TAX HIGHLIGHTS

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Permanent Establishment

International circuit for Formula One championship constitutes a fixed place PE under the India-U.K. tax treaty

The Supreme Court in the case of Formula One World Championship Ltd. dealt with the issue that whether the international circuit for formula one race constitutes a fixed place of business under the India-U.K. tax treaty. Further whether such international circuit was under the control and at the disposal of the taxpayer. The Supreme Court observed as follows:

- On a combined reading of Article 5(1), 5(2), 5(3) of the tax treaty, it indicates that only certain forms of establishment would not form a Permanent Establishment (PE) that are excluded in Article 5(3) of the tax treaty. Article 5(2) uses the word 'include' which means the list is not exhaustive and it may include the places which are not specified therein as PE. In order to bring any other establishment which is not specifically mentioned, the requirements laid down in Article 5(1) of the tax treaty are to be satisfied. Twin conditions which need to be satisfied are: (i) existence of a fixed place of business; and (ii) through that place of business an enterprise is wholly or partly carried out its business.
- It cannot be denied, that Buddh International Circuit is a fixed place. From this circuit different races, including the Grand Prix is conducted, which is undoubtedly an economic/business activity.
- There cannot be any race without participating/competing teams, a circuit and a paddock. All these are controlled by the taxpayer and its affiliates. An event has taken place by conduct of race physically in India. Entire income is generated from the conduct of this event in India. Thus, commercial rights are with the taxpayer which are exploited with actual conduct of race in India.
- Even the physical control of the circuit was with the taxpayer and its affiliates from the inception, i.e. inclusion of event in a circuit till the conclusion of the event. Omnipresence of the taxpayer and its stamp over the event is loud, clear and firm.
- As per Philip Baker, a PE must have three characteristics: stability, productivity and dependence. All characteristics are present in the present case. Fixed place of business in the form of physical location, i.e. Buddh International Circuit, was at the disposal of the taxpayer through which it conducted business. Aesthetics of law and taxation jurisprudence leave no doubt that a taxable event has taken place in India and a non-resident taxpayer is liable to pay tax in India on the income earned.
- The Supreme Court rejected the taxpayer's contention that since the duration of the event was only three days, the total duration for which limited access was granted to it was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE. The Supreme Court observed that the question of the PE has to be examined keeping in mind that the aforesaid race was to be conducted only for three days in a year and for the entire period of the race the control was with the taxpayer.
- Also rejected the taxpayer's contention that it was Jaypee who was responsible for conducting races and had complete control over the event and clarified that mere construction of track by Jaypee or its ownership or organising other events is immaterial.

Formula One World Championship Ltd v. CIT [2017] 394 ITR 80 (SC)

For further details, please refer to our Flash News dated 28 April 2017 available at this link

Indian subsidiary of a foreign company providing back office support services does not constitute a PE in India under India-USA tax treaty

The taxpayers are companies incorporated in U.S. They were assessed and have paid taxes on their global income in U.S. The taxpayers were engaged in the four businesses, namely, ATM management services, electronic payment management, decision support and risk management and global outsourcing and professional services. e-Fund India had performed back office

operations in respect of the first three. Both the taxpayers have entered into international transactions with e-Fund India.

The Assessing Officer (AO) held that income of the two taxpayers were attributable to India because the two taxpayers had a PE in India and should be taxed in India, irrespective of whether the said taxpayers had paid taxes in U.S. Income earned and taxed in the hands of e-Fund India was different from the income attributable to the two taxpayers. Thus, the income attributable to the two taxpayers, which was not included in income earned and taxed in the hands of e-Fund India, should be taxed in India. The AO held that the taxpayers had a fixed place PE from where they carried on their own business in India. Consequently, the taxpayers were liable to pay tax in respect of what they earned from the aforesaid fixed place PE in India.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that Article 5 of the tax treaty was attracted, not only because there was a fixed place business, but also because they were 'Service PEs' and 'Agency PEs' under Article 5 of the tax treaty. Subsequently, the Tribunal held that the CIT(A) was right in holding that a 'fixed place PE' and 'service PE' had been made out under Article 5 of the tax treaty. The High Court held in favour of the taxpayers. The High Court held that the Indian subsidiary does not create a fixed place PE under the tax treaty. Merely because the non-resident taxpayer to protect their interest, for ensuring quality and confidentiality has sent its employees to provide stewardship services, will not make the Indian subsidiary or another entity, a PE even if the employees of the non-resident taxpayer were taken on deputation. The High Court held that the activities, which were not undertaken by e-Fund India and the assets of the taxpayers located outside India, cannot be taken into account or attributed for earning/income of the taxpayers.

Supreme Court's decision

Fixed place PE

- There must exist a fixed place of business in India, which is at the disposal of the U.S. companies, through which they carry on their own business. In the present case there is, no specific finding in the assessment order or the appellate orders that applying the aforesaid tests, any fixed place of business has been put at the disposal of these companies.
- The High Court has dealt with this aspect in more detailed manner and held that the lower authorities have primarily relied upon the close association between e-Fund India and the taxpayer and applied functions performed, assets used and risk assumed (FAR) criteria to determine whether or not the taxpayer has fixed place of business. This is not a proper and appropriate test to determine the location PE. The allegation that e-Fund India did not bear sufficient risk is irrelevant when deciding whether location PE exists.
- Similarly, the High Court held that the direct or indirect costs and corporate allocations in software development centre or BPO does not help or determine location PE. Assignment or sub-contract to e-Fund India is not a factor or rule which is to be applied to determine applicability of Article 5(1) of the tax treaty. Subsidiary company will not become location PE under Article 5(1) merely because there is interaction or cross transactions between the Indian subsidiary and the foreign Principal under Article 5(1) of the tax treaty.
- No part of the main business and revenue earning activity of the two American companies is carried on through a fixed business place in India which has been put at their disposal. The Indian company only renders support services which enable the taxpayers in turn to render services to their clients abroad. This outsourcing of work to India would not give rise to a fixed place PE and the High Court decision is, therefore, correct on this score.

Service PE

- The Supreme Court observed that the requirement of Article 5(2)(l) of the tax treaty is that an enterprise must furnish services 'within India' through employees or other personnel. None of the customers of the taxpayer are located in India or have received any services in India. All its customers receive services only in locations outside India. Only auxiliary operations that

facilitate such services are carried out in India. Therefore, it is clear that the first ingredient contained in Article 5(2)(l) is not satisfied. Therefore, the taxpayer did not have Service PE in India.

Agency PE

- Before the Supreme Court, the taxpayer argued that the 'agency PE' aspect of the case need not be gone into as it was given up before the Tribunal. The taxpayer is right as no argument on this score is found before the Tribunal. However, the Supreme Court observed that for the sake of completeness, it is only necessary to agree with the High Court, that it has never been the case of revenue that e-Funds India was authorized to or exercised any authority to conclude contracts on behalf of the US company, nor was any factual foundation laid to attract any of the said clauses contained in Article 5(4) of the tax treaty.

Profit attribution

- The Supreme Court in the case of Morgan Stanley held that the object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2) of the tax treaty, not all profits of foreign company would be taxable in India but only those which have economic nexus with PE in India. A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the PE in India. The Supreme Court held that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE. If transfer pricing analysis does not adequately reflect the FAR by the enterprise, there would be a need to attribute profits to PE for those functions/risks that have not been considered.
- The taxpayer is correct in stating that as the arm's length principle has been satisfied in the present case, no further profits would be attributable even if there exists a PE in India.

