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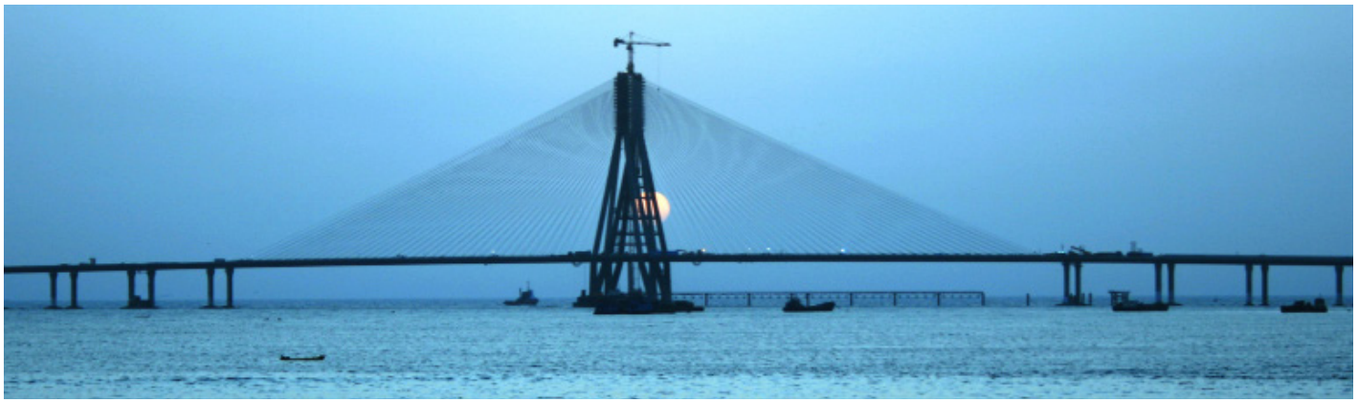
December 2014

India Tax Konnect



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Editorial

The Government of India (GoI) unveiled the inflation numbers. Wholesale Price Inflation declined from 2.4 percent in the preceding month to 1.8 percent, lowest in the last five years, primarily as a result of decline in the rate of price rise in various segments, the lowered prices of global commodities and the revival of monsoon. The Consumer Price Index also eased from 6.5 percent in September to 5.5 percent in October — a historic low for the index — as a result of the falling prices of vegetables and certain fruits. However, during this period, products such as pulses and milk witnessed a rise in prices by 7.5 percent and 11.4 percent, respectively.

On the international tax front, the Delhi Tribunal in the case of Consulting Engineering Corporation held that the activities carried out by the Indian branch office was not of preparatory or auxiliary character under the India-USA tax treaty. The Indian branch represented a fixed place of business through which substantial work was carried out by the taxpayer and therefore, it constitutes as a Permanent Establishment (PE) of the taxpayer in India. Further, the Tribunal held that the Indian branch took some risks viz. drawing and designing calculations, whereas certain other risks were taken by the taxpayer. Therefore, the profit attributed to the operations carried out in India was determined on the basis of 50 per cent of the global profit rate of the U.S. company.

The Delhi Tribunal in the case of Mitsubishi Corporation India Pvt. Ltd held that no disallowance under Section 40(a)(i) of the Income-tax Act, 1961 (the Act) shall be made if payments are taken into account by the non-resident recipient in its computation of income, taxes on such income are paid and income tax return has been filed by such a recipient, in view of the non-discrimination clause in the India-Japan tax treaty. Further, the Tribunal observed that different tax treatment to the foreign enterprise per se is enough to invoke the non-discrimination clause in the tax treaty.

On the transfer pricing front, the Delhi Tribunal in the case of Mitsubishi Corporation India Pvt. Ltd pointed out the importance of inventory level as a crucial factor in determining the kind of activity the taxpayer has carried out and upheld the difference between sogo shosha (general trading) and normal trading. The Tribunal held that Berry ratio is an appropriate Profit Level Indicator (PLI) where the business does not assume any significant inventory risk or perform any functions or add any value to the goods traded. Additionally, the Tribunal upheld that no additional allocation for location savings is required if the savings are directly flowing to the independent customers and do not add to the profits of the group as a whole.

We at KPMG in India would like to keep you informed of the developments on the tax and regulatory front, and its implications on the way you do business in India. We would be delighted to receive your suggestions on the ways to make this publication more relevant.

International tax

Decisions

Delhi High Court sets aside AAR's ruling on taxability of operational and other support services to group companies under the India-Netherlands tax treaty

The taxpayer, a Netherlands company, entered into a technology and know-how license agreement with Perfetti India for providing technical know-how in relation to its manufacturing and sales of products of brands which were owned by the licensors. Simultaneously, the taxpayer also entered into support services agreement (SSA) with Perfetti India.

The taxpayer was of the view that the support services do not 'make available' technical knowledge, skill, etc., and therefore is not taxable as Fee for Technical Services (FTS) under the India-Netherlands tax treaty. Subsequently, the taxpayer filed an application with the Authority for Advance Rulings (AAR).

The AAR held that the SSA clearly indicated that the intention of the parties was to assist Perfetti India by applying the experience of its sister concerns and group companies. Accordingly, the services providing the knowledge and experience of the confectionery industry to Perfetti India are technical in nature. Further, the AAR held that the phrase 'make available' under Article 12(5) of the India-Netherlands tax treaty has reference to technical knowledge, experience, skill, know-how or process and it does not contain the phrase 'consist of the development and transfer of a technical plan or design'.

Accordingly, the AAR held that the services under SSA when read with the technology and know-how license agreement, fall within the purview of Article 12(5)(a) of the India-Netherlands tax treaty, since such services are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment of royalty described in Article 12(4) of the India-Netherlands tax treaty is received. Accordingly, payment for such services is taxable in India.

