. Bank has discretion or option to engage any service provider for implementation of the software, and it is not a condition for granting license transferring right to use the software. Further, since delivery of customized copyrighted software takes place once consideration is paid for the grant of licenses and is not contingent upon completion of implementation, VAT not leviable thereto as a 'pre-sale expense'. Hence, the entire consideration liable to service tax which has already been discharged by the taxpayer.

However, Karnataka High Court upholds VAT on customised banking software, whose proprietary right vests with assessee and what is granted is the only license transferring right to use such copyrighted article. As regards maintenance and upgrades, Karnataka High Court holds the same as 'goods' and 'deemed sale' effected in the course of rendition of annual technical support service by the taxpayer, liable to VAT as works contract. The taxpayer has rightly discharged VAT declaring self as 'works contractor'.

TS-481-HC-2015(Kar)-VAT-Infosys Ltd

Contract manufacturing not liable to VAT in the absence of transfer of effective control of brand name

The taxpayer, in the present case, owns brands name related to beer and water. The taxpayer had entered into contracts with certain Contract Bottling Units (CBU's) for manufacturing beer for which the taxpayer was to provide the know-how for manufacturing beer under its brand name. Such manufactured beer was to be supplied to the taxpayer or its indentors, and the CBU's had no right to directly sell the beer to its own customers.

As per the agreement between the taxpayer and CBU's, the brewing and bottling of the beer was to be done as per the specifications given by the taxpayer and by using trademarks, logos names made available by it to the CBU's. Further, it was specifically provided that the CBU's shall sell entire beer manufactured to the taxpayer or its indentors. In the case of packaged drinking water, the agreements with the manufactures were different, and the manufacturers were to pay a brand franchise fee to the taxpayer for use of brand name/trade name and were then allowed to sell the packaged drinking water to its customers.

Karnataka High Court observed that as per the agreement, the CBUs have the right to use the brand name only for and on behalf of the taxpayer and do not acquire any right over it, as they are not free to sell the product in the market to customers of their choice. The Karnataka High Court contended that the CBUs were captive manufacturers of a taxpayer who must produce beer in terms of the specifications and other conditions as provided. The CBU's do not get effective control of the brand name for full commercial exploitation and hence it could not be considered as ‘sale' of intangible goods by the taxpayer. Karnataka High Court further noted that the taxpayer had been paying service tax on the amount received as ‘brand franchise fees’ from CBUs and thus levying VAT on the same would lead to double taxation. In view of the above, Karnataka High Court held that levy of tax, penalty and interest on the transfer of technical know-how for manufacture of beer was not justified in law.

In the case of packaged drinking water, Karnataka High Court observed that the agreement granted the right to exploit the brand name/trade name for commercial use and thus the same amounted to a transfer of the right to use intangible goods which are liable to tax. Karnataka High Court contended that the effective control over the brand name was transferred to the licensees and, therefore, upheld the demand on royalty received towards packaged drinking water.

The State of Karnataka v. United Breweries Ltd. [TS-602-HC-2015(KAR)-VAT]

Input tax credit

Input Credit on purchase of DEPB scrips allowed; High Court draws analogy with CENVAT scheme

In the present case, the issue before the Delhi High Court was whether the input tax credit on the purchase of Duty Entitlement Pass Book (DEPB) scrips was eligible to the dealers.

The taxpayer is engaged in the business of import and sale of goods. They had purchased DEPB scrips from registered dealers on payment of VAT under the DVAT Act in the course of their regular business activity. The DEPB scrips were utilized for payment of customs duty on the imports made by them which were subsequently sold in the local market after charging output VAT. The taxpayer adjusted the input tax paid by them on the purchase of the DEPB scrips against the output tax liability, and the balance tax was deposited by them. However, the Revenue disputed that the input tax credit in respect of VAT paid on the purchase of DEPB scrips. The taxpayer filed an appeal before the VAT Tribunal, which dismissed the objections of the taxpayer. Aggrieved by the same, the taxpayer filed an appeal before the Delhi High Court.