MAP proceedings

- The taxpayer has referred to paragraph 3.6 of the Organisation for Economic Co-operation and Development (OECD) Manual on Mutual Agreement Procedure (MAP)[1]. A perusal of the same would indicates that a competent authority should engage in discussion with the other competent authority in a principled, fair and objective manner, with each case being decided on its own merits. The Supreme Court observed that where an agreement is not otherwise achievable, then both parties should look for appropriate opportunities for compromise in order to eliminate double taxation on the facts of the case, even though a principled approach is important.
- The High Court had held that the MAP procedure and agreement of earlier year is relevant but cannot be the primary basis to decide whether the taxpayer had PE in India. Whether or not PE exists is a matter of law and fact, and there has to be determination of the said issue on merits. The Supreme Court held that MAP cannot be considered as a precedent for subsequent years, and the High Court's conclusion on this aspect is correct.

ADIT v. E-Funds IT Solution Inc. [2017] 86 taxmann.com 240 (SC)

For further details, please refer to our Flash News dated 28 October 2017 available at this link

Indian subsidiary of group holding company of Netherland entity does not constitute permanent establishment in India

The taxpayer is a non-resident company engaged in the business of selling storage system equipments and products including embedded software and rendering certain services in India.

[1] OECD Manual on MAP Procedure provides that competent authority agreements or resolutions are often case and time specific. They are not considered precedents for either the taxpayer or the tax administrations in regard to adjustments or issues relating to subsequent years or for competent authority discussions on the same issues for other taxpayers. In fact, the letters exchanged between competent authorities to resolve a case often state as much. This is because the competent authorities have reached an agreement that often takes into account the facts of the particular taxpayer, the differences in the provisions of the tax law in each country, as well as the effects of the economic indicators on the particular transactions at the relevant time. Any review or adjustments of subsequent years by a taxpayer or tax administration is best based upon the particular circumstances, facts and documentary evidence existing for those years

The taxpayer sales NetApp products and services in India through third party distributors who are appointed on non-exclusive basis and they purchases NetApp products and services from the company on principal to principal basis and resale the same to customers or to other resellers. The taxpayer also provides services through Netapp India private limited, subsidiary of NetApp US company in terms of agreements entered with them by the taxpayer. The company also engages in direct sales contracts and the title of the goods passes directly to the customer to enable them to claim indirect taxes such as customs, etc. However, the distributor is responsible for the sale process. The taxpayer earns income in India from sale of storage products, sale of subscriptions and provision of support services. The taxpayer also provides installation, warranty and professional services with respect to data migration, data integration and disaster recovery services.

The AO held that the taxpayer has a business connection in India under Section 9(1) of the Act. It was also held that the taxpayer has a PE in India under Article 5 of the India-Netherlands tax treaty because of existence of NetApp India. Payment received by the taxpayer towards licensing of the software are taxable as royalty and further this software payment are effectively connected with the PE in terms of Article 12 and 7 of the tax treaty, the same shall be chargeable to tax as business income in India. With regard to service fees on account of services rendered to its Indian clients, the AO was of the view that the services are predominately technical in nature and further, it is falling within the definition of royalty. It is also effectively connected to the PE of the taxpayer, therefore chargeable to tax under Article 7 of the tax treaty. The AO contended that part of the profits arising from payment towards hardware is also attributable to the activities of the PE in India. Accordingly, attributed 90 per cent of the profit applying the gross profit margin of 26 per cent to the PE.

Tribunal's ruling

Subsidiary PE

- The taxpayer has not deputed any of its personnel in India and also the directors of the Indian company have not functioned for the business of the taxpayer. Further, the control over the financial and administrative activities of Indian company by the taxpayer i.e. the Indian company shall account for expenditure and receipts, and shall also report and provide general administrative services to the taxpayer, cannot be result into the control over the Indian entity by the taxpayer resulting into PE. Therefore it cannot be said that taxpayer controls or is controlled by the Indian company or vice a versa.

Fixed place PE

- The AO has not put forth any evidence which leads to the fact that it is not the business of the Indian company, but it is the business of the taxpayer being carried out in India through the Indian entity.
- The Indian company is a separate legal entity, which has its own board of directors, premises, employees, contracts, etc. and the employees of Indian company work under the control and supervision of Indian company only and not the taxpayer for provision of its services to the taxpayer.

Agency PE

- Common directors of the taxpayer and Indian company are not engaged in the day-to-day activities of the taxpayer's renegotiation of any contracts or performing any marketing functions in India on behalf of the taxpayer. Merely because there are common directors, one cannot say that the Indian company has an authority to conclude contracts on behalf of taxpayer. Even otherwise the common director and holding of the company by itself does not constitute either company as a PE of the other as per Article 5(6) of the tax treaty.
- For holding PE in terms of Article 5(5) of the tax treaty, it is imperative that the agent has and is habitually exercising that authority to conclude contracts on behalf of the taxpayer. The tax department failed to establish with credible evidence that such authority is vested in Indian company and Indian company habitually exercises that authority. The activities of Indian entity

are only part of its marketing support services and are for the business of the Indian entity and cannot be said that they are made for sales in India by the taxpayer through Indian entity.

- With respect to the purchase orders the Indian entity do not solicit or accept purchase orders on behalf of the appellant but the purchase orders raised on the appellant are through distributors. The receipt of the purchase orders by the Indian entity is only for facilitation for onward transmission to the taxpayer. In this aspect, the revenue has totally ignored the functions performed for getting purchase orders by the distributors. Even otherwise this function alone do not constitute PE under the provisions of the double taxation avoidance agreement.
- In view of above, the Tribunal observed that the taxpayer does not have agency PE in India.

BEPS

- Further BEPS Action point 7 is also on the issue to address the tax experience that the foreign enterprise is able to avoid the application of Article 5(5) of the OECD Model Tax Convention, to the extent that the contracts concluded by the person acting as a commissionaire are not binding on the foreign enterprise. Since Article 5(5) relies on the formal conclusion of contracts in the name of the foreign enterprise, it is possible to avoid the application of that rule by changing the terms of contracts without material changes in the functions performed in a State.
- Commissionaire arrangements as it is in the present case have been major pre-occupations of tax. In most of the cases that went to court, the tax administration's arguments were rejected. The only answer to that would be factually establishing the role of the Indian companies regarding their actual authority of concluding the contracts.

Service income

- As the services rendered by the taxpayer are installation services, warranty services and professional services. It cannot be said that they are made available to the customers using Net app BV products. In fact, the warranty service is taken by the buyer of the product to keep the goods purchased in good condition for its lifespan.
- In view of this the argument of the tax department that such services fees are chargeable to tax as Fees for Technical Services (FTS) was rejected.

Income from sale of hardware

- As the taxpayer did not have a PE in India, the income of the taxpayer was not chargeable to tax with respect to sale of the hardware products in India.