Aggrieved by the AAR's decision, the taxpayer filed a writ petition before the Delhi High Court. The taxpayer contended that any tax treaty between India and an Organisation for Economic Co-operation and Development (OECD) country could be looked into while construing the India-Netherlands tax treaty. However, the AAR in the present case has not considered the India-Portugal tax treaty which is an OECD country. Further MOU concerning Fees for Included Service referred in Article 12(4) of the India-USA tax treaty concerning expression 'make available' was also not considered by the AAR. The AAR held that only the India-Netherlands tax treaty needed to be looked into.

The tax department contended that the AAR was correct in not looking into the India-Portugese tax treaty. However, in so far as the India-USA tax treaty is concerned, a provision similar to that tax treaty has been incorporated in the India-Netherlands tax treaty by virtue of Article 12(5) of the same, whereby the same 'make available' clause has been incorporated into India-Netherlands tax treaty by way of amendment. The AAR had not considered the said amendment.

In view of the above, the Delhi High Court has set aside the AAR ruling and the matter has been remitted back for fresh consideration to decide the taxability of operational and other support services to group companies under the India-Netherlands tax treaty.

Perfetti Van Melle Holdings B.V. v. AAR [(W.P(C) 1502/2012)]

Indian branch of a foreign company forms a PE in India. Profit attributed on the basis of 50 per cent of the global profit rate of the foreign company

Permanent Establishment

The taxpayer had a branch in India which was engaged in providing various services to the taxpayer, viz., engineering, calculations as well as drawing of various architectural designs. Further 95 qualified employees were working in the Indian branch office for the associated enterprises (AEs) based in the US.

The Assessing Officer (AO) held that the taxpayer had a fixed place of business in India in the form of branch office, through which the business of the taxpayer was partly carried out and therefore, in terms of Article 5(2)(c) of the India-US tax treaty, the taxpayer had a PE in India.

The taxpayer contended that the Indian branch was only engaged in providing the supporting services to the taxpayer which were in the nature of preparatory and auxiliary services and therefore, did not have a PE in India.

The Delhi Tribunal held that the branch office represents a fixed place of business of the taxpayer through which substantial work was carried out by the taxpayer, which constitutes PE of the taxpayer in terms of Article 5(2)(b) and (c) of the tax treaty. The branch was doing R&D work for the taxpayer and the same was being done exclusively by the branch and was the core business of the taxpayer. This important facet of the Indian branch's work was not of preparatory or auxiliary nature within the ambit of Article 5(3)(e) of the tax treaty. Accordingly, the Indian branch cannot be excluded from being a PE.

Attribution of profit

As per the transfer pricing analysis report, the taxpayer had adopted the mark-up to the cost at 1.83 per cent whereas the AO found that the net profit earned by the taxpayer in its tax return filed in USA was 8.5 per cent and 10.6 per cent for relevant years which was based on sales.

The taxpayer contended that the adoption of the global profit rate of 8.5 per cent and 10.6 per cent was very high. Further, that the Commissioner of Income-tax (Appeals) [CIT(A)] was not correct in directing the AO to calculate attributable profit at 50 per cent of the figure arrived at by the AO after applying 8.5 per cent and 10.6 per cent representing the global profit ratio of the taxpayer.

However, the AO contended that attribution of profit to the Indian PE on the basis of risk assumed, assets used and activities performed by the PE in the given set of activities allocated between the Head Office (HO) and PE was correct. The Indian branch in the status of PE does the entire designing and drawing work which includes the risk of design and drawing. The Indian branch also takes same risk as important designing and drawing calculations are carried out by the Indian company. Accordingly, the AO had allocated the profits applying

Rule 10 of the Income-tax Rules, 1962 (Rules) which was rightly held to be attributable to the operations carried out by the PE in India.

The Delhi Tribunal observed that the CIT(A) had considered the fact that the Indian branch had taken some risks, as the important drawing and designing calculations are carried out by the Indian branch. The risk was not exclusively borne by the Indian branch or the US company and therefore, 50 per cent of the profit determined by the AO based on global profit rate, was attributed to the Indian PE.

Consulting Engineering Corporation v. JDIT (I.T.A.No.1597/Del/2009; Assessment Year: 2003-04)

No disallowance under Section 40(a)(i) in the hands of the deductor : non-discrimination clause

The taxpayer was a subsidiary company of Mitsubishi Corporation Japan (MCJ) in India. Mitsubishi Japan operates worldwide through small business segment units called divisions and Liaison Office.

During the Assessment Year (AY) 2007-08, the taxpayer made payments to MCJ for purchase of goods. The AO held that since Mitsubishi Japan had a PE in India, the taxpayer was required to deduct tax from the payments made to Mitsubishi Japan. Since, the taxpayer had failed to deduct tax at source under Section 195 of the the Act, the payments were disallowed under Section 40(a)(i) of the Act.

The taxpayer contended that Section 40(a)(i) of the Act is discriminatory in character as no such disallowance was required to be made if the payments for purchases are made to a resident taxpayer. The AO held that neither such disallowance constituted discrimination, nor was it open to a resident taxpayer to invoke provisions of the tax treaty. The AO observed that the taxpayer was a resident in India and was not eligible to claim the tax treaty benefits.

The Delhi Tribunal placing reliance on the ruling of DaimlerChrysler India Pvt Ltd v DCIT [2009] 29 SOT 202 (Pune) held that it is not necessary that the taxpayer, in whose case this non-discrimination is invoked, should be resident of, or even national of, the other contracting state.

The Tribunal had a chance to analyse the provision of Article 24(3) of the tax treaty, wherein, the Tribunal agreed with the scope of the deduction neutrality clause in non-discrimination provision under the tax treaty. Therefore, the Tribunal observed that a different treatment to the foreign enterprise per se is enough to invoke the non-discrimination clause in the India-Japan tax treaty.