The Delhi High Court observed that that the price of the goods imported has an element of customs duty paid on such goods. The component of customs duty is reduced to the extent of the usage of the DEPB scrips. Further, the reduced customs duty is embedded in the resale price of the imported goods. Thus, the use of the DEPB scrips is for the purpose of the taxpayer selling the imported goods. 'Usage' in this context has to be seen as a use that affects the price of the goods although it may not be used tangibly in the goods themselves. The Delhi High Court also drew an analogy with the CENVAT/Modified Value Added Tax (MODVAT) credit scheme, the purpose of which, like VAT, was to mitigate the cascading effect of taxes at various stages of trade. The High Court also clarified that there are a number of intangibles which have an impact on the value of final products in respect of which input tax credit may be availed, which goes on to show that such input tax paid goods contribute to the sale of the final product, either directly or indirectly.

The Delhi High Court also rejected the contention of the Revenue that credit cannot be availed unless the taxpayer is themselves dealing in DEPB scrips as such an interpretation would defeat the purpose of introducing the system of value added taxes to reduce the cascading effect of multiple taxes and at various stages. As long as it can be shown that the use of DEPB scrips had impacted the cost of products sold, the input tax credit on the purchase of DEPB scrips shall be available to the taxpayer. Given the above, the Delhi High Court allowed the appeal.

Jagriti Plastics Ltd. & Another v. Commissioner of Trade & Taxes [TS-539-HC-2015(DEL)-

VAT

Battery charger being accessory is taxable at general VAT rate

Battery charger an 'accessory' taxable at general and not concessional rate

In the instant case, the issue before Supreme Court was whether cell phone battery charger, sold as a composite package along with cell phone was eligible to a concessional rate of tax applicable to ‘cell phones and parts thereof’.

The taxpayer sold cell phones along with battery charger and other accessories in a single pack, and paid tax at 4 per cent, as applicable to the sale of cell phones under Entry 60 of Schedule B of the Punjab VAT Act. Revenue was of the view that battery charger sold by the taxpayer would not be eligible for 4 per cent concessional rate, but instead, be taxable at the general rate of 12.5 per cent as it is an ‘accessory’.

Assessing Authority upheld Revenue’s demand that battery charger was a separate commodity chargeable at 12.5 per cent and also observed that Entry 60 to Schedule B of the Punjab VAT Act includes only cellular phones and not its accessories. On further appeal, Deputy Excise & Taxation Commissioner (Appeals) confirmed the assessing authority’s order. Aggrieved by the same, the taxpayer approached the Tribunal, who dismissed the appeal and confirmed Revenue’s demand of tax and interest thereon. The taxpayer further filed an appeal before the Punjab and Haryana High Court, which was allowed by the said High Court holding that battery charger is a part of a composite package of a cell phone. Hence, Revenue appealed before Supreme Court.

The Supreme Court held that Assessing Authority, Appellate Authority and the Tribunal had rightly held that the battery charger is not a part of the mobile/cell phone. If the charger were a part of the cell phone, then cell phone could not have been operated without using the battery charger, but in reality, it is not required at the time of operation. Supreme Court stated further that, the battery in the cell phone can also be charged directly by other means like a laptop without employing the battery charger, hence implying that battery charger is nothing but an accessory to the mobile phone. Accordingly, Supreme Court held that the mobile/cell phone charger is an accessory to cell phone and not a part of the cell phone, it can be sold separately, without selling the cell phone. Therefore, Supreme Court set aside the impugned High Court order and allowed Revenue appeal.

State of Punjab & Others v. Nokia India Pvt Ltd (TS-590-SC-2014-VAT)

Sale of goods in transit

Goods transferred after filing BoE/assessment an "inter-state sale", not "high seas sale."

In the present case, the issue before the High Court was whether the contract of sale of goods in transit before such goods enters into the Customs frontiers of India would be considered as inter-state sale and taxable as per CST Act.