NetApp B. V. v. DDIT [2017] 78 taxmann.com 97 (Del)

For further details, please refer to our Flash News dated 15 February 2017 available at this link

Liaison office of overseas group entity constitutes fixed place PE and Indian subsidiary constitutes agency PE under the India-USA tax treaty

The taxpayer is a US company and is a part of the GE Group. The taxpayer supplies equipment to customers in India relating to oil and gas business, energy business, transportation business and aviation business. The taxpayer is engaged in various sales activities in India, for which the business heads are generally expatriates, who are appointed to head Indian operations, with the support staff provided by GE India and also by various third parties. These expatriates are on the payroll of GE International Inc. (GE) but working for various businesses of GE group. One of the group entity of the taxpayer was having Liaison Office (LO) in India to undertake liaison activities. LO had entered into a Global Service Agreement (GSA) with an Indian company to provide certain support services to the group company. It does not include commercial activities.

A survey was conducted by the tax authorities at the premises of LO whereby certain documents were found. On the basis of information gathered during the course of survey, it was revealed that in addition to the liaison activities, the taxpayer has provided commercial and trading activities. The AO observed that marketing and sales activities took place in India. Expatriates from GE were involved and participated in the negotiation of prices. Such negotiations of prices took place in

India. The AO also held that the taxpayer had fixed place PE as well as a dependent agent PE in India. Since the taxpayer was making sales in India with the involvement of its PE in India, the profits attributable to such PE were chargeable to tax. The AO deemed 10 per cent value of supplies made to the clients in India as the profits arising from such supplies and 35 per cent of such profit was attributed to the PE in India.

Tribunal's ruling

Fixed place PE

- GE India comprising expatriates from GE were permanently using the LO premises of the group entity. Though the LO premises was taken on lease by the group company, the same was also being constantly occupied by these expatriates, who, though on the payroll of GE, were working in India for the GE Overseas entities. The said premises was also occupied by the employees of other group company of the taxpayer who were working under the direct control and supervision of the expatriates.
- From the job descriptions and appraisal reports with the manager assessment, it indicates that the expatriates were India Country heads or working at the top positions, managing the business, securing orders and doing everything possible that could be done here qua the Indian operations of GE overseas entities in India.
- On reference to the emails found during the course of survey, it indicates that GE India was in full command of the sales activities in India and not allowing GE overseas even to interfere with what they had agreed with the customer in India.
- The activities carried on by GE India from the LO premises were of substantial and core and not merely preparatory or auxiliary. All the three conditions for constituting a fixed place PE under Article 5 of the tax treaty are fully satisfied as LO premises is a fixed place from which business of GE Overseas is partly carried on in India and the activities carried out from such fixed place are not of preparatory or auxiliary character.

Agency PE

- The expatriates of GE and employees of other group company were appointed to act as agent of multiple GE overseas enterprises. Although the number of GE overseas entities looked after by each of them is more than one, the fact that such entities were in one of the three broader lines of businesses of GE group, makes them agents of dependent status per se.
- Para 26 of OECD commentary, though dealing with the activities of preparatory or auxiliary nature, also acknowledges that a fixed place of business which renders services to more than one company would not fall in exemption provided in Article 5 of the tax treaty and hence, constitute PE. Therefore, it has been held that GE India consisting of expatriates of GE and employees of other group companies, etc., are the persons covered in Article 5(4) acting in India on behalf GE Overseas entities.
- Having discussed the nature of activities done by GE India, which are of core nature and not merely preparatory or auxiliary, it has been held that they clearly indicate its authority to conclude contracts on behalf of GE Overseas. Therefore, GE India constituted agency PE of all the GE Overseas entities in India.

Attribution of income

- There can be no hard and fast rule of attribution of profit to marketing activities carried out in India at a particular level. Attribution of profits to PE in India is fact based, depending upon the role played by the PE in the overall generation of income. Such activities carried out by a PE in India resulting in generation of income, may vary from case to case. Attribution of income has to be in line with the extent of activities of PE in India.
- The Tribunal estimated 26 per cent of total profit in India as attributable to the operations carried out by the PE in India. Therefore, as against the AO applying 3.5 per cent to the amount of

sales made by the taxpayer in India, it has been directed to apply 2.6 per cent on the total sales for working out the profits attributable to the PE in India.

GE Energy Parts Inc. v. ADIT [2017] 56 ITR(T) 51 (Del)

For further details, please refer to our Flash News dated 1 March 2017 available at this link

A foreign company constitute Service PE in India under the India-UAE tax treaty. Services provided in the form of sharing or permitting to use the special knowledge or expertise falls within the term 'royalty' under the tax treaty

The taxpayer is UAE based entity engaged in the business of providing regional service activities for the benefit of ABB legal entities in India, Middle East and Africa. In pursuance of the regional headquarter service agreement between the taxpayer and ABB Limited, the taxpayer rendered services to ABB Limited during FY 2009-10 and 2010-11. In terms of the agreement, the taxpayer has received payment from its associate concern. The taxpayer claimed that the above amounts is not taxable in India under the tax treaty, as the tax treaty does not have a clause for FTS. Since this clause has been specifically excluded from the treaty, the taxability would fall under Article 22 of the India-UAE tax treaty. As per Article 22 of the tax treaty the amount would be taxable in India only if the entity has a PE in India and in the instant case since there is no PE in India, the sum is not liable to be taxed in India.

The AO held that the services rendered by the taxpayer would be treated as FTS both under the Act and under the tax treaty as prescribed under Explanation 2 to Section 9(1)(vii) of the Act. In an alternative argument, the AO held that most of the services rendered by the taxpayer were covered under the definition of 'royalty' as per the Explanation 2(ii), 2(iv) and 2(vi) under Section 9(1)(vi) of the Act, as well as under Article 12(3) of the tax treaty. The Dispute Resolution Panel (DRP) confirmed the order of the AO.

The Bengaluru Tribunal held that the taxpayer was having Service PE in India since the taxpayer has been furnishing services to the Indian company even without any physical presence of its employees in India. In the present age of technology the services, information, consultancy, management, etc. can be provided with various virtual modes like email, internet, video conference, remote monitoring, remote access to desktop, etc., through various software. Service PE is not dependent upon the fixed place of business as it is only dependent upon the continuation of the activity.

The Tribunal also held that the services provided by the taxpayer were in the form of sharing or permitting to use the special knowledge, expertise and experience of the taxpayer and it falls under the term 'royalty', under Article 12(3) India-UAE tax treaty. The visits of the officials of the taxpayer was only for the purposes of providing access for using the information pertaining to industrial/commercial/scientific experience and to help to commercially exploiting it. The dominant character of agreement between the taxpayer and Indian company was for sharing secret, confidential and Intellectual Property Rights (IPRs) information made available. The Tribunal observed that tax treaty clearly uses the word for the 'use of' or 'right to use of', commercial, scientific equipment and has not used the word either 'imparting' or 'alienation' of knowhow. The language used in the tax treaty is plain and unambiguous and therefore reading of words 'alienation' or 'imparting' of know-how in the tax treaty would not be permissible.