The Tribunal relying on the decision of Rajeev Kumar Agarwal v. ACIT [2014] 149 ITD 363 (Agra), observed that disallowance under Section 40(a)(ia) of the Act cannot be made in respect of payments made to a resident taxpayer, even in case of non-deduction of tax at source, if related payments were taken into account by the non-resident recipient in its computation and appropriate taxes were discharged by the recipient, and return of income was filed. Accordingly, applying the non-discrimination clause, the Tribunal observed that when payments were taken into account by the non-resident recipient in its computation and appropriate taxes were discharged by the recipient, such payments are not liable to disallowance under Section 40(a)(i) of the Act.

Therefore, the Tribunal deleted the disallowance under Section 40(a)(i) of the Act and ruled in favour of the taxpayer.

Mitsubishi Corporation India Pvt. Ltd v. DCIT (I.T.A. No.: 5042/Del/11) (Delhi Tribunal)

Determination of taxability of FTS on installation, commissioning and training to employees

The taxpayer is an Indian company engaged in the business of printing and publishing of newspapers. The taxpayer needed a sophisticated plant and machinery (mail room equipment) that could collate the various pages of the newspaper, assist in printing, picking and stacking them and pack the newspapers for timely delivery.

The taxpayer entered into two contracts with FERAG AG, of which one was for the supply of the various components/units of the mail room equipment, and second was for installation and commissioning of such equipment in the premises of the taxpayer and training of the staff of the company for operation of this equipment to be supplied. The taxpayer did not withhold taxes at source on payments made to FERAG AG under the second contract.

The AO held the payments under the second contract as FTS and directed the taxpayer to withhold tax with appropriate interest thereon.

The activity of installation and commissioning of the equipment is 'assembly', hence not taxable

The Mumbai Tribunal held that the equipment was a complex equipment. The bid document stipulated that the units/components of the equipment would have to be installed and commissioned by trained and qualified personnel of the supplier, who shall, then provide training to the taxpayer's employees, on the operation and maintenance of the equipment. The price quoted included installation, commissioning and training. However, the supply price was separately indicated in the contract of supply.

FERAG AG, had, in fact, supplied a pickup station, a gripper conveyor, stacker and automatic bundle addressing system, etc. All these units and components had to be fitted together in a manner that they were properly positioned, aligned and, connected to ensure optimum functioning, in the shortest duration. This activity can be called an 'assembly'. However, the word assembly has not been defined in the Act and has to be understood in common parlance. Therefore, the consideration paid towards these installation and commissioning services was only taxable in Switzerland in the hands of FERAG AG, by virtue of the provisions of Article 14 of the India-Switzerland tax treaty.

The activity of training taxpayer's employees is not 'assembly', hence taxable

However, the training of employees by FERAG AG was not considered by the Tribunal as assembly. The Tribunal held that the training period would not have been substantial and not essentially shop floor training; how to operate the equipment, would have been training on the machine. Therefore, Article 12 of the India-Switzerland tax treaty shall apply on class room training. Accordingly, an estimate of 25 per cent of the training cost, as attributable to income from training would be reasonable.

ITO v. Bennet Coleman & Co. Ltd. (ITA No. 57/Mum/2009, ITA No. 7315/Mum/2008) (Mumbai Tribunal)

Corporate tax

Decisions

TDS under Section 194H inapplicable to absent principal-agent relation

The taxpayer is engaged in the business of readymade garments. A letter was received by the AO that the taxpayer had paid commission to HDFC bank on payments received from customers who made purchases through credit cards. Survey under Section 133A of the Act had been conducted on HDFC, who had provided card swiping machines to retail merchants, including the taxpayer. The AO held that the amount earned by the acquiring bank, i.e. HDFC in this case, was in the nature of 'commission' and should have been subjected to deduction of tax at source at the rate of 10 per cent under Section 194H of the Act. Since no Tax Deducted at Source (TDS) was deducted on the commission payment, the same was disallowed under Section 40(a)(ia) of the Act. The CIT(A) upheld the orders of the AO. The Tribunal held that the taxpayer had not violated provisions of Section 194H and consequently is not liable for addition under Section 40(a)(ia) of the Act.

The Delhi High Court relying on the decision of the Gujarat High Court in the case of Ahmedabad Stamp Vendors Association v. UOI [2002] 257 ITR 202 (Del) held that there should be an element of agency in all the three situations as envisaged in clause (i) of the Explanation to Section 194H of the Act. The Supreme Court concurred with the said view of the Gujarat High Court. The High Court further referred to the Allahabad High Court ruling in the case of Chief Treasury Officer v. UOI [2013] 355 ITR 484 (All) which also held that the words 'by a person acting on behalf of another person' imply element of agency and must be present in all such services or transactions in order to fall within the expression 'commission' and 'brokerage'. The High Court in view of the above concluded that section 194H of the act would not be applicable in the instant case as HDFC bank was not acting as the taxpayer's agent. The High Court observed that once payments were received by the HDFC bank and credited to the taxpayer's account, a small fee was deducted by the bank for use of swipe machines. Thus, the High Court concluded that HDFC bank had not carried out any act on behalf of the taxpayer and thus the relationship between the taxpayer and HDFC bank was not that of agent and principal. The High Court further opined that principle of doubtful penalisation which requires strict construction of penal provisions was another reason for non applicability of Section 40(a)(ia) of the Act. The High Court noted that the aforesaid principle requires that a person should not be subjected to any sort of detriment unless the obligation is clearly imposed, since the provisions of ection 40(a)(ia) of the Act was a deterrent and a penal provision same has to be construed strictly. The High Court concluded that when the words are equally capable of more than one construction, the one not inflicting the penalty or deterrent may be preferred.

CIT v. JDS Apparels Private Limited [TS-707-HC-2014(DEL)]

'Carriage fees'/'Placement fees' liable for TDS under Section 194C and not 194J

The taxpayer is engaged in the business of distribution of television channels. Channels are distributed through cable operators. Due to bandwidth constrains with the cable network, it is up to the cable operator to decide which channel will reach the end viewer at what frequency. Accordingly, the taxpayer makes payment to the cable operator to carry its channels at a particular frequency and it is referred to as 'carriage fees'/'placement fees'. The taxpayer deducted tax at source at the rate of 2 per cent under Section 194C of the Act. However, the department contended that the payment made to the cable operators was for providing technical services to the taxpayer, therefore, liable for TDS under Section 194J at the rate of 10 per cent.

The Tribunal observed that the Punjab and Haryana High Court in the case of Kurukshetra Darpans (P) Ltd. v. CIT 169 Taxman 344 had held that as the expression 'work' as used in Explanation to Section 194C included inter alia broadcasting and telecasting including production of programmes for such broadcasting and telecasting, payments for obtaining TV signals would be liable for TDS under Section 194C of the Act. The Tribunal also observed that the Delhi High Court in the case of CIT v. Prasar Bharati (Broadcasting Corporation of India) 292 ITR 580 had held that as the work of broadcasting and telecasting of the programmes specifically falls under the ambit of provisions of section 194C it had to be preferred over the provisions of Section 194J of the Act.

In view of these decisions the Tribunal held that placement fee paid by the taxpayer to the cable operators should be subjected to TDS as per provisions of Section 194C of the Act.

ACIT v. UTV Entertainment Television Limited (ITA no. 2699/mum/201) (Mumbai Tribunal)

New unit formed with existing partners and employees of erstwhile firm eligible for benefit of Section 80IC

A newly set-up firm had claimed benefit of Section 80IC which was denied by the AO on the grounds that it was formed by splitting up or reconstruction of the erstwhile firm. The CIT(A) and the Tribunal had allowed the benefit of Section 80IC of the Act. Aggrieved, the Revenue preferred an appeal before the Himachal Pradesh High Court. The Revenue argued that the firm was formed with same partners as in the the erstwhile firm. It further stated that the workers of the erstwhile firm were also shifted to the new firm and the control and management of the existing and new firm remained the same. Hence, as the new firm

was formed by splitting up the existing business, benefit of Section 80IC of the Act ought to be denied.

The High Court noted that the AO had observed that the taxpayer had set-up a new unit in a new building and installed new machinery. The taxpayer had also made fresh investments and only 1.31 per cent of the total value of the plant and machinery was purchased from the erstwhile firm, which was in conformity with the limit prescribed in Section 80IC(4) of the Act. The taxpayer had also purchased new land and constructed a new building on it. The installed capacity of the taxpayer i.e. the new firm was 13 lakh fans, while that of the erstwhile firm was 6 lakh. The taxpayer had also obtained different Permanent Account Number (PAN) and separate registration under the H.P. State Industrial Development Corporation and Department of Industries, Solan as Small Scale Industry, at a different location. The taxpayer also had different customers.

In view of the above facts the High Court held that the AO was wrong as he had ignored the quantum of fresh capital, investment in plant and machinery, new building, new registration number and PAN. The new unit cannot be even presumed as reconstruction of the old existing business, much less the formation of the undertaking by splitting up the existing undertaking. The shifting of the employees would not affect the constitution of the new firm to avail the benefit under Section 80IC of the Act. In this regard, reliance was placed on the Supreme Court decision in the case of Textile Machinery Corp. Ltd. v. CIT [1977] 107 ITR 195 (SC), Delhi High Court ruling in Gedore Tools India Pvt.Ltd. [1980] 126 ITR 673 (Delhi) and Patna High Court ruling in CIT vs. Ridhkeren Someni [1980] 121 ITR 668 (Pat). The High Court observed that in the present case a new unit had emerged, which was a physically separate industrial unit and it cannot be said that the same persons were carrying on substantially the same business in this case.

CIT v. Yash International Inc. [TS-666-HC-2014(HP)]

Payment made by the taxpayer (media agency) to hoarding contractors for limited right of display of its clients' advertisements is subject to TDS under Section 194C and not 194I of the Act

The taxpayer is engaged in the business of advertising. It books hoarding sites, owned by hoarding contractors, for displaying its client's advertisements. During the year under consideration the taxpayer deducted tax at the rate of 2 per cent under Section 194C while making payment to the hoarding contractors. The AO relying on the Central Board of Direct Taxes (CBDT) Circular No. 715 dated 8 August 1995 held that payments were subjected to Section 194I and therefore levied interest under Section 201(1A) of the Act.

The Tribunal observed that neither the hoarding sites were owned by the taxpayer nor taken on rent. The taxpayer had only the limited right to display its clients' advertisement on that hoarding for a particular period of time. It also observed that the hoarding sites were booked by the taxpayer through hoarding contractors on behalf of its clients for display of their advertisement. It therefore held that the prime responsibility of payment of rent of the sites was of the hoarding contractor and not of the taxpayer. Considering the totality of facts and CBDT Circular No. 715, the Tribunal held that contract between the taxpayer and hoarding contractors was purely in the nature of contract for the work of advertising as defined in clause (iv) of Explanation to Section 194C of the Act and therefore payments were subjected to TDS under Section 194C of the Act.

DCIT v. Madison Communications Private Limited [ITA No 4991 & 4992 (Mum)/2013]

Toll road being 'building' and not 'plant' is entitled to depreciation at a lower rate

The taxpayer is a 100 per cent subsidiary of National Highways Authority of India (NHAI) and was formed with the sole object of constructing the highway and bypass on Built Operate Transfer (BOT) basis. During the year under consideration, the taxpayer claimed depreciation at 25 per cent on toll roads stating that it is a plant. The AO restricted the claim to 10 per cent holding that roads are part of building and thereby disallowed the balance claim. The disallowance was sustained by CIT(A) and the Tribunal on further appeal.