The taxpayer was an import facilitator having infrastructure facilities for importation at Customs port (Visakhapatnam). Under the quadri-partite agreement entered with Indus Tropics Ltd. (Indus), Radha Industries (Radha) and World Best Trading Co. (L.L.C.), Dubai (U.A.E), taxpayer was purchasing the goods from Indus (who purchased these goods from World Best Trading Co.) as agent of Radha and transferred the documents of purchase to Radha on high seas. Further, Radha agreed to pay the commission of 2 per cent plus bank charges. The taxpayer claimed that the said transaction is in nature of commission transaction and not an inter-state sale and hence, exempted from CST. It was submitted that the importer endorsed the bill of Lading (invoice) in favour of the taxpayer and taxpayer thereafter endorsed the same in favour of Radha while the goods were still on high seas. Therefore, the ultimate purchaser of the goods was Radha Industries, and the sale was effected by the endorsement of the bill of lading. In view of this, the taxpayer stated that endorsement and subsequent transfer of title of goods took place before goods left the customs station and hence, would be considered as the sale in the course of import.

However, Revenue argued that the disputed transaction would amount to inter-state sales and therefore, subject to CST. During adjudication, said demand was confirmed. Being aggrieved, the taxpayer filed the present writ before High Court.

The High Court dismissed taxpayer’s writ and held that transfer of goods after filing Bill of Entry (BOE) is not a sale in the course of import but an interstate sale. High Court observed that the taxpayer would be considered the importer as the goods were imported in its name and not in the name of the subsequent buyer. Further, High Court pursued the high seas sales agreement and observed that as per Customs Act only the name of the last purchaser would reflect in Import General Manifest (IGM). Further, High Court noted that taxpayer's name was recorded in IGM as the last purchaser, and therefore, the taxpayer would be considered the importer of goods. Further, Bill of Entry to the Custom House for assessment contained the name and PAN number of the taxpayer as Importer. Hence, the goods were treated to be imported by the taxpayer and subsequent sale in India liable to tax and not high seas sale transaction.

Vellanki Frame Works v. the Commercial Tax Officer and others (TS-598-HC-2014(TEL and AP)

Works contract

Profit retained by contractor towards sub-contracted works non-taxable under Kerala VAT law

In the present case, Writ Petition was filed before Kerala High Court regarding the issue of taxability of profit element of the main contractor, where the entire work was sub-contracted for execution.

The taxpayer, a works contractor, was awarded a contract by BPCL and in turn, the entire work was sub-contracted. The taxpayer applied to the Commercial Tax Officer for the issuance of liability certificate in Form 20B under the Kerala VAT Rules to show that the tax liability, if any, has been discharged. The amount mentioned in the certificate represented the profit component earned by the taxpayer under the said contract. The taxpayer contended that it was not liable to discharge any tax liability on the said amount as it merely represented profit under the works contract. However, the Commercial Tax Officer declined the request, resulted as the discharge of tax liability under protest. After payment of tax liability under protest, the taxpayer was issued Form 20B and subsequently obtained the final payment from BPCL. Aggrieved thereby, the taxpayer filed the Writ petition before Kerala High Court.

Kerala High Court referred to the Apex Court ruling *in State of Andhra Pradesh and Others v. Larsen & Tourbo Ltd. and Others [(2008) 17 VST 1(SC)],* wherein it was observed “*work executed by a sub-contractor, results in a single transaction and not multiple transactions….if the argument of the Department is to be accepted it would result in plurality of deemed sales which would be contrary to Article 366(29A)(b) of the Constitution.*” Kerala High Court observed that in the present case, the taxpayer had sub-contracted the entire work and had also obtained Form 20H certificate (a certificate to be issued by sub-contractor to the main contractor under the Kerala VAT Act) from the sub-contractor. The sub-contractor discharged the tax liability in respect of entire work that was sub-contracted, and the amounts retained by the taxpayer, represented only the profit element that accrued to it in the capacity as the main contractor. Kerala High Court held that taxpayer was not liable to pay any tax under Kerala VAT Act, as there was no sale of material in the execution of the said works contract. In the absence of any taxable event under Kerala VAT laws, the authorities could not have demanded the tax on the amounts retained as profit.

Surya Constructions v. the State of Kerala and others [TS-552-HC-2014(KER)-VAT]

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.