ABB FZ-LLC v. DCIT [2017] 166 ITD 326 (Bang)

For further details, please refer to our Flash News dated 6 July 2017 available at this link

Royalty and Fees for Technical Services

Payment for granting distribution right of 'Adwords program' is taxable as 'royalty' under the Act as well as under the India-Ireland tax treaty

The taxpayer (Google India) is the wholly owned subsidiary of Google International LLC, US (GIL). Google India is appointed as a non-exclusive authorised distributor of 'Adwords programs' to the

advertisers in India by GIL. Under the Google Adwords Program Distribution agreement, Google India was granted the marketing and distribution rights of Adwords program. The taxpayer made payment to GIL for granting distribution right of 'Adwords programme' without deducting tax at source. Hence, AO made disallowance under Section 40(a)(i) of the Act, which was further confirmed by CIT(A). The AO treated the amount as royalty under the Act as well as under the India-Ireland tax treaty. According to the AO, the 'distribution rights' are 'Intellectual Property rights' covered by 'similar property' [under the ambit of royalty definition under Explanation 2 to Section 9(1)(vi)] and the distribution fee payable is in relation to transfer of distribution rights.

The Bangalore Tribunal observed that GIL is allowing Google India access to all intellectual property and confidential information which is used by the Google India for activities related to distribution agreement. Google India is also having right, title and interest over the IPR of Google. With the help of I.P. address, Google search engine is having the access to various information and data pertaining to the user of the website in the form of name, sex, city, state, country, phone number, religion, etc. Besides the above basic information, the Google is also having the access of the history of the users as well as to the behavior of the persons searching Google search engine. The agreement between the taxpayer and the GIL does not merely work by providing the space in the Google search engine, but it works only with the help of various patented tools and software. It is not merely an agreement to provide the advertisement space but is an agreement for facilitating the display and publishing of an advertisement to the targeted customer. IP of Google vests in the search engine technology, associated software and other features, and hence use of these tools for performing various activities, including accepting advertisements, providing before or after sale services, clearly fall within the ambit of royalty.

Further the Tribunal held that the taxpayer cannot claim that the royalty is chargeable to tax in the hands of the non-resident on receipt basis. In the present case, though it is not the concern of the taxpayer as to which method is being following by the GIL yet, noting that GIL is following the mercantile method of accounting, the chargeability of tax would be in the year when it is accrued and not in the year when it was received. It is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged.

With respect to proceeding under Section 201 of the Act, the Tribunal observed that in absence of any direct jurisdictional High Court decision and taking note of various contrary decisions post amendment under Section 201, the period of limitation for initiation of proceedings for resident as well as non-resident under Section 201 should be 6 years from the end of the financial year. The Tribunal relying on the non-discrimination clause under the tax treaty observed that it cannot be said that a non-resident would be given special and beneficial treatment in comparison to the resident or treated unequally by providing unlimited time to initiate proceedings under section 201 of the Act. If the law requires initiation of proceedings within 6 years from the end of financial year for the resident, the same treatment is required to be given to the non-resident.

Google India Private Ltd. v. ACIT [2017] 86 taxmann.com 237 (Bang)

For further details, please refer to our Flash News dated 27 October 2017 available at this link

Payments to foreign entities are not taxable as fees for technical services in view of MFN clause under India-Belgium tax treaty

During the year under consideration the taxpayer had made certain remittances towards technical consultancy and professional services without deducting tax at source. The AO had passed order under Section 201(1) and 201(1A) read with Section 195 of the Act stating that payments made by the taxpayer to the U.S.A., Canada and Belgium entities were in the nature of FTS within the meaning of Section 9(1)(vii) of the Act. The AO observed that the payment made to the foreign parties were taxable in India under India-U.S.A. and India-Canada tax treaty as the services were made available in the form of report on analytical study as per the agreements. Further the services provided by the Belgian parties were FTS as per Article 12(3)(b) of the India-Belgium tax treaty.

The CIT(A) held that that the services provided to the taxpayer by the non-resident parties did not fall within the purview of included services/technical services and hence there was no liability on the taxpayer to deduct tax at source under Section 195 of the Act.

Regarding the payment made to the U.S.A. and Canada entities, the Tribunal observed that the coordinated bench in taxpayer's case for earlier years decided the similar issue in favor of the taxpayer stating that the services provided by nonresident did not involve any transfer of technology. Article 12(4)(b) of the tax treaty with the U.S.A. and Canada is not applicable since the non-resident parties did not 'make available' any technical knowledge, and the services rendered to the taxpayer by the above foreign parties has not transmitted any technical knowledge. Mere provision of services cannot be said to result in a transfer of technology as the taxpayer has not derived enduring benefits to utilise this knowledge on his own. Regarding payments to Belgian entities, the Tribunal observed that services rendered by the non-resident were for the purpose of due diligence in connection with the proposed acquisition outside India. The services were rendered outside India and utilised outside India. The scope of FTS Article under the India-Canada tax treaty and the India-U.S.A. tax treaty is more restricted than that under India-Belgium tax treaty. Because of the Most Favoured Nation (MFN) clause, the language of FTS Article of the aforesaid two treaties shall apply to the India-Belgium tax treaty. In view of above, the services provided to the taxpayer by the non-resident parties did not fall within the purview of included services/technical services and hence there was no liability on the taxpayer to deduct tax at source under Section 195 of the Act.

ITO v. Cadila Health Care Ltd [2017] 78 taxmann.com 330 (Ahd)

For further details, please refer to our Flash News dated 9 March 2017 available at this link

POEM

Income of a foreign shipping company is not taxable in India as place of effective management is outside India

The taxpayer (agent) for two voyages during the FY 2010-11 was a freight beneficiary of Faber Ship Brokers APS, Denmark (Faber Ship Brokers/foreign company) filed income-tax return without paying tax. The return was accompanied with certain details like indemnity bond, etc. The foreign company did not have regular business in the Port of Porbandhar and it conducted only occasional business. On the prima facie verification of documents, it was noticed that certain details were required to be called for. Accordingly, the tax department had issued a notice under Section 172(4) of the Act. In response to the said notice, the taxpayer had submitted details of filing of return under Section 172(3) for obtaining port clearance under Section 172(6) of the Act. The AO observed that the taxpayer had not submitted complete details called for except the copy of vessels registration certificate. As per the AO, the benefit under the tax treaty was claimed with incriminating and forged documents. The action of the local agent has itself proved the same beyond doubt. Under the circumstance, the tax treaty claimed is provisional. Accordingly, the final return under Section 172(3) of the Act is withdrawn and demand under Section 172(4) was raised.

Tribunal's ruling

According to Section 172 of the Act, income of owner or charter who receives freight is chargeable to tax. In this case, freight is received by Faber Ship Brokers and it has earned that freight. Therefore, the income of Faber Shipbroker is chargeable to tax in India. Faber Ship Brokers is resident of Denmark having a tax residency certificate which was available on record. As per the decision of the Supreme Court in case of UOI v. Azadi Bachao Andolan [2003] 132 taxman 373 (SC), the benefit of the tax treaty shall be available to the Faber Ship Brokers.

As per Article 9 of the tax treaty, profits derived from the operation of ships in international traffic shall be taxable only in the state where POEM of the enterprise is situated. In this case the Place of Effective Management (POEM) of the Denmark entity is situated in Denmark as - registration certificate, residence of shareholder, passport of owner show that Faber Ship Broker is a resident

of Denmark and its POEM is in Denmark. Therefore, 'head and brain' of Faber Ship Broker is situated in Denmark. The taxpayer has proved that the POEM is outside India by furnishing several documents including a declaration by the director of the company that it is 100 per cent owned by Mr. Jens Faber Anderson. A copy of owner's passport was submitted to prove his nationality.

Director of Faber Ship Brokers resides in Denmark and has been operating the business wholly from Denmark, all the important decisions are taken from Denmark in the form of meeting and therefore, the POEM and control is in Denmark only. The Faber Ship Brokers is engaged in international traffic and its residence is in Denmark. Therefore, on the basis of Article 9 of the tax treaty, the income on account of operation of ship in international traffic shall be taxable in the state in which the POEM is situated i.e. in this case Denmark. Therefore, the income from ships shall not be taxed in India as per Article 9 of the tax treaty.

Pearl Logistics and EX-IM Corporation v. ITO [2017] 80 taxmann.com 217 (Rajkot)

For further details, please refer to our Flash News dated 19 April 2017 available at this link

CBDT issues guiding principles for determination of the Place of Effective Management of a company

The provisions of Section 6(3) of the Act were amended to provide that a company is said to be resident in India in any previous year, if (i) it is an Indian company; or (ii) its POEM in that year is in India. These provision have come into effect from 1 April 2017 and it applies from Assessment Year (AY) 2017-18 onwards.

On 23 December 2015, the Central Board of Direct Taxes (CBDT) issued draft guiding principles for the determination of POEM of a company. On 23 January 2017, CBDT issued the guiding principles to be followed for determination of POEM. Key features of the guiding principles are as follows:

- The final guidelines provide guidance on 'income', 'value of assets', 'number of employees' and 'payroll' in context of determining 'active business outside India' which were not present in the draft.
- The guidelines are primarily based on the fact as to whether or not the company is engaged in 'active business outside India'. For determination of 'active business outside India' factors such as passive income, total asset base, the number of employees, payroll expenses in India and outside, etc. are considered.
- The guidelines state that the concept of POEM is one of substance over form.
- It also deals with the impact of modern technology in POEM determination.
- These guidelines are not intended to cover foreign companies or to tax their global income, merely on the ground of presence of a PE, a foreign company completely owned by an Indian company, some of the directors are resident in India, etc.
- An exception has been provided for 'interest' income earned by banking companies/Public Financial Institutions (PFIs). Any income by way of interest earned by banks/PFIs shall not be considered as passive income. The guidelines provide certain illustrations to provide clarity on various aspects.
- The guidelines provide that the AO would require to seek prior approval of the Principal Commissioner or the Commissioner before initiating any proceedings. The AO shall also obtain approval from Collegium of Principal Commissioners of Income-tax before holding that POEM of a non-resident company is in India.
- It has been clarified that the principles for determining the POEM are for guidance only and a 'snapshot' approach is not to be adopted.

CBDT Circular No. 06/2017, dated 24 January 2017

For further details, please refer to our Flash News dated 24 January 2017 available at this link

CBDT issues press release and draft notification on special transitional provisions for a foreign company said to be resident in India on account of POEM

The Finance Act, 2016, inter alia, introduced special provisions in respect of foreign company said to be resident in India on account of POEM by way of insertion of a new Chapter XII-BC consisting of Section 115JH in the Act with effect from 1 April 2017.

Section 115JH of the Act, inter alia, provides that the central government may notify exception, modification and adaptation subject to which, provisions of the Act relating to computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before. It has been further provided that these transitional provisions would also cover any subsequent previous year upto the date of determination of POEM in an assessment proceedings.

In June 2017, CBDT issued a press release and draft notification providing for said exception, modification and adaptation for application of provisions of the Act in case where a foreign company is said to be a resident in India on account of POEM.

The draft notification, *inter alia*, states that the foreign company will be eligible for depreciation, brought forward and unabsorbed depreciation as per tax records in the foreign country or as per books of accounts maintained in accordance with the laws of the foreign country, as the case may be. It provides clarity with respect to accounting year to be taken. Further it provides that where more than one Tax Deducted at Source (TDS) related provisions of Chapter XVII-B of the Act apply to the foreign company as resident as well as foreign company, the provisions applicable to the foreign company shall apply. Also, it is proposed to allow foreign tax credit under Section 90/91 of the Act. Section 195(2) (relating to application to AO for lower TDS) shall apply in such manner so as to include payment to the foreign company.

However, it has been provided that the rate of tax in case of a foreign company shall remain the same even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.

CBDT press release and draft notification, dated 15 June 2017

For further details, please refer to our Flash News dated 16 June 2017 available at this link

CBDT issues clarification related to guidelines for establishing 'Place of Effective Management' in India

The CBDT has issued a circular clarifying that as long as the regional headquarter operates for subsidiaries/group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of payroll functions, accounting, HR functions, IT infrastructure and network platforms, supply chain functions, routine banking operational procedures, and not being specific to any entity or group of entities per se; it would not constitute a case of BOD of companies standing aside and such activities of regional headquarter in India alone will not be a basis for establishment of POEM for such subsidiaries/group companies. The CBDT has also clarified that the provisions of General Anti avoidance Rule (GAAR) may get triggered in such cases where the above clarification is found to be used for abusive/aggressive tax planning.

CBDT Circular No. 25 of 2007, dated 23 October 2017

For further details, please refer to our Flash News dated 24 October 2017 available at this link

Indirect transfer

CBDT clarifies that indirect transfer provisions shall not apply to a non-resident on account of redemption or buy-back of its share or interest held indirectly in specified funds

As per the provisions of Section 9(1)(i) of the Income-tax Act, 1961 (the Act), all income accruing or arising, whether directly or indirectly, through or from, any business connection in India, or any property in India, or any asset or source of income in India or through the transfer of a capital asset situated in India, shall be deemed to accrue or arise in India. Explanations 5, 6 and 7 to Section 9(1)(i) of the Act further define the scope of said provision.

Concerns have been expressed by investment funds, including private equity funds and venture capital funds, that on account of the extant indirect transfer provisions in the Act, non-resident investment funds investing in India, which are set up as multi-tier investment structures, suffer multiple taxation of the same income at the time of subsequent redemption or buyback. Such taxability arises firstly at the level of the fund in India on its short term capital gain/business income and then at every upper level of investment in the fund chain on subsequent redemption or buyback.

In November 2017, CBDT has issued a circular clarifying that the provisions of indirect transfer (provided under Section 9(1)(i) of the Act read with Explanation 5) shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buy-back of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India. However, such benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realised by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

CBDT Circular No. 28/2017, dated 7 November 2017

For further details, please refer to our Flash News dated 13 November 2017 available at this link

Foreign tax credit

Foreign tax credit allowed on the basis of 'gross receipts'

The taxpayer, a wholly owned subsidiary of a U.S. based company, engaged in the business of software development and products. During the relevant previous year, the taxpayer did not have any income taxable under the normal provisions of the Act. However, the taxpayer computed the book profits under Section 115JB of the Act and paid Minimum Alternate Tax (MAT) thereon. The AO observed that the taxpayer has claimed a Foreign Tax Credit (FTC) in respect of the taxes withheld abroad. The taxpayer had received certain amount, after TDS at the rate of 10 per cent from a Singapore based company. The taxpayer had also received certain amounts, after TDS at the rate of 15 per cent from an Indonesia based company. It was the aggregate of these tax deductions that the taxpayer had claimed as FTC. The AO, however, did not approve the claim of the taxpayer.

The Tribunal held that the India-Singapore and India-Indonesia tax treaties state that the FTC shall not exceed the part of the income tax as computed before the deduction is given, 'which is attributable as the case may be, to the income which may be taxed in that other State' but there is little guidance on how to compute such income. However, quite clearly, as the expression used is 'income', which is essentially implied 'income' embedded in the gross receipt, and not the 'gross receipt' itself. It is, therefore, not really the right approach to take into account the gross receipts,

as was contended by the taxpayer, for the purpose of computing admissible tax credit. However, based on the unique facts of the instant case, the Tribunal has given relief to the taxpayer by allowing computation of the FTC on the basis of 'gross receipts'.

Elitecore Technologies Private Limited v. DCIT [2017] 184 TTJ 166 (Ahd)

For further details, please refer to our Flash News dated 13 January 2017 available at this link

Tax credit is allowed on the interest income based on the tax sparing clause under India-Cyprus tax treaty

The taxpayer granted a loan to its subsidiary in Cyprus, and the subsidiary paid interest to the taxpayer. As per Article 11 of the India-Cyprus tax treaty, 10 per cent of the gross amount of interest is chargeable to tax in Cyprus. The taxpayer submitted that the domestic law at Cyprus provides the tax incentives for the promotion of economic development in Cyprus and therefore, there was no withholding of tax on interest amount remitted to the taxpayer in India. Article 25 of the India-Cyprus tax treaty provides for the tax credit in India with respect to taxes withheld/levied in Cyprus on the interest amount, and not withstanding that no tax has in fact, been withheld as mentioned above. Accordingly, the taxpayer claimed a tax credit at 10 percent of the gross amount received from Cyprus. The DRP observed that Cyprus did not levy any tax and therefore, the claim for credit of tax payable in Cyprus was rejected. The DRP held that AO has to compute the tax on interest income and allow the tax attributable to interest income under the India-Cyprus tax treaty. The AO is directed to verify whether the taxpayer has paid tax on interest income, and if the tax is paid then allows the deduction for tax deemed to have been paid.

The Tribunal remanded the matter to the file of the AO to verify whether the taxpayer has paid tax on interest income in India, and if so, to allow the deduction of the tax admitted to have been paid under Article 25(2) read with Article 25(4) of the tax treaty.

Dr. Reddy's Laboratories Ltd. v. ACIT [2017] 53 ITR(T) 285 (Hyd)

For further details, please refer to our Flash News dated 16 January 2017 available at this link

Tax credit can be claimed with respect to taxes deducted in the U.S.; restricted to rates prescribed in the India-USA tax treaty

The taxpayer is an individual, resident in India, and is in employment of JP Morgan India Pvt Ltd. as Managing Director and Global head of technology research of the company. During the year under consideration the taxpayer earned dividend income from foreign securities in the United States and the taxes withheld from such dividend income was of INR3,72,698. The taxpayer claimed tax credit under Section 90 of the Act with respect to dividend income earned outside India. The AO declined the tax credit claim of the taxpayer, in respect of tax of INR3,72,698 deducted from its dividend earnings in the United States on the ground that relief will be available on actual payment made in the return of income filed in USA and tax paid thereon and tax credit cannot be given on simply TDS from foreign dividend income. The CIT(A) upheld the order of the AO.

The Ahmedabad Tribunal held that the taxpayer can claim Foreign Tax Credit (FTC) in respect of taxes deducted in the U.S. against dividend income on satisfaction of the conditions specified in the FTC Article of the India-USA tax treaty. Furthermore, where tax deduction is at a rate higher than the rate prescribed in the tax treaty, the taxpayer will be eligible to claim FTC restricted to the amount computed based on the rates prescribed in the tax treaty.

Bhavin A Shah v. ACIT [2017] 164 ITD 610 (Ahd)

For further details, please refer to our Flash News dated 10 April 2017 available at this link

GAAR

CBDT clarifications on implementation of General Anti-Avoidance Rules under the Income-tax Act

The CBDT has issued a Circular in the form of answers to specific questions on the implementation of the provisions of GAAR. The Circular has been summarised as follows:

Qn. No.	Question	Response/Answer
1.	Will GAAR be invoked if Specific Anti-Avoidance Rule (SAAR) applies	It is internationally accepted that specific anti-avoidance provisions may not address all situations of abuse, and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can co-exist and are applicable, as may be necessary, in the facts and circumstances of the case.
2.	Will GAAR be applied to deny treaty eligibility in a case where there is compliance with Limitation of Benefit (LOB) test of the treaty	Adoption of anti-abuse rules in the tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the tax treaty, there shall not be an occasion to invoke GAAR.
3.	Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction	GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.
4.	Applicability of the provisions of GAAR where the jurisdiction of the Foreign Portfolio Investor (FPI) is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities Will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.	GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply. For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under Section 96 of the Act.
5.	Applicability of GAAR provisions to: i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 1 April,	Grandfathering under Rule 1OU(1)(d) of the Income-tax Rules, 1962 (the Rules) will be available to investments made before 1 April

		2017; shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; ii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding	2017 in respect of instruments compulsorily convertible from one form to another, at terms finalised at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1 April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 1OU(1)(d) of the Rules.
	6.	Whether grandfathering would extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.	Grandfathering is available in respect of income from transfer of investments made before 1April 2017. As per Accounting Standards, 'investments ' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.
	7.	Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling (AAR)	If arrangement is held permissible by AAR, GAAR will not apply. The AAR ruling is binding on the Principal Commissioner of Income-tax (PCIT)/ Commissioner of Income-tax (CIT) and the Income-tax authorities subordinate to them in respect of the applicant.
	8.	Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.	Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.
	9.	Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions?	In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.
	10.	How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference	The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner/ Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.
	11.	Can GAAR lead to assessment of notional income or disallowance of real expenditure	If the arrangement is covered under Section 96 of the Act, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.

12.	Whether a definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions regard to section 97(4)[2] of the Act.	Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under Section 97(4) of the Act to determine whether an arrangement lacks commercial substance.
13.	It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.	In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.
14.	Tax benefit of INR3 crores defined in Section 102(10) of the Act may be calculated in respect of each arrangement and each taxpayer and for each relevant AY separately. The tax impact of INR3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).	The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the 'Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is AY specific. GAAR is with respect to an arrangement or part of the arrangement and therefore limit of INR3 crores cannot be read in respect of a single taxpayer only.
15.	Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year.	If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.
16.	No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.	Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under Act. The taxpayer, may at his option, apply for benefit under Section 273A of the Act if he satisfies conditions prescribed therein.

Circular No. 7 of 2017 dated 27 January 2017

For further details, please refer to our Flash News dated 28 January 2017 available at this link

Slump Sale

Sale of business on a 'going concern' basis is a 'slump sale' and not a sale of depreciable asset under Section 50(2) of the Income-tax Act

The taxpayer was engaged in the business of manufacturing sheet metal components out of CRPA & OP sheds at Ahmadabad. On 31 December 1990, the taxpayer sold their entire running business in one go with all its assets and liabilities on 31 December 1990. The taxpayer filed their income tax return for the AY 1991-1992. In the return of income, the taxpayer claimed deduction under

[2] The period of time for which an arrangement (including operations therein) exists may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance.

Section 48(2) of the Act as it stood then by treating the sale to be in the nature of 'slump sale' of the going concern being in the nature of long-term capital gain in the hands of the taxpayer.

The AO did not accept the contention of the taxpayer in claiming the deduction. The AO held that the case of the taxpayer was covered under Section 50(2) of the Act because it was in the nature of short-term capital gain as specified in Section 50(2) of the Act and hence did not fall under Section 48(2) of the Act as claimed by the taxpayer. Accordingly, the AO reworked the claim of the deduction treating the same to be falling under Section 50(2) of the Act and framed the assessment order.

The Supreme Court held that the present case does not fall within the four corners of Section 50(2) of the Act. Section 50(2) of the Act applies to a case where any block of assets are transferred by the taxpayer. Where the entire running business with assets and liabilities is sold by the taxpayer in one go, such sale cannot be considered as a 'short-term capital asset'. The provisions of Section 50(2) of the Act would apply to a case where the taxpayer transfers one or more block of assets, which he was using in running of his business. This is not the case here because in this case, the taxpayer sold the entire business as a running concern. As rightly noticed by the CIT(A) that the entire running business with all assets and liabilities having been sold in one go by the taxpayer, it was a slump sale of a 'long-term capital asset'. It was, therefore, required to be taxed accordingly. Accordingly, the tax department's appeal was dismissed.

CIT v. Equinox Solution Pvt. Ltd. [2017] 393 ITR 566 (SC)

For further details, please refer to our Flash News dated 20 April 2017 available at this link

14A disallowance

Expenditure is to be disallowed under Section 14A in relation to dividend income which is subject to dividend distribution tax

The taxpayer is engaged in the business of manufacture of steel furniture, security equipments, typewriters, electrical equipments and a host of other related products. It is also a promoter of various other companies and invests its funds in such companies in order to maintain control of such concerns as sister concerns. For AY 1998-1999, 1999-2000 and 2001-2002, the AO notionally allocated the interest expenditure to the earning of the dividend income and disallowed such interest expenditure and consequently, reduced the exemption available under Section 10(33) of the Act to the net dividend.

The CIT(A) allowed exemption of the entire dividend income. The Tribunal confirmed the order. The said order had attained finality. During AY 2002-03, the facts were similar to earlier years. The taxpayer has not made fresh investments during AY 2002-2003, in fact, there is a reduction in the value of investments. The taxpayer had sufficient interest free funds available for the purpose of making investments. However, the AO disallowed the part of interest expenditure holding the same to be attributable to earning the dividend income. The CIT(A) deleted the disallowance relying on earlier favourable decision of the Tribunal. On further appeal to the Tribunal, it was held the decision in favour of the tax department holding that sub-sections (2) and (3) of Section 14A of the Act were retrospectively applicable and the matter is remanded back to the AO for recording his/her satisfaction/findings in the light of Section 14A of the Act. On appeal to the High Court, the High Court held that Section 14A of the Act has to be construed on a plain grammatical construction thereof and the said provision is attracted in respect of dividend income referred to in Section 115-O as such income is not includible in the total income of the shareholder. Against the decision of the High Court, the taxpayer filed an appeal before the Supreme Court.

Supreme Court's decision

Disallowance in respect of exempt dividend income

On reference to Section 14A of the Act it indicates that the income must not be includible in the total income of the taxpayer. Once the said condition is satisfied, the expenditure incurred in earning the said income cannot be allowed to be deducted. The section does not contemplate a situation where even though the income is taxable in the hands of the dividend paying company

and the same to be treated as not includible in the total income of the recipient taxpayer, yet, the expenditure incurred to earn that income must be allowed. Such a meaning, if ascribed to Section 14A of the Act, would be plainly beyond what the language of Section 14A can be understood to reasonably convey.

So far as the provisions of Section 115-O of the Act are concerned, even if it is assumed that the additional income tax under the aforesaid provision is on the dividend and not on the distributed profits of the dividend paying company, no material difference to the applicability of Section 14A would arise. Sub-sections (4) and (5) of Section 115-O of the Act clearly provides that the further benefit of such payments cannot be claimed either by the dividend paying company or by the taxpayer. The provisions of Sections 194, 195, 196C and 199 of the Act, would further fortify the fact that the dividend income under Section 115-O of the Act is a special category of income which has been treated differently by the Act making the same non-includible in the total income of the recipient taxpayer as tax thereon had already been paid by the dividend distributing company. Accordingly, it has been held that Section 14A of the Act would apply to dividend income which is subject to dividend distribution tax.

Applicability of Section 14A of the Act to the facts of the present case

The issue with respect to Section 14A of the Act stands concluded in its favour in respect of the AYs 1998-1999, 1999-2000 and 2001-2002. Earlier to the introduction of sub-sections (2) and (3) of Section 14A of the Act, such a determination was required to be made by the AO in his best judgement. In all the aforesaid AYs it was held that the tax department had failed to establish any nexus between the expenditure disallowed and the earning of the dividend income in question. In some of the AYs, the aforesaid question was specifically looked into from the standpoint of the requirements of the provisions of sub-sections (2) and (3) of Section 14A of the Act which had by then been brought into force. It is on such consideration that findings have been recorded that the expenditure in question bore no relation to the earning of the dividend income and hence the taxpayer was entitled to the benefit of full exemption claimed on account of dividend income.

Whether such determination is to be made on application of the formula prescribed under Rule 8D or in the best judgement of the AO, what the law postulates is the requirement of a satisfaction in the AO that having regard to the accounts of the taxpayer, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the taxpayer.

In the present case, neither any basis has been disclosed establishing a reasonable nexus between the expenditure disallowed and the dividend income received. Any part of the borrowings of the taxpayer had been diverted to earn tax free income despite the availability of surplus or interest free funds available remains unproved by any material whatsoever. Accordingly, it has been held that for the AY 2002-2003, no disallowance shall be made under Section 14A of the Act.

Godrej & Boyce Manufacturing Company Limited v. DCIT [2017] 394 ITR 449 (SC)

For further details, please refer to our Flash News dated 11 May 2017 available at this link

Capital gain

No 'transfer' results for capital gains taxation if joint development agreement is not registered; income cannot be taxed on a hypothetical basis

The taxpayers are members of the Punjabi Co-operative Housing Building Society Ltd. The society along with its members was the owner of 21.2 acres of land. The owners entered into a tripartite Joint Development Agreement (JDA) dated 25 February 2007 for development of land. The developers were to make payments in four instalments. The developers made payments up to the second instalment and the taxpayer paid capital gains tax on the same for AY 2007-09 and 2008-09. For the subsequent AYs proceedings were pending before the Punjab and Haryana High Court and thereafter before the Delhi High Court. The necessary permissions for development were not granted, as a result of which the JDA did not take off the ground. The AO held that since physical and vacant possession had been handed over under the JDA, the same would tantamount to

'transfer' within the meaning of Sections 2(47)(ii), (v) and (vi) of the Act. Accordingly, entire amount was taxable in the year in which JDA was executed.

The Supreme Court held that held that the provisions of 'transfer' under Section 2(47)(v) of the Act are not applicable since JDA entered into by the taxpayer with developers is not registered. In order to qualify as a 'transfer' of a capital asset under Section 2(47)(v) of the Act, there must be a 'contract' which can be enforced in law under Section 53A of the Transfer of Property Act, 1882 (TOPA). There is no contract which can be taken cognizance of, for the purpose specified in Section 53A of the TOPA after the amendment in 2001 unless the said contract is registered. Since JDA was never registered, the JDA has no efficacy in the eye of law, therefore, no 'transfer' can be said to have taken place.

The Supreme Court also observed that the income from capital gain on a transaction has never materialised and it is a hypothetical income. There is no profit or gain which arises from the transfer of a capital asset. The taxpayer did not acquire any right to receive income, in as much as such alleged right was dependent upon the necessary permissions being obtained. There was no debt owed to the taxpayers by the developers and therefore, the taxpayers has not acquired any right to receive income under the JDA. Therefore, no profits or gains 'arose' from the transfer of a capital asset so as to attract Sections 45 and 48 of the Act.

CIT v. Balbir Singh Maini [2017] 86 taxmann.com 94 (SC)

For further details, please refer to our Flash News dated 10 October 2017 available at this link

No capital gains arising to Netherlands entity on sale of shares of its Indian subsidiary deriving its value from immovable property

The taxpayer is a resident of Netherlands and was holding equity share capital of its wholly owned Indian subsidiary company. The taxpayer sold all its shares in Indian company to Singapore Company in terms of the share purchase agreement. The taxpayer claimed that the capital gains was not taxable in India under the tax treaty. The tax officer observed that the value of the transferred shares comprised mainly value of immovable property located in India, therefore, specific clause of the capital gains article of the tax treaty dealing with transfer of shares having underlying value from immovable properties would not be applicable. Further, the residuary clause would be applicable only if the capital gains were not taxable under any other paragraph of capital gains article of the tax treaty. Since shares of Indian company partake the character of immovable property under the Act, the capital gains arising from alienation of such shares are chargeable to tax in India under specific clause of capital gain article dealing with transfer of immovable property. The CIT(A) upheld the order of the tax officer. However, the Tribunal held in favour of the taxpayer. The matter went to the High Court where it was observed as follows:

- The lower authorities failed to note the difference between alienation of the company's immovable property and alienation of the company's shares by a shareholder. The legal distinction between the concept of a 'share sale' as opposed to an 'asset sale', succinctly summed up by the Supreme Court in Vodafone International Holdings B.V., was completely ignored by the tax officer and the CIT(A).
- Before the High Court, the tax department fairly concedes that the clause of the capital gains article dealing with transfer of immovable property was wrongly applied by the lower authorities and contended that clause of the capital gains article dealing with transfer of shares having underlying value from immovable properties is applicable. However, this issue was never raised by the tax department before the Tribunal.
- Thereafter, it was open to the tax department to raise the issue before the Tribunal by filing cross-objections. However, at that stage also, the tax department did not raise such issues. It is only before this High Court that issue was raised.
- Without a factual finding as to whether the immovable property of Indian company was property in which its business was carried on, the question of applying one or the other parts of clause of the capital gains article dealing with transfer of shares having underlying value from immovable properties at this stage would not arise. Thus, the appeal would have to be restricted

to the finding of the Tribunal that the clause of the capital gains article dealing with transfer of immovable property had no application to the transaction and the residuary clause would have application.

- The High Court confirmed the finding of the Tribunal that the capital gains earned by the taxpayer from the said transaction are covered by the exemption provided under residuary clause of capital gains article and hence it would not be taxable in India.

DDIT v. Venenberg Facilities BV [2017 397 ITR 425 (AP)

For further details, please refer to our Flash News dated 9 July 2017 available at this link

CBDT issues final notification for exemption of acquisitions of equity shares from long-term capital gain tax under Section 10(38) of the Income-tax Act

Section 10(38) of the Act, prior to its amendment by the Finance Act, 2017, provided that the income arising by way of a transfer of long-term capital asset, being equity share in a company, shall be exempt from tax if such transfer is undertaken after 1 October 2004 and chargeable to Securities Transaction Tax (STT) under Chapter VII of the Finance (No. 2) Act, 2004.

In order to curb the practice of declaring unaccounted income as exempt long-term capital gain by entering into sham transactions, the Finance Act, 2017 amended the provisions of Section 10(38) of the Act to provide that exemption under this section for income arising on transfer of equity share acquired or on after 1 October 2004 shall be available only if the acquisition of share is chargeable to STT.

However, to protect the exemption for genuine cases where the STT could not have been paid, it was provided that the central government was to notify the acquisition for which the condition of chargeability to STT shall not apply. Accordingly, the CBDT has issued a press release and the draft notification under Section 10(38) of the Act. The draft notification proposed a negative list. It stated that all transactions will be eligible for benefit under Section 10(38) of the Act except for the specified transactions.

In June 2017, the CBDT has notified final rules for exemption of acquisitions of equity shares from long term capital gain tax under Section 10(38) of the Act. The CBDT notified all transactions of acquisition of equity share entered into on or after the 1 October 2004 which are not chargeable to STT under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004), other than certain specified transactions. The final Notification has provided relief to certain additional transaction.

CBDT Notification No. 43/2017, dated 5 June 2017

Minimum Alternate Tax

CBDT issues FAQs on computation of book profit for levy of MAT and proposes amendment to Section 115JB of the Income-tax Act

On 25 July 2017, CBDT issued clarifications in the form of Frequently Asked Questions (FAQs) on issues relating to the levy of MAT for Ind AS compliant companies along with the proposed amendment in the Act. This issue of IFRS Notes provides an overview of the following:

- Clarifications in the form of FAQs on issues relating to the levy of MAT for Ind AS compliant companies
- Proposal for amendment to Section 115JB of the Act in relation to Ind AS compliant companies.

Overview of the clarifications comprised in FAQs

- **Starting point for computing book profits for Ind AS compliant companies**

The CBDT has clarified that for the purposes of Section 115JB of the Act, starting point for computing book profits for Ind AS compliant companies would be profit before Other Comprehensive Income (OCI) item number XIII in Part 2 (statement of profit and loss) of Division II of Schedule III to the Companies Act, 2013. An Ind AS compliant company should not consider 'Total Comprehensive Income (including OCI) item number XV in Part 2 (statement of profit and loss) of Division II of Schedule III' to the Companies Act, 2013 as the starting point for computing book profits.

- **Appropriate manner of computation of transition amount on convergence date**

  The CBDT clarified that the amounts as on start of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

- **Items that would not require an adjustment for computing book profits for the purposes of MAT**
  - ***Affects both transition amount and post Ind AS transition MAT computation***
    - *Mark to Market (MTM) gains/losses on financial instruments at Fair Value Through Profit or Loss (FVTPL)*

      The CBDT has clarified that since MTM gains recognised through the statement of profit and loss on FVTPL classified financial instruments are included in book profits for MAT computation, therefore, MTM losses on such instruments recognised through statement of profit and loss would not require any adjustments as provided under clause (i) of Explanation 1 to Section 115JB(2) of the Act. However, in case there is a provision for diminution/impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of Explanation 1 to Section 115JB(2) of the Act would be required. For financial instruments where gains and losses are recognised through OCI, then CBDT has clarified that the amended provisions of MAT would continue to apply i.e. such items would be considered for MAT upon being debited/credited to statement of profit and loss or as otherwise provided.
  - ***Affects only transition amount computation***
    - *Proposed dividend*

      The CBDT has clarified that the adjustment of the proposed dividend (including dividend distribution taxes) would not form part of the transition amount.
    - *Deferred taxes*

      The CBDT has clarified that the deferred taxes adjustments recorded on the transition date of Ind AS should be ignored for the purpose of computing 'transition amount'.
    - *Bad and doