KPMG
cutting through complexity

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India Tax Konnect

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Editorial

The Union Budget 2014 is scheduled to be declared on 10 July 2014. This will be the first budget to be presented by the new government and it is to see how this government lays down the path to boost the growth of the economy, and at the same time holds back from levying any new burden on the taxpayers. The expectations are to usher in a flow of fresh investments and rebuild business confidence. At the same time, the government faces a few challenges like curtailing fiscal deficit, taming inflation, generating employment and creating a conducive atmosphere to attract foreign direct investment to India.

Recently, KPMG in India conducted a webinar that included pre-budget suggestions. During this webinar, we received encouraging feedback on certain macro aspects relating to tax and regulatory policies. The survey result brings up some interesting suggestions, for e.g. retrospective amendments introduced in the last few years should be rolled back, introduction of provisions of the general anti-avoidence tax should be extended, concrete steps should be introduced in the budget to reduce transfer pricing litigation, and the government should allow 49 per cent foreign direct investment across sectors.

In its monetary policy review, the Reserve Bank of India (RBI) has maintained the repo rate at eight per cent and the cash reserve ratio rate at four per cent. However, the statutory liquidity ratio has been reduced by 0.5 per cent to 22.5 per cent effective from 14 June 2014.

On the international tax front, the Delhi Tribunal in the case of Nortel Networks India International Inc. held that since the hardware supplied by the taxpayer was installed by an Indian subsidiary and the contracts were pre-negotiated by it, the Indian subsidiary constituted a fixed place of business and dependent agent Permanent Establishment (PE) of the taxpayer in India under the India-USA tax treaty. Further, the Tribunal held that since the accounts of the taxpayer have no sanctity and the same were not audited, resorting to Rule 10 of the Income-tax Rules, 1962 would be justified. Accordingly, an attribution of 50 per cent of the profits to the activities of PE in India would be a reasonable attribution in the taxpayer's case.

On the transfer pricing front, the Delhi High Court in the case of Cushman and Wakefield (India) Pvt. Ltd. rejected the taxpayer's contention that since the associated enterprise has charged only cost incurred without any mark-up, further benchmarking was not necessary in view of Section 92(3) of the Income Tax Act, 1961 (the Act). The High Court also held that the Assessing Officer's (AO's) reference to the transfer pricing officer is for the limited purpose of determining the arm's length price and does not curtail the powers of the AO to check if expenditure is wholly and exclusively incurred for the purposes of the business.

The Delhi Tribunal, in the case of Jyotinder Singh Randhawa, granted the benefit of extending the stay period from 60 days to 182 days, treating the self-employed Indian citizen who leaves India for the purpose of employment as a non-resident under the Act.

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 ways to make this publication more relevant.

International tax

Decisions

Indian group company held to constitute a PE under the India-U.S. tax treaty

The taxpayer, incorporated in the USA, is a part of a group engaged in the supply of hardware and software products to telecom companies. An Indian group company entered into a contract with a customer in India for the supply (including installation, testing and commissioning) of hardware equipment. Immediately thereafter, the Indian company assigned the supply part of the contract to the taxpayer without any consideration. A Canadian group company also had a Liaison Office (LO) in India.

The taxpayer purchased the equipment from a group company outside India and supplied it to the customer in India at a substantial loss.

Based on the facts of the case, the Income-tax authorities in India held that the Indian company and the LO constituted a PE of the taxpayer in India under the India-USA tax treaty. Further, based on Rule 10 of the Income-tax Rules, 1962 (the Rules), the Income-tax authorities applied the global gross profit margins of the group to the consideration for the supply of equipment and computed profits attributable to the PE.

On appeal, the Income-tax Appellate Tribunal (the Tribunal), based on facts, held that the Indian Company/the LO constituted a fixed place PE/dependent agent PE of the taxpayer in India. The following are the observations of the Tribunal:

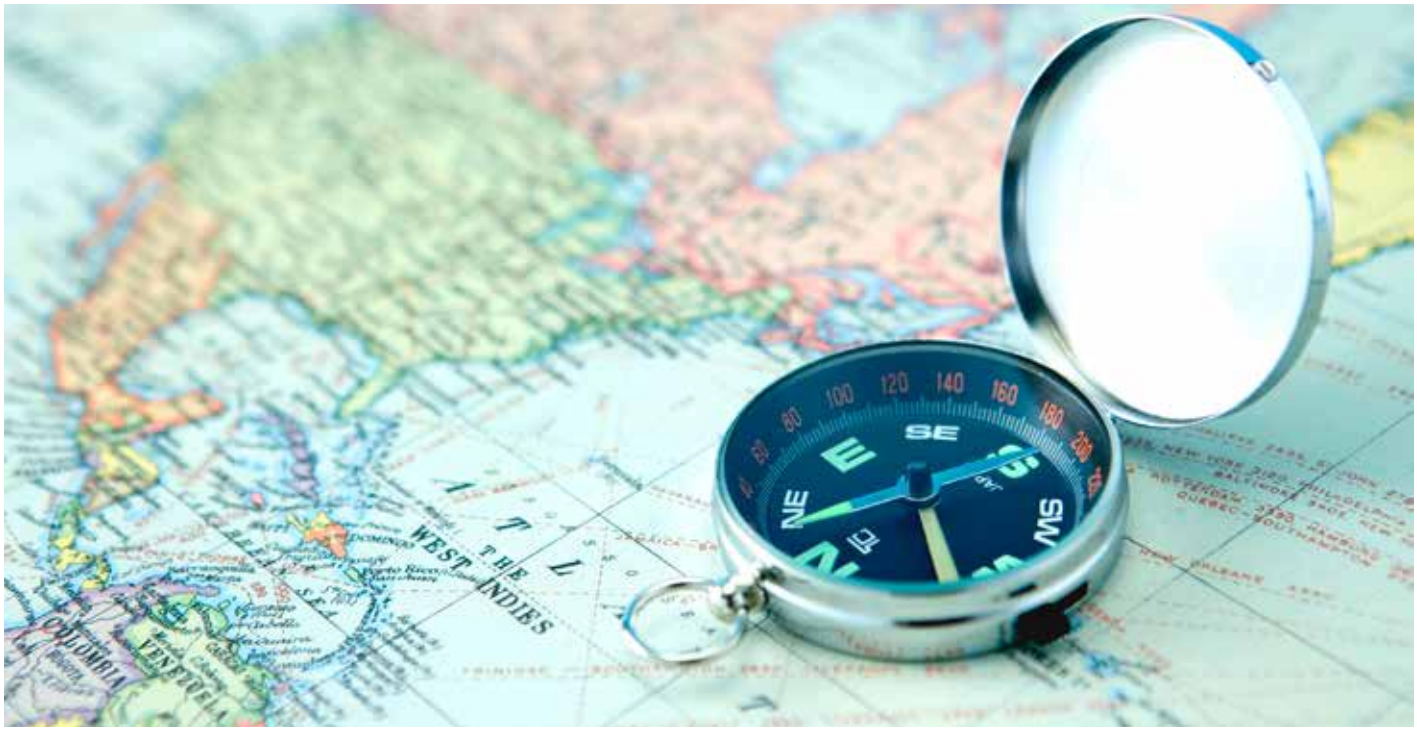
PE

- The contract was a turnkey and indivisible contract for supply, installation, testing, commissioning etc. The compensation received for the sale of equipment represented the payment for a work contract.
- The Indian company was responsible for negotiating and securing contracts. Further, the Indian company also undertook the installation and commissioning. The LO was also rendering service to the taxpayer.
- The entire business activity of the taxpayer is managed by the Indian Company and hence, constitutes a PE.

Apportionment of profit

- The profit of the taxpayer from the supply of equipment, computed by reference to the gross profit rate of the group and further allowance for selling, general marketing expenses and research and development expenses is acceptable.
- Since the accounts of the taxpayer have no sanctity and the same were not audited, resorting to Rule 10 of the Rules would be justified.
- Fifty per cent of the resulting profit is attributable to the PE.

Nortel Networks India International Inc. v. DDIT (ITA Nos. 1119, 1120 & 1121 of 2010)



Corporate tax

Decisions

Payment made to full time consultant doctors qualify for tax deduction under Section 194J of the Act (for professional services) and not under Section 192 of the Act (for salary)

The taxpayer is a multi-specialty hospital engaged in providing healthcare services under the name 'Global Hospitals'. The taxpayer deducted tax at source for payments made to doctors under Section 194J, treating them as consultants and not as employees. The AO was of the view that the taxpayer ought to have deducted the tax under Section 192 instead of Section 194J of the Act. The AO observed that the full time consultant doctors were full time employees of the hospital and they were subjected to all services rules and regulations framed by the hospital. The AO finally concluded that there existed an employer and employee relationship between the taxpayer and the doctors, and payments made to full time consultant doctors i.e., the first category of doctors were within the purview of Section 192 of the Act. Thus, the taxpayer was treated as assessee in default under Section 201(1) of the Act.

The Hyderabad Tribunal after perusing the service agreements between the taxpayers and doctors observed that there was nothing on record to show that the full time consultant doctors were subject to same service conditions like other resident doctors or other full time employees of the hospital. The Tribunal held that there was nothing on record to prove that full time consultant doctors were either provided with specific working hours or subject to any rules and regulations of taxpayer hospital, hence no employer-employee relationship could be deduced. Thus, absent employer-employee relationship between the taxpayer and doctors, payments to full time consultant doctors qualifies for tax deduction under Section 194J (for professional services) and not under Section 192 of the Act (for salary). The Tribunal inter alia relied on the decision of the co-ordinate bench in the case of DCIT v. Yashodha Super Speciality Hospital [2010] 133 TTJ 17(Hyd).

Ravindranath GE Medical Associates Pvt. Ltd. v. DCIT [TS-344-ITAT-2014(HYD)]

No sub-contract relationship arose between a taxpayer AOP and its member entities during project execution, hence provisions of Section 194C is not applicable

The taxpayer is an Association of Persons (AOP) which comprises two entities, viz. SMC Infrastructure Pvt. Ltd., a company, and Ambika Enterprises, a propriety firm. The association was formed for the purpose of bidding for the contract of the Thane Municipal Corporation. The association, which placed its bid, was eventually awarded the contract on 16 November 2004, which was made by the two aforesaid entities. The work was carried out by these two entities and the amount received after work carried out was handed over to the entities in order to enable them to execute the contract. The taxpayer neither kept any commission nor any profit. The lower authorities held that the relationship between the taxpayer and the two entities resulted in a sub-contract relationship, and therefore the provisions of Section 194C would be applicable. However, the Tribunal reversed the order of lower authorities. Aggrieved by the same, Revenue filed an appeal before the Bombay High Court.

Before the Bombay High Court, Revenue argued that the Tribunal merely relied upon the absence of a written contract to hold that there was no sub-contract relationship between the taxpayer and the two entities. Rejecting Revenue's contentions, the High Court observed that it is the association comprising two entities joined together for the purpose of executing the project, and under such circumstances no inference of any sub-contractor relationship could be drawn.

CIT v. SMC Ambika JV [TS-362-HC-2014(BOM)]

High Court allows writ, directs Revenue to pay 'compensation' for a delay of 11 years in the payment of interest on refund due to a taxpayer, under Section 214 of the Act

For Assessment Year (AY) 1984-85, the taxpayer paid advance tax of INR2.25 million and had TDS credit of INR50,000. The taxpayer's income was finally assessed under the head 'Long Term Capital Gains' for a sum of INR0.328 million. Thus, the taxpayer became eligible for a refund of an amount of INR1.97 million with interest under Section 214 of the Act. Vide refund order dated 22 December 1998, it was determined that the taxpayer was entitled to a refund of INR1.97 million. The taxpayer was also entitled to be paid interest under Section 214 of the Act for the period 1 April 1984 to 31 March 1987 (i.e. date of assessment order) as per the applicable rates, which arrived at INR0.83 million. However, the taxpayer also claimed compensation payment on account of delay in payment of interest from 31 March 1987 to 22 December 1998. However, such claim was rejected by the AO on the ground that there was no provision in the Act to grant interest on interest. Aggrieved, the taxpayer filed a writ petition before the Andhra Pradesh High Court.

The Andhra Pradesh High Court observed that the taxpayer's case was covered by the Supreme Court ruling in the case of Sandvik Asia Ltd. v. CIT [2006] 280 ITR 643 (SC). Following Supreme Court ruling in the case of Sandvik Asia Limited, the High Court allowed the taxpayer's writ petition directing Revenue to pay simple interest at the rate of nine per cent per annum for the period i.e., from 31 March 1987 to 22 December 1998. The High Court further directed revenue

to pay such compensation amount within a period of two months from the date of receipt of this order, failing which the revenue shall pay penal interest at the rate of 15 per annum for the above said period.

The Sirpur Paper Mills Ltd. v. JCIT [TS-359-HC-2014(AP)]

TDS liability cannot be fastened due to retrospective amendment

The taxpayer, an Indian company, is engaged in the business of distributing cable signals. It receives satellite signals from various channel companies like Star Den Media Ltd., Zee Turner Limited, M.S.M. Discovery P. Ltd., U.T.V. Global Broadcasting P. Ltd. etc. in the capacity of a Multi System Operator. The taxpayer is liable to make payment to the above said companies for receiving the signals. During the course of assessment proceedings for AY 2009-10, the AO held that the amount paid to various companies for receiving signals as 'pay channel charges' is royalty and the same is liable for tax deduction at source under Section 194J of the Act. Thus, the AO disallowed pay channel charges under Section 40(a)(ia) of the Act.

The Cochin Tribunal referred to the explanation 6 to Section 9(1)(vi), inserted by Finance Act, 2012 with retrospective effect from 1 June 1976, which states that the expression 'process' includes and shall be deemed to have always included transmission by satellite, cable, or by any other similar technology. The Tribunal observed that explanation 6 starts with the words 'for removal of doubts', and hence the said explanation is clarificatory. Thus, the Tribunal held that the payment made by taxpayer as 'Pay Channel Charges' is 'royalty', by virtue of Explanation 6 to Section 9(1)(vi) of the Act. Notwithstanding this, the Tribunal further held that the taxpayer could not be held to be liable to deduct tax at source relying on the subsequent amendments made in the Act with retrospective effect.

Kerala Vision Ltd. v. ACIT [TS-342-ITAT-2014(COCH)]

A final assessment order passed after the TPO's order, without issuing a draft assessment order, is invalid and not in accordance with Section 144C

The taxpayer has entered into international transactions for AY 2009-10. The transfer pricing assessment of international transactions was referred to a Transfer Pricing Officer (TPO) and the TPO passed his order on January 30 2013. Thereafter, the AO, instead of passing the draft assessment order [as specified under Section 144(C)] directly passed a final assessment order under Section 143(3) of the Act. The assessment order was passed on 26 March 2013. The AO also raised the tax demand and imposed penalty on the taxpayer. After realising his mistake of passing a final assessment order instead of the draft assessment order, the AO issued a corrigendum on 15 April 2013. The corrigendum stated that the order passed on 26.02013 under Section 143C of the Act has to be read and treated as a draft assessment order. The AO also granted 30 days' time to respond to the taxpayer. The taxpayer made reference to the Dispute Resolution Panel (DRP). However, the DRP refused to issue any directions on the grounds that the order passed by AO was final, and hence the DRP did not have any jurisdiction. Aggrieved by the same, the taxpayer filed a writ petition before the Madras High Court.

The Madras High Court quashed the assessment order and the corrigendum, since it was barred by a time limitation. The High Court observed that as per Section 144C of the Act the AO has no right to pass final assessment order pursuant to the TPO's recommendations. Relying on the Supreme Court ruling in the case of Deepak Agro Foods v. State of Rajasthan and others [2008] 16 VST 454 (SC), the High Court observed that if an order is passed beyond the statutory period prescribed, such order is a nullity and has no force of law. Accordingly, the High Court in the taxpayer's case concluded that the order passed by the AO lacked jurisdiction especially when it was beyond a period of limitation prescribed by the statute. Further, High Court also held that when there is a statutory violation in not following the procedures prescribed, such an order could not be cured by merely issuing a corrigendum. The High Court inter alia relied on the decision of Andhra Pradesh High Court in Zuari Cement Limited v. ACIT (WP No. 5557 of 2012 dated 21 February 2013) that dealt with similar issue.

Vijay Television Pvt. Ltd. v. DRP [2014] 46 taxmann.com 100 (Mad)

Where the taxpayer had not collected and deposited service tax but on being pointed out, deposited the same; amount being expended by the taxpayer in the course of business was allowable as business expenditure

During the course of assessment proceedings, the service tax authorities raised an audit objection pointing out that the taxpayer had not collected the service tax on mechanical erection and installation of plant and machinery, structure work, piping work and contract works for the period from financial years 2003-04 to 2006-07, and a demand of service tax was raised and interest thereon. The taxpayer accepted the audit objection and paid up the said amount and claimed deduction thereof as business expenditure. The stand of the revenue was that this amount having been expended by the taxpayer for infraction of law, the deduction thereof was not available. The Commissioner of Income-tax (Appeals) [CIT(A)] as well as the Tribunal accepted the claim of the taxpayer. Aggrieved by the same, Revenue filed an appeal before the Gujarat High Court.

The Gujarat High Court upheld the view taken by CIT(A) and the Tribunal. The High Court held that the amount was expended by the taxpayer during the course of business, wholly and exclusively for the purpose of business. If the taxpayer had taken proper steps and charged service tax to the service recipients and deposited with the Government, there was no question of the taxpayer expending such sum. It is only because the taxpayer failed to do so, that he had to expend the said amount, though it was not his primary liability. Be that as it may, this cannot be stated to be a penalty for the infraction of law. Further, it also held that payment of interest is compensatory in nature and would not partake of the character of penalty.

CIT v. Kaypee Mechanical India (P) Ltd. [2014] 45 taxmann.com 363 (Gujarat)

Changes in DSIR guidelines for approval of in-house research and development centres

Recently, the Department of Scientific and Industrial Research (DSIR), Ministry of Science and Technology has released updated guidelines in relation to approval of in-house research and development (R&D) centres for claiming weighted deduction under section 35(2AB) of the Act. The guidelines are broadly in line with earlier guidelines released in May 2010. However, there are certain additional condition/clarifications provided in the updated guidelines are as follows:

- R&D expenditure should be disclosed in the schedules/ notes to accounts of the audited financial statements. The company is required to file an undertaking along with the application that is filed for seeking approval for in-house R&D centre.
- Capital expenditure in the nature of intangible asset would not be eligible for weighted deduction. The same should also be certified by the auditors.
- For the purpose of claiming weighted deduction, the manpower employed for in-house R&D centre should have/possess a degree/diploma in science or engineering discipline or any other qualification above it.
- Expenditure on manpower under the category of retainership/consultants and manpower on contract will not be admissible for weighted deduction. The same should also be certified by the auditors.
- The new in-house R&D centre setup by a company may be approved from the year in which the recognition is granted provided the company submits Form 3CK online before end of the financial year in which the recognition is granted and print out should be sent to DSIR.

Mergers and acquisitions

Decisions

Transfer under family arrangement

Three brothers transferred shares held/loans given by them, to a private limited company equally owned by them, pursuant to a family arrangement to equalise their holding and to avoid future disputes. The Tribunal upheld that transfer of shares/ assignment of loans under a family arrangement to a private limited cannot be regarded as being without consideration, and therefore is not a gift, and therefore the private limited company is not entitled to the period of holding of the previous owner.

Bilakhia Holdings P. Ltd. [TS-319-ITAT-2014(Ahd)]

Circulars/Notifications/Press releases

MCA Circular No 20 of 2014 – Mandatory e-voting

The Companies Act, 2013 has introduced provisions relating to participation in general meeting through e-voting. The process is causing practical difficulties. Therefore, the Ministry of Corporate Affairs (MCA) has issued this circular deferring the mandatory e-voting provisions till 31 December 2014. The circular also provides following clarifications:

- Voting through show of hands not to be allowed in cases involving of e-voting.
- Person who has voted through the e-voting mechanism shall not be debarred from participation in the general meeting, but he shall not be able to vote again.
- In relation to transactions covered in the list of mandatory postal ballot, cannot be transacted at general meeting even if e-voting is provided.
- Voting through e-means takes into account 'proportion principle' [i.e. 'one share - one vote'], the provisions relating to demand for poll would not be relevant.
- In relation to general meeting with e-voting, a person not attending or using e-voting does not have the option of a postal ballot.
- A company not mandated under rule 20(1) for adopting e-voting can decide to give its shareholders the e-voting facility, however, such company should follow the entire process and should not adopt a part of the prescribed process.

General Circular No. 2O/2O14, dated 17 June 2014

Transfer pricing

Decisions

The Delhi High Court rules that transfer pricing reference does not curtail the test of deductibility of expenses under Section 37 of the Act. Further, cost-to-cost reimbursement transactions should also be benchmarked from an arm's length perspective.

The taxpayer, an Indian company, reported several international transactions including (i) payment of referral fees to associated enterprises (AEs); and (ii) reimbursement to AEs for the costs incurred by them for certain coordination and liaison services provided to the taxpayer. The TPO disallowed reimbursement of expenses transaction by determining its arm's length price (ALP) as nil, and held that no intra-group services existed in this case as the taxpayer was unable to file any evidence to support the specific need for such services and the benefits that were actually accrued from them. No benchmarking or transfer pricing analysis was conducted to substantiate the arm's length nature of such transactions. The TPO also noted that the taxpayer may have received only incidental benefit from the global relationship between the AEs and clients. As regards the payment of the referral fees, the TPO concluded it to be at arm's length. However, the AO disallowed the same under Section 37 of the Act, stating that the taxpayer failed to demonstrate the genuineness of the transaction, the receipt of any such services, and the business purpose of the same. The DRP upheld the adjustments made by the AO. The Tribunal reversed the findings of the AO/TPO on both of the above-mentioned transactions.

On appeal, the High Court held as follows:

- The High Court observed that whether a third party, in an uncontrolled transaction with the taxpayer, would have charged amounts lower, equal to or greater than the amounts claimed by the AEs, has to be tested under the various methods prescribed in Section 92C of the Act. The argument of the taxpayer that it only reimbursed the cost incurred, while an uncontrolled transaction would involve an additional element of profit, is not tenable. This being a transaction between related parties, whether the cost itself is inflated or not is a matter to be tested under a comprehensive transfer pricing analysis. The High Court also noted that the application of Section 92(3) of the Act is not a logical inference from the fact that the AEs have only asked for reimbursement of costs.
- The jurisdiction of the AO under Section 37, and that of the TPO under Section 92CA of the Act, are distinct. The High Court noted that the authority of the TPO is to conduct a TP analysis to determine the ALP, and not to determine whether there is a service or not from which the taxpayer benefits. That aspect of the exercise is left to the AO under Section 37 of the Act.
- In reference to the referral fee transaction, the High Court noted that the TPO determines whether the transaction value represents the ALP or not (including whether the ALP is nil), while the AO makes the decision as to the validity of the deduction under Section 37. This would include the decision as to whether the expenditure was 'laid out or expended wholly and exclusively for the purposes of the business' as the same is a fact determination or verification to be undertaken by the AO. The authority of the AO under Section 37 is not curtailed in any manner by a reference under Section 92C of the Act.
- The findings of the Tribunal on both the transactions were set aside, and the matter was remanded to the file of the AO, for an ALP assessment by the TPO, followed by the AO's assessment order in accordance with law.

Cushman and Wakefield (India) Pvt. Ltd. [ITA 475/2012/Delhi HC]

The Mumbai Tribunal confirms concealment penalty under Section 271(1)(c) of the Act and also rules on the validity of revised return

The taxpayer is a joint venture between two companies and entered into a software development service agreement with one of the joint venture partners to provide software related services. The TPO accepted all transactions to be at arm's length except reimbursement of market services availed, (similar to two preceding years). The TPO was of the opinion that the taxpayer was not required to undertake any marketing function as per the master service agreement and that both the parties had a clearly demarcated role to play for which they were compensated. Accordingly, the TPO held that there was no valid reason for the joint venture partner to allocate any part of the cost incurred by it to perform the role agreed by it, which is the marketing function. The TPO accordingly determined the ALP of the reimbursement of market services availed as zero and proposed to make TP adjustments. The taxpayer had pointed out to the TPO that it had revised its return of income for the AY 2003-04 and AY 2004-05 on 29 March 2006 and 14 December 2007 respectively, disallowing the entire marketing expense claimed in the original return, and therefore, there was no question of any TP adjustment under Section 92CA of the Act. The TPO rejected this claim observing that the taxpayer had failed to file a revised Form 3CEB in line with the revised returns. Further, in the regular assessment the AO disallowed the claim of the taxpayer for enhanced deduction under Section 10A on disallowance of reimbursement of marketing services in view of the provisions of Section 92C(4) of the Act. The AO did not give cognise to the revised returns or the suo motu disallowance of the reimbursement of marketing services. Penalty under Section 271(1)(c) of the Act was accordingly levied at 100 per cent of the tax on the amount initially claimed as marketing expense. The CIT(A) upheld the AO's order.

The Tribunal held as follows:

- The joint venture partner markets the taxpayer's capabilities, which is precisely what it is required to do under its arrangement with the taxpayer. Accordingly, it was held that there was no question of any reimbursement by the taxpayer to the joint venture partner for the marketing services provided.
- The taxpayer had failed to demonstrate the service it received or the benefit it received from receipt of such marketing services. No separate documentation; the cost allocation as made and incurred by the taxpayer was submitted to the TPO.
- Since the return was revised only after a reference was made to the TPO, the revision was made in anticipation of the proposed adjustment with a motive to avoid the adjustment, and thereby the disallowance of Section 10A benefit on the amount of TP adjustment.
- If anything wrong is discovered in Form 3CEB filed, the same needs to be withdrawn and replaced by a revised Form 3CEB to give a correct picture although there is no specific provision in the Act for the same.
- Since the taxpayer failed to demonstrate that any service was in fact rendered, the foreign exchange to that extent stands lost to the country, warranting a denial of deduction under Section 10A to which the amount may otherwise be eligible.
- With regard to the taxpayer's plea that there has been a complete disclosure of material facts, the Tribunal observed that the taxpayer failed to demonstrate any business purpose of its relevant international transaction. It is only by way of reference to and inquiry by the TPO, which brings forth the complete absence of business purpose, leading to its valuation at nil and, resultantly, a retraction by the taxpayer. The disclosure per the audit report under Section 92E of the Act forming part of its return is thus both false and misleading.
- Since the Tribunal had concluded that the withdrawal or revision was not voluntary, but with a sole objective to avoid the rigour of the Section 92C(4) of the Act, the penalty proceedings against the taxpayer were justified.
- The Tribunal concluded that the findings of the CIT(A) are comprehensive and correct in fact and law. The appeal of the taxpayer was rejected.

Deloitte Consulting India Pvt. Ltd. v. ACIT (ITA Nos. 7650 & 7651/Mum/2013)

The Hyderabad Tribunal accepts revised return making suo moto adjustment as valid; however, it denied the plus/minus five per cent benefit on the adjusted ALP

The taxpayer entered into an international transaction of exporting sub-assembly and components from its Export Oriented Manufacturing Unit (EOU) to its AE for AY 2007-08 and 2008-09. The taxpayer also rendered Software Engineering Services to its AE (CADEM Segment). A revised return, for AY 2007-08 was filed by the taxpayer under Section 139(5) of the Act making a suo moto TP adjustment of INR32.17 million in respect of EOU. The TPO made adjustments to the sale of sub-assembly components and to the CADEM segment without considering the revised return filed by the taxpayer. The taxpayer's objections before the DRP were rejected and accordingly, the AO passed a consequential order making adjustments to the income returned. Aggrieved, the taxpayer filed an appeal before the Tribunal.

The Tribunal relied on its ruling in taxpayer's own case for AY 2006-2007 and held as under:

- **Acceptance of revised return along with TP report** – The original return filed by the taxpayer cannot be considered as a valid return, as it did not contain statutorily prescribed TP documentation and the value of international transactions as per books of accounts. The revised return enclosing the TP documentation and declaring higher value of international transactions considering suo moto adjustment cannot be rejected and the same is valid under Section 139(5) of the Act. The extent of declaration of international transaction and suo moto adjustment can be certainly treated as omission or wrong statement in the original return as per Section 139(5) of the Act.
- **TPO's adjustments ignoring suo moto adjustment** – The TPO/DRP cannot ignore the suo moto adjustment for arriving at the profit margins realised by the taxpayer for the purpose of Rule 10B(e)(v) of the Rules.
- **Correctness of re-computation of operating cost by the TPO** - The taxpayer operates a 100 per cent EOU eligible for deductions under Section 10A/10B of the Act. The taxpayer has also maintained separate books of accounts and the same were accepted under the provision of the Act. Therefore, the action of the TPO in rejecting the segmental information and estimating the operating cost based on proportionate turnover is not valid. The Tribunal directed the TPO/AO to consider the segmental working provided by the taxpayer for the determination of an ALP.
- **Validity of comparables selected by the TPO** – The Tribunal allowed the contention of the taxpayer that the comparables selected by TPO had either different accounting periods than that of the taxpayer or they were functionally not comparable to the taxpayer's business and restored the issue to TPO for re-examination.
- **Availability of plus/minus five per cent benefit** - The Tribunal referred to the provision of Section 92C(2) of the Act and held that the plus/minus five per cent range should be applied only on the actual value of the transactions and any suo moto adjustment made by the taxpayer should not be considered for the threshold determination. The Tribunal also noted that the taxpayer has exercised the plus/minus five per cent option by performing suo moto adjustment to the value of international transactions, therefore the taxpayer cannot contend that the threshold of five per cent shall be available again, if the TPO's action results in further addition.

Based on the above, Tribunal directed the AO/TPO to re-compute the ALP. Further for AY 2008-2009, considering similarity in the fact pattern, the Tribunal remanded the case back to AO/TPO for determination of ALP.

For CADEM segment the Tribunal held as follows:

The Tribunal relied on the co-ordinate bench ruling and directed the TPO to exclude the ten comparable companies objected to by the taxpayer. The Tribunal also directed the TPO to restrict the TP adjustment to the value of the AE transactions only.

As regards to the salary paid to the Marketing Director, the Tribunal directed the AO/TPO to examine the taxpayer's contentions and consider whether any proportionate cost needs to be included in the operating cost.

Tecumseh Products India Pvt. Ltd v. ACIT (ITA.No.2228/ Hyd/ 2011)

The Delhi Tribunal rejects the TPO's approach of using a PSM for agency services; the taxpayer assumed minimal risk, performed limited functions.

The taxpayer is a wholly owned subsidiary of the Marubeni Corporation, Japan (MCJ), and its operations primarily consist of agency services on behalf of MCJ and other Marubeni group companies. For AY 2008-09 the taxpayer entered into five international transactions and selected the Transactional Net Margin Method (TNMM) with operating profit/operating cost as the Profit Level Indicator (PLI). There was no dispute on four transactions; however, the international transaction in the nature of 'Provision of Agency and Marketing Support Services', was challenged by the AO/TPO and the TPO contended that some vital services provided by the taxpayer to the AE form the backbone of the sourcing services performed in India.

As per the TPO, the taxpayer was making sizeable investments in exploring and analysing the Indian market and also arranged feasibility studies, industry analysis and project evaluation for potential projects identified by the AEs. The taxpayer also helped the AE in taking sale and purchase decisions. Unique intangibles were developed which gave advantage to its AEs and usage cost was not taken into consideration in receiving compensation. TPO held that the taxpayer was not adequately compensated by its AEs and that PSM must be applied for determining the ALP of the international transactions under this segment. The TPO placed reliance on the Tribunal ruling of Li & Fung (India) Pvt. Ltd. v. DCIT [2012] 143 TTJ 201 (Del). Based thereon, the taxpayer was required to be compensated in the total profits on the Freight On Board (FOB) value of the goods transacted by foreign AEs, in the ratio of 70:30, in favour of the taxpayer, and arrived at a value of INR301.4 million as a share in profits. The DRP upheld the TPO's order. Aggrieved, the taxpayer filed an appeal before the Tribunal.

The Tribunal held as follows:

- The Tribunal stated that the contentions made by the TPO that the taxpayer assuming substantial risks, performing critical functions for its AEs, and allowing the use of its highly-valued intangibles to such AEs are all in air without any bedrock. There was absolutely no evidence to support the findings.
- As the TPO could not provide any evidence of the taxpayer assuming high level of risks or creating unique intangibles, a PSM could no longer be adopted.
- The TPO initially denied the taxpayer's TNMM benchmarking study and carried out its own study, but did not disclose anything about the same. Hence, this issue was restored to the AO/TPO for arriving at the ALP afresh. However, it found strength in the TPO's claim of denying use of multiple year data.

Marubeni Corporation, Japan (ITA No: 5397/Del/2012)

Indirect tax

Service tax - Decisions

Rejection of declaration under the Voluntary Compliance Encouragement Scheme (the scheme) owing to the shortfall in depositing the first installment (viz. 50 per cent of the tax dues) by 31 December 2013 is valid.

In the instant case, the question was that if the declarant has defaulted in discharging the first installment of the tax declared under the scheme (on or before the due date i.e. 31 December 2013), then whether such declaration would be rejected.

The High Court held that the scheme makes no difference between tax dues which are short-paid due to bonafide error and deliberate inaction and the High Court has no power in writ for waiving/relaxing the condition of depositing first installment flowing from statute. Also, if the shortfall could be accepted with the interest, there was no need to make special provision for extending time deposit for the second installment along with interest upto 31 December 2014. Therefore, rejection of declaration due to failure to fulfill essential requirement of the scheme was held to be valid.

Ramilaben Bharatbhai Patel v. UOI [TS-190-HC-2014(GUJ)-ST]

Computerised Reservation Services received by the Indian branch office of foreign airlines from foreign companies not liable to Service tax during period 18 April 2006 to 31 May 2008.

In the instant case, the issue was that whether Computerised Reservation Services (CRS) received by the Indian branch office of foreign airlines from foreign companies is liable to Service tax under the reverse charge mechanism.

The Delhi Tribunal observed the following:

- CRS are in the nature of 'Online Information and Database Access or Retrieval Service';
- The Indian branch office and foreign airlines would be construed as different legal persons in terms of the Service tax law;
- The foreign airlines would be construed as the service recipient and not Indian branch office since the contract is between foreign airlines and foreign companies.

Accordingly, the Tribunal held that CRS received by Indian branch office of foreign airlines from foreign companies would not be liable to Service tax.

British Airways v. Commissioner (ADJN), Central Excise [2014-TIOL-979-CESTAT-DEL]

Central Excise - Decisions

The amendment of definition of 'input services' by way of deleting the expression 'activities relating to business' is prospective in nature

In the present case, the taxpayer had availed CENVAT Credit in respect of courier service, landline/mobile phone services and insurance of plant and machinery during the period prior to April 2011.

The Central Excise authorities denied the credit on the aforementioned input services on the ground that these services have no nexus with the manufacture of final product and also, the amendment made to Rule 2(l) of CENVAT Credit Rules, 2004 (effective from 1 April 2011) by which the expression 'activities relating to business' in the inclusive portion of the definition of 'input services' was deleted, is clarificatory in nature and hence, would apply even for the period prior to 1 April 2011 also.

In this background, the Delhi Tribunal held that an amendment which restricts the definition of 'input services', and thereby restricting the availability of CENVAT credit to an assessee cannot be given retrospective amendment when there is no such intention expressed in the amending provision and accordingly, credit could be availed in respect of the aforesaid services.

J K Cement Works v. CCE [2014-TIOL-848-CESTAT-DEL]

Rebate cannot be claimed, in case the duty is not paid before clearance of the goods for exports

In the present case, the taxpayer had exported goods in the month April 2009 to August 2009 and had paid the relevant duty on such clearances, under the provisions of Rule 8 of the Central Excise Rules, 2002 (the Excise Rules) in December 2009 along with interest. The taxpayer has subsequently claimed the duty paid as rebate under the provisions of Rule 18 of the Excise Rules.

The Central Excise authorities have rejected the rebate claim on the ground that as per Notification No.19/2004-C.E – NT (which deals with export of goods under the claim of rebate), the duty should have been paid before clearance of the goods for exports.'

In this background, the Delhi High Court held that one of the conditions for granting of rebate under Rule 18 of the Excise Rules is that the excisable goods should be exported after payment of duty and this mandatory condition for availing of the rebate cannot be waived on any equitable consideration and accordingly, rebate cannot be granted in this case.

Sandhar Automotives v. Joint Secretary, GOI & Others [2014-TIOL-826-HC-DEL-CX]

Customs Duty - Decisions

Duty cannot be remitted for an EOU unit, in case the goods destroyed are not insured to cover the duty portion also.

In the present case, the taxpayer is operating as an Export Oriented Unit (EOU). In fire the raw materials as well as finished products were damaged. The Customs authorities demanded duty on the raw materials contained in the finished products which were destroyed and also on the raw material which were damaged.

The taxpayer sought remission of duties on the ground that the condition of the exemption notification is not violated in as much as the goods were utilis ed for the manufacture of finished products. However, in view of the destruction of the finished products due to fire, the condition of export of finished products became impossible and accordingly, the duties payable is eligible for remission under Section 23 of the Customs Act, 1962 (the Customs Act).

In this background, the Mumbai Tribunal held that one of the conditions of the licence and warehousing bond executed by the appellant is that the taxpayer shall insure the goods against theft, pilferage, fire accident and other natural calamities at least for a value equal to the Customs duty by a warehousing insurance policy drawn in favour of the Commissioner of Customs. In the instant case, the taxpayer failed to insure the materials for that part of the value representing the duty and insured only to the extent of basic value of the goods. Therefore, having breached the terms and conditions of the licence and bond which were issued under Section 58, 59 and 65of the Customs Act, the taxpayer cannot seek to claim benefit under Section 23 of the Customs Act by remission of duty, as Section 23 is a general provision whereas Section 58, 59 and 65 of the Customs Act are specific provisions relating to warehousing and manufacture-in-bond. Accordingly, taxpayer is not eligible for the duty remission.

Sandoz Private Limited v. CCE [2014-TIOL-933-CESTAT-MUM]

Foreign Trade Policy

Trade Notices

Online complaint resolution system relating to EDI issues.

An online complaint resolution system relating to electronic data interchange (EDI) issues have been established where users can file online complaints. A key number for each complaint will be generated, which can be followed up by the users and Directorate General of Foreign Trade (DGFT) officials for early resolution of issues. If the issue is not resolved in five working days, an email may be sent to Shri Anil Kumar Sinha, DDG (NIC) – anilksinha@nic.in

Trade Notice No. 10/2014 dated 04 June 2014

VAT – Decisions

The supply, erection, installation and commissioning of lifts/elevators constitute 'works contracts' and not 'contracts for sale.'

The issue involved in the present case was whether the supply, erection, installation and commissioning of lifts/elevators constituted 'works contracts' or 'contracts for sale'.

The taxpayer is engaged in the manufacture, supply and installation of lifts involving civil construction. For the AY 1995-96, the Sales Tax Appellate Tribunal, Andhra Pradesh held that the supply, erection, installation and commissioning of lifts/elevators is in nature of works contract. On a revision filed, the High Court of Andhra Pradesh affirmed the view of the Tribunal.

Aggrieved by the High Court decision, the State of Andhra Pradesh filed a special leave petition before the Supreme Court wherein it was held that the above transaction is a sale. Being aggrieved by the said order, the petitioner filed a writ petition before the Supreme Court (5-judge bench).

The Three Judge Bench of Supreme Court had earlier held that the activity of supply and installation of lifts constitutes a sale of goods. However, now by way of a majority view, the Constitution Bench (consisting of five members) overruled the said judgment and held that a composite contract for the supply and installation of lifts has to be treated as a works contract and not as a sale of goods/chattel.

The observations of the Constitution Bench are as follows:

- The Constitution bench referred to the decision given in the case of Otis Elevators wherein it was held that the contract for the manufacture, supply, installation and commissioning of lifts was an indivisible contract for the execution of the works contract and there was no sale of goods.
- Upon installation of the lift in the building, it becomes a permanent fixture in the premises and that the involvement of technical skill and experience pertain to the precision in execution for rendering satisfactory service and the obligation to maintain which are integral to the supply and installation.
- The bench then referred to the earlier Three Judge Bench decision, whereby the Constitution bench observed that once there is a composite contract for supply and installation, it must not be treated as chattel or sold as chattel.
- In the present case, the contract itself speaks of the obligation to supply goods and materials as well as the installation of the lift. Hence, fundamental characteristics of works contract are satisfied.

Kone Elevators India Pvt Ltd vs. State of Tamil Nadu and Others [TS-142-SC-2014-VAT]

Notifications/Circulars/Press release

Andhra Pradesh

With effect from 2 June 2014, the following amendments have been made in the Andhra Pradesh Value Added Tax (VAT) Rules, 2005:

- For registrations issued or reissued in the month of June 2014, the effective date for registration shall be 2 June 2014;
- The return in prescribed Form VAT 200 for the tax period from 2 June 2014 to 30 June 2014 should be filed on or before 20 July 2014;
- For general registration number (GRN)/turnover tax (TOT) dealers, the calendar quarter for the return to be filed in Form TOT 007, for the quarter ended June 2014 shall cover transactions for the period 1 April 2014 to 1 June 2014 and shall be filed on or before 31 July 2014. Further, the succeeding calendar quarter shall be the period from 2 June 2014 to 30 September 2014 and the return shall be filed on or before 31 October 2014.

Notification G.O. Ms. No. 248 dated 30 May 2014

Jharkhand

With effect from 29 May 2014, the composite rate of tax on works contract has been increased from two to four per cent.

Notification No. S.O. 5 dated 29 May 2014

Karnataka

Sub section (5) was recently inserted to Section 31 of Karnataka Value Added Tax Act, 2003 requiring every registered dealer to furnish an annual statement relating to his turnover in the form and manner to be prescribed. However, the rules and format of such statement are yet to be notified. Accordingly, a Circular has been issued by the Commissioner of Commercial Taxes directing the departmental officers not to insist upon the dealers to file the annual statement for FY 2013-14 till the rules are notified in this regard.

Circular No. 05/2014-15 Dated 23 May 2014

Orissa

Certain instructions have been issued in relation to declaration forms, which are as under:

- Once assessing authority is satisfied that the primary objective of Form C i.e. 'goods are dispatched to other states and the same are accounted for by the dealer of other states' is met, the assessing authority may accept Form C as valid;
- Form C can be accepted as valid relating to goods delivered in quarter, based on the date of dispatch or date of receipt of goods in other State or date of invoice or combination of all the three;
- Similarly, in case of Form F, all transfer of goods in one calendar month can be accepted either based on dispatch dates of goods or based on the receipt date of goods in other State or combination of both.

Instruction No. III (I) 38/09 - 8445/CT dated 24 May 2014

Punjab

- A public notice has been issued wherein the department has proposed to accept data regarding stock/Input Tax Credit tax slab wise as per the format prescribed in the notice. The said worksheet is required to be appended to Form VAT-15.
- Input Tax Credit (ITC) will be worked out by the system automatically on the figures given in the said worksheet. Further, ITC on capital goods will be allowed in the manner already existing prior to the said amendment

Public Notice dated 11 June 2014

Personal tax

Decisions/Circulars/Notifications/ Press releases

The AAR holds that lump sum contribution to Defined Benefit Superannuation Scheme is not taxable in the hands of individual employees

Recently, the Authority for Advance Rulings (AAR) in the case of Royal Bank of Scotland held that a lump sum contribution (based on actuarial valuation) by the employer to an employee's Defined Benefit Superannuation Scheme is not taxable in the hands of each employee.

In its judgement, the AAR has placed reliance on the Supreme Court ruling in the case of L.W. Russel, and the Delhi High Court rulings in the case of Mehar Singh Sampuran Singh Chawla and Yoshio Kubo.

The Royal Bank of Scotland (AAR No. 964 of 2010)

The Delhi Tribunal extends the benefit of 182 days for the determination of residential status for self-employed professionals going abroad

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of Jyotinder Singh Randhawa (the taxpayer), granted the benefit of extending stay period from 60 days to 182 days treating an Indian citizen who leaves India for the purpose of employment as a non-resident under the Act. The taxpayer was a self-employed professional.

As per the Act, an individual is said to be resident in a given financial year if his stay exceeds 60 days in that year, together with 365 days or more in the four years preceding that year. Further, the 60 days may be extended to 182 days in case of an Indian citizen who leaves India in any previous year as a member of the crew of an Indian ship or for the purposes of employment.

Jyotinder Singh Randhawa v. ACIT (ITA No. 4895/Del/2012, AY 2009-10)

The Employees' Provident Fund Organisation issues guidelines on surcharge to be levied for investment deviations and re-auditing of accounts for private provident fund trusts

Recently, the Employees' Provident Fund Organisation (EPFO) has issued two circulars for securing proper compliance in respect of establishments permitted to run in-house PF Trusts under the EPF Act:

- Guidelines on the rate of surcharge to be levied on the Board of Trustees of exempted/relaxed establishments under the EPF Act for deviation from the prescribed pattern of investment.
- Re-auditing of accounts of provident funds maintained by Exempted and Relaxed establishments under the EPF Act.

The decision by the PF authorities that the past cases of investment deviations will be regularised by levy of nominal surcharge is a welcome relief for the industry since many establishments had to move from an in-house PF trust to the statutory fund in the past for investment deviations.

The PF authorities have made a distinction between investment deviation (within permitted asset classes) and investment violation (investments in asset classes not permitted in investment pattern). Establishments running in-house PF trusts should be more vigilant on their investments and other governance issues as the PF office is now monitoring the functioning of private PF trusts vigorously.

Source: www.epfindia.com

Liberalisation of visa guidelines

Earlier this year, the Ministry of Home Affairs (MHA), Government of India, liberalised the visa guidelines and ensured that changes made over the years are compiled into a single document.

Now MHA has made another favourable move by introducing additional changes to the employment, business and project visa guidelines, which include certain relaxations and a grant of additional powers to the jurisdictional Foreigners' Registration Office (FRRO/FRO).

The changes introduced by the MHA seem to be a result of series of deliberations and discussions based on their practical experience and the issues faced. Delegation of powers of visa extension and visa conversion to the State Government/UT Administration was the need of the hour and could go a long way to reduce the visa processing turnaround time.

Companies and foreign nationals should take note of the amended guidelines and make the best use of the new version.

Source: www.mha.nic.in

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