The High Court observed that on combined reading of definition of 'plant' and 'building' as given in Clause 3 to Section 43 of the Act and in Note to Appendix 1 to the Rules, it is clear that a road is not a 'plant'. The note in Appendix 1 to the Rules stipulates that 'buildings' include roads, bridges, culverts, wells and tubewells. It further observed that the toll road was a capital asset which is the very business of the taxpayer and not an implement or a tool used by the taxpayer for his business. Small booths (manned or unmanned) are primarily a facility/convenience for collecting the usage charges of the road and nothing more and that would not change the characteristic of a road. In view of the various decisions and position of law, the High Court concluded that the toll road is a building and hence it is subject to depreciation at the rates which are prescribed for a building.

Moradabad Toll Road Co Ltd v. ACIT [TS-681-HC-2014(DEL)]

Note: It is to be noted that in a recent ruling, the Bombay High Court in the case of North Karnataka Expressway Ltd [TS-679-HC-2014(BOM)] denied depreciation on toll road on the reason that the taxpayer had no ownership over the BOT project.

Mergers and acquisition

Decisions

Assessment order issued on a non-existent entity (pursuant to amalgamation) is void and such defect is not curable

The taxpayer (amalgamating company) amalgamated with the amalgamated company. Assessment order, pursuant to search action, was made on the tax payer on 31 December 2010 for AY 2003-04 to AY 2008-09. The appeal against the assessment order was filed on the grounds that the order is invalid as the same was passed after the taxpayer company had ceased to exist from 9 December 2009. The CIT(A) and the Tribunal agreed with the contention of the tax payer and held that assessment upon a dissolved company is impermissible.

On further appeal by the tax department, the High Court held that assessment proceedings on a non-existent company i.e. the taxpayer is invalid.

CIT v. Dimension Apparels Pvt. Ltd. (ITA No. 327, 328, 329, 330 and 332 of 2014)

Depreciation is allowed on goodwill under Section 32 of the Act

CGE Limited (CGEL) amalgamated with the taxpayer. As per the order dated 14 March 2003, passed by the Mumbai High Court, the assets and the liabilities appearing in the books of CGEL were shown as assets and liabilities of the taxpayer at the same value as they appear in the books of CGEL and the difference between assets and liabilities taken over and book value of investments in CGEL appearing in the books of the taxpayer was shown as goodwill. The High Court approved the scheme. The taxpayer had claimed depreciation on such goodwill. The Assessing Officer had denied such claim for depreciation.

On an appeal the Tribunal had confirmed the denial of depreciation. The taxpayer further appealed to the High Court. During the pendency of the High Court appeal, the Supreme Court rendered its decision in the case of Smifs Securities holding that depreciation is allowable on goodwill under Section 32 of the Act. In view of the same, the High Court in the taxpayer's case restored the issue back to the Tribunal for fresh decision on merits and in light of the Supreme Court decision.

Now on the restored matter, the Tribunal held that goodwill is a depreciable asset eligible for depreciation under Section 32 of the Act. The Tribunal, following the ratio of the Bombay High Court decision in the case of Sadanand Varde, further held that once the Scheme is sanctioned by the Court it ceases to be a contract and operates with force of statute and thus neither the nature nor the quantity of goodwill can be disputed.

DCIT v. Toyo Engineering India Limited (ITA No. 3279/M/2008) (Mumbai Tribunal)

Transfer pricing

Decisions

'Sogo shosha' different from normal trading, no allocation for location saving and assembled workforce required; and Berry ratio an appropriate PLI where no funds are blocked due to inventory

The taxpayer is a wholly owned subsidiary of Mitsubhishi Corporation Japan (MCJ) which is one of the leading sogo shosha establishments in Japan. Sogo shosha is a Japanese expression which means general trading company engaged in both import and export of a diverse range of products.

In the instant case, the taxpayer was engaged in two segments namely, trading segment i.e. import of goods from an AE for resale and service fees/commission income segment pertaining to sales and marketing support services to the AE.

The taxpayer selected the transaction net margin method (TNMM) as the most appropriate method with Berry ratio (gross profit/operating expenses) as the profit level indicator PLI. The taxpayer mentioned in its functional, risk and assets (FAR) analysis that it is essentially in the business of providing sales support and coordination activities in relation to international transaction, and therefore it will be akin to that of a service provider rather than that of a trader.

During the course of TP assessment proceedings, the Transfer Pricing Officer (TPO) rejected the PLI adopted by the taxpayer stating that in case of Berry ratio, entire international transactions relating to sales and services of commodities will remain out of PLI. Also, while considering operating expenses as the cost base, the cost of sales will get excluded from the denominator of the PLI used. The TPO proposed adjustment by selecting comparable companies with an arithmetic mean of 2.49 per cent and taking Operating Profit /Total Operating Cost as the PLI for the combined segments i.e. trading and service.

Tribunal's ruling

The Tribunal pointed out the importance of inventory level as a crucial factor in determining the kind of activity the taxpayer has carried out and upheld the difference between sogo shosha (general trading) and normal trading. The Tribunal held that Berry ratio is an appropriate PLI where the business does not assume any significant inventory risk or perform any

functions or add any value to the goods traded. Additionally, the Tribunal upheld that no additional allocation for location savings is required if the savings are directly flowing to the independent customers and do not add to the profits of the group as a whole. The Tribunal also clarified that the mere existence of a routine supply chain or human intangibles with a taxpayer does not automatically require additional returns to be attributed.

Mitsubishi Corporation India Pvt. Ltd. v. DCIT [ITA No. 5042/Del/11 – AY 2007-08]

Notifications/Circulars/Press Releases

BEPS Action 10: Proposed modifications to Chapter VII of the OECD Transfer Pricing Guidelines relating to low value-adding intra-group services

The OECD has issued a discussion draft report in relation to Action 10 ('draft report') under the Base Erosion and Profit Shifting Action Plan. The draft report contains simplified transfer pricing approach for low value-adding intra-group services which leads to revision in Chapter VII of the OECD Transfer Pricing Guidelines. The OECD has sought comments from the public on the draft report.

The Chapter VII of the OECD guidelines broadly provides guidance on the determination of intra-group services and charge for such services in accordance with the arm's length principle. The draft report is consistent with the present guidelines with minimal fine tuning, besides specific focus on the low value-adding intra-group services and an elective, simplified methodology to determine charges for such services.

The OECD expects that the measures proposed in the draft report would reduce the scope for erosion of the tax base through excessive management fees and HO expenses. It has proposed an approach to:

- Identify a broad range of common intra-group services, which command a very limited profit mark-up on costs;
- Apply a consistent allocation key for all recipients;
- Provide greater transparency through specific reporting requirements.

The key modifications proposed in the draft report are discussed below.

What constitutes 'low value-adding intra-group services'

Low value-adding intra-group services are defined to be the services which:

- Are of a supportive nature;
- Are not part of the core business of a multinational enterprise (MNE) group;
- Do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles;
- Do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk.

The OECD has provided that the following activities would not qualify as low value-adding intra-group services:

- Services constituting the core business of a MNE group;
- Research and development services;
- Manufacturing and production services;
- Sales, marketing and distribution activities;
- Financial transactions;
- Extraction, exploration, or processing of natural resources;
- Insurance and reinsurance;
- Services of corporate senior management.

Simplified determination of arm's length charges for low value-adding intra-group services

The simplified approach prescribed under the draft report is based on determination of cost pools, allocation of low value-adding intra-group service costs, profit mark-up i.e. 2 to 5 per cent of the relevant cost.

Application of the benefits test to low value-adding intra-group services

The OECD has lowered the threshold for evaluation of the benefits test in respect of low value-adding intra-group services and provided the following guidance to the tax administration:

- The tax administration should consider benefits only by categories of services and not on a specific charge basis. Thus, the taxpayer needs to only demonstrate that assistance was provided with, for example, payroll processing, rather than being required to specify individual acts undertaken that give rise to the costs charged.
- Further, a single annual invoice describing a category of services should suffice to support the charge and correspondence, or other evidence of individual acts should not be required.

Documentation and reporting

The draft report prescribes the information and documentation should be prepared and be made available upon request to the tax administration of any entity within the group, either making or receiving a payment for low value-adding intra-group services such as, description of the categories of low value-adding intra-group services provided, reasons justifying that each category of services constitute low value-adding intra-group services within the definition set; rationale for the provision of services within the context of the business of the MNE; description of the benefits or expected benefits of each category of services, etc.

Source - www.oecd.org

Indirect tax

Central Excise - Decisions

In case of stock transfer from EOU to DTA, the SAD exemption may be claimed, even if no VAT is payable on such stock transfer

Vide Notification No. 23/2003-C.E (NT), EOU units are exempt from the payment of Special Additional Duty (SAD) on the clearance of manufactured goods to Domestic Tariff Area (DTA), if the goods being cleared are not exempt by the state government from payment of sales tax/ Value Added Tax (VAT). In this case, the taxpayer has claimed the exemption from the payment of SAD, in respect of clearances of goods to their own units in DTA on stock transfer basis. The Central Excise authorities have denied the exemption as no VAT was paid which is the requisite condition as per the Notification.

The Mumbai Tribunal has held that it is not disputed that such goods when sold in DTA had not been exempted by the state government by any Notification. Accordingly, it is not required to go into the analysis as to whether the goods are leviable to sales tax as there is no sales tax on stock transfer. The fact remains that the goods sold in DTA are not exempted from sales tax. Accordingly the benefit of exemption has been extended to the taxpayer.

CCE v. VVF Limited [2014-TIOL-2047-CESTAT-MUM]

Notifications/Circulars/Press Releases

The scope of 'place of removal' for the purpose of CENVAT Credit rules clarified by CBEC

The CENVAT Credit Rules, 2004 provides that the credit of input services is available upto the 'place of removal'. The expression 'place of removal' was defined vide Notification No. 21/2014-C.E (NT) dated 11 July 2014.

In this context, the Central Board of Excise and Customs (CBEC) has clarified that the place where sale has taken place or where the property in goods passes from the seller to the buyer is relevant to determine the 'place of removal Factors such as payment of transport, inclusion of transport charges in value, payment of insurance or who bears the risk, etc., are not the only relevant considerations to ascertain the 'place of removal'. Accordingly, the "place of removal" needs to be ascertained in term of provisions of Central Excise Act, 1944 read with provisions of the Sale of Goods Act, 1930.

Circular No. 988/12/2014-CX dated 20 October 2014

Credit cannot be claimed on towers and its parts and accessories, by a cellular mobile service provider

In lieu of the Bombay High Court pronouncement in the case of Bharti Airtel Limited v. CCE, [2014-TIOL-1452-HC-MUM-ST], CBEC has clarified that CENVAT Credit cannot be claimed on the towers and its parts and accessories, by a cellular mobile service provider, on the grounds that the towers cannot be considered as a part of an antenna.

Instruction No. F. No. 267/60/2014-CX.8 dated 11 November 2014

Customs Duty - Decisions

The date of Let Export Order is not relevant to compute the time limit prescribed for claiming drawback on re-exports

As per Section 74 of the Customs Act, 1962, the duty drawback may be claimed at the time of re-export of imported goods, if such goods are re-exported within 36 months from the date of its imports. In the present case, the taxpayer has filed the shipping bills for re-export of various machineries, under the claim of duty drawback, within 36 months from date of its imports. However, the Let Export Order was given by the Customs only after 36 months. Accordingly, the Customs authorities have denied the drawback on the premise that the Let Export Order has been issued beyond the period of 36 months from the date of imports.

The Mumbai Tribunal has held that when the goods are entered in the Customs area for export the said date is to be considered and not the date of Let Export Order. As the goods have been brought in the Customs area within 36 months from the date of imports, the taxpayer is entitled for drawback claim, even though the Let Export Orders are received after 36 months.

Oil and Natural Gas Corporation Limited v. Com of Cus [2014-TIOL-2235-CESTAT-MUM]

Service Tax - Decisions

Hiring of expatriate employees from overseas group entities, under an employment agreement does not qualify as 'manpower recruitment or supply services'

In the instant case, the issue was whether hiring of expatriate employees from overseas group companies by an Indian company to work in India would qualify as 'manpower recruitment or supply services'. The High Court, rejecting the department's appeal, made the following observations and held that no taxable service involving the recruitment or supply of manpower was provided by the overseas group entities:

- The Indian company only obtained from its group companies (directly or by transfer of the employees), the services of expatriate employees;
- The Indian company paid the salaries, deducted tax and contributed to statutory social security benefits for the expatriate employees under a contract of employment entered with the employee directly;
- No service has been provided by the group companies and employees while working on the payroll of the Indian company.

CCE. v. M/s Computer Science Corporation India Pvt. Ltd. [2014-TIOL-1896-HC-ALL-ST]

Agency services provided to overseas entity with respect to money transfer in India qualify as 'export'

In the instant case, the issue was whether services provided by the taxpayer to the overseas customer in India with respect to money transfer from abroad to a person situated in India would qualify as 'export'. The Tribunal held that the services qualify as 'export' and are not subject to service tax and made the following observations:

- It was observed that services were provided by the appellant to the overseas entity and not to any Indian customers. Also, payment for services was received by the appellant from the overseas entity;
- Reliance was also placed on the judgments in the case of Paul Merchant[1], wherein, identical transactions were held as 'export'.

Wall Street Finance Ltd. and Weizman Forex Ltd. v. C.S.T [TS-481-Tribunal-2014-ST]

'Commitment charges' payable on account of non withdrawal of the loan amount sanctioned held taxable

In the instant case, the issue was on applicability of service tax on the 'commitment charges' imposed by the banks on clients who decides not to draw the amount of the loan that has been at their disposal. The Delhi Tribunal held that the commitment charges being integrally connected with the lending services (which was a taxable services) should be chargeable to service tax and also observed the following:

- Commitment charges were recovered basically to cover the loss of interest that the bank would have earned if the client has drawn the money from the loan account;
- The bank keeps the fund available in the loan account in order to give limit/ overdraft facility;
- Such charges cannot be separated from the lending services and hence, taxable.

Punjab National Bank. v. C.C.E [2014-TIOL-2080-CESTAT-DEL]

Service tax on services provided in relation to serving of food and beverages in air conditioned restaurant, hotel, inn, guest house, etc. held unconstitutional

In the instant case, the issue was whether services provided in relation to serving of food and beverages in air conditioned restaurant, hotel, inn, guest house, etc. should be chargeable to service tax. The Kerala High Court held that service tax levy on serving food and beverages in air conditioned restaurant, hotel, inn, guest house, club or camp-site is unconstitutional. The High Court considered the following points:

- After 46th amendment in the Constitution, supply of food and other articles for human consumption in restaurants has been categorically enumerated as 'deemed sale';
- It cannot be said that there is any service involved;
- States alone have legislative competence to impose tax on whole consideration received for such sales and Union cannot characterise the same transaction as 'service' for levy of service tax.

Union of India & Others v. M/s Kerala Bar Hotels Association [TS-501-HC-2014(KER)-ST]

Offshore drilling services provided beyond territorial waters of India are taxable under 'supply of tangible for use' service category

In the instant case, the issue was whether hiring of oil drilling rigs for operation in continental shelf / exclusive economic zone of India, beyond territorial waters should be classified under the taxable category of 'supply of tangible goods for use' and attract service tax. The Mumbai Tribunal held that such services qualify as 'supply of tangible goods for use' and hence liable to service tax on the basis of following grounds:

- The transaction in the instant case satisfies the following two conditions stipulated for a service to qualify as 'supply of tangible goods for use':
  - supply of tangible goods for use;
  - since goods were supplied along with the personnel to operate the same, no transfer of right of possession and effective control of such goods was made to the service receiver.
- Since the services are provided in continental shelf / exclusive economic zone of India i.e. in area notified under the maritime Zone Act, 1976, the same was held to be provided in taxable territory and hence, taxable.

Great ship (India) Ltd. v. Commissioner of Service Tax [2014-TIOL-2122-CESTAT-MUM]

VAT - Decisions

BOT contracts are liable to works contract

The taxpayer, a consortium of three companies, entered into an agreement with the Maharashtra Government for improvement of Surat Dhule Road and construction of diversion outside Dhule Town on BOT basis for a period of eight years. As per the agreement, the taxpayer was required to invest a fixed amount for construction of the project and in return, the government had granted the taxpayer rights to collect toll from the users of the road. On completion of 8 years, the taxpayer was required to handover the project to the government free of cost. The taxpayer filed an application for DDQ which was decided by the Additional Commissioner. Being aggrieved by the said order, the taxpayer had filed present appeal.

It was held that the skill, labour, experience, service and goods were to be used by the appellant and therefore, the case would fall in the category of works contract. The end result is permitting public to use the road for price i.e. toll, no one is permitted to use the road without payment of toll, except specifically provided for. Instead of the state, price is paid by the public at large by way of toll, therefore, there is an element of price involved.

The word 'free of cost' used does not mean that the appellants are required to work at loss. Handing over the project free of cost is after the concession period is over, as it is deemed that entire cost of the project, inclusive of interest and expenses and profits have been realised. Therefore, contention of the appellant that he is not earning any profit cannot be accepted. There is valuable consideration which has been passed and there is transfer of property involved in works contract. Hence, the same is liable to VAT.

M/s Ashoka Infrastructures v. the State of Maharashtra. [2014-VIL-12-MSTT]

[1]Paul Merchants case - 2012-TIOL-1877-CESTAT-DEL

Interest chargeable from 'return date' on non-production of Form C, not 'assessment' under CST Act

The taxpayer is a public sector undertaking registered under Karnataka VAT Act and Central Sales Tax Act. Under the assessment order for Financial Year (FY) 2005-06, higher tax rate and interest were levied on transactions not covered by 'C' Forms under Central Sales Tax (CST) Act. The taxpayer filed an appeal before the Joint Commissioner which was partly allowed. On further appeal, the Tribunal quashed the levy of interest on transactions not covered by 'C' Forms. Aggrieved by the same, Revenue was in revision before the High Court.

The High Court observed that the taxpayer was aware that non submission of declaration in 'C' Form under CST Act would result in non-availment of concessional tax benefit and paying higher rate of tax. Accordingly, the High Court held that the taxpayer was liable to pay interest from the date when the taxpayer was liable to pay the required tax and not from the assessment date.

State of Karnataka vs. Bharat Heavy Electricals Ltd & Others [TS-499-HC-2014(KAR)-VAT]

Notifications/Circulars/Press Releases

Gujarat

The due date for filing VAT audit report for FY 2013-14 has been extended from 31 December 2014 to 31 January 2015. Further, it has been clarified that penalty for delay in filing the said report would be computed considering the due date as 31 January 2015.

Notification No. Guj/VAT-17C/14-15/Sr. No. 155/134 Dated 21 October 2014

The due date for filing annual return by the dealers who are liable for VAT audit for FY 2013-14 has been extended from 31 December 2014 to 31 January 2015. Further, it has been clarified that penalty for delay in filing annual return shall be computed considering due date as 31 January 2015.

Notification No. Guj/VAT-15/13-14/Sr. No. 157/135 Dated 27 October 2014

Jammu and Kashmir

Jammu and Kashmir VAT Rules were amended vide Notification No. SRO 395 Dated 4 October 2014 to provide that the due date for filing returns for the second quarter of 2014-15 and revised returns for the first quarter of 2014-15 has been extended up to 31 January 2015. However, it was later clarified that the extended due date (i.e. 31 January 2015) will not apply to multi national Companies, C & F agencies and automobile dealers.

Notification No. SRO 453 Dated 22 October 2014

Jharkhand

With effect from 1 April 2014, composition tax rate for payment of VAT by developers/builders under works contract (construction) has been notified at 1 percent of the total value of consideration in respect of developer's share, subject to prescribed conditions and restrictions.

Notification S.O. 50 Dated 10 October 2014

Rajasthan

Procedure has been prescribed for verification of deposit of tax up to FY 2011-12 for the purpose of allowing the input tax credit, where the demand has been created due to mismatch of input tax credit claimed by a dealer.

Notification No. F. 16(100) Tax/CCT/14-15/2787 Dated 21 October 2014

The due date for filing annual return via Form VAT-11 for FY 2013-14 by the dealers having a turnover of more than INR1 crore during FY 2013-14 has been extended from 30 November 2014 to 31 December 2014.

Notification No. F. 26(315) ACCT/MEA/2014/1054 Dated 14 October 2014

Personal tax

Notifications/Circulars/Press Releases

SEBI replaces the erstwhile ESOP guidelines with new regulation

The Securities Exchange Board of India (SEBI) on 28 October 2014 has notified New Regulations[1] for share based employee benefits which have replaced the erstwhile ESOP guidelines[2]. The New Regulations shall be effective from the date of notification.

Source - www.sebi.gov.in

GoI simplifies immigration procedures for Japanese nationals

One of the vital points of discussion in Shri Narendra Modi's Annual Summit meeting with the Japanese Prime Minister, during his recent visit to Japan, was on the means to enhance people-to-people exchanges in business and tourism by GoI way of simplifying visa procedures.

As a gesture of cooperation, the GoI has simplified the rules on the validity of residential permit and visa/residential permit extension procedure for Japanese nationals travelling to India.

Key changes

- Japanese nationals holding employment visa and their dependents holding entry visas would be granted residential permits whose validity period would be same as that of their respective visas.
- Japanese nationals would no longer be required to be physically present at the concerned Foreigners Registration Office for purposes of obtaining residential permits or for extension of visa/residential permits. An official from the concerned company/organisation duly authorised by it may represent the Japanese national for completion of the said procedures.

International workers and their beneficiaries can now get disbursement of provident fund benefits into their overseas bank accounts

The Employees' Provident Fund Organisation (EPFO) has vide its letter dated 20 October 2014, laid down the mechanism for disbursement of Provident Fund (PF) claims to overseas bank accounts of International Workers (IWs) including their beneficiaries.

To execute the disbursement process, EPFO has opened a dedicated bank account with State Bank of India.

Procedure to facilitate payment to overseas bank account of IWs and their beneficiaries

- The existing claim applications will continue. However, IWs would need to mention their foreign bank account details in the relevant claim application form.
- The field officers will complete the necessary documentation formalities for onward transmission to the regional PF office in Delhi to ensure that the payment can be made to the beneficiaries in their overseas bank account in foreign currency.

The above procedure specified by EPFO is yet another welcome step and is expected to ease the hardships faced by the expatriate population in India in getting their PF claims settled.

Source - www.epfindia.com

[1]SEBI (Share based employee benefits) Regulations, 2014
[2]SEBI (Employee stock option scheme and employee stock purchase scheme) guidelines, 1999

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Printed in India (NEW1114_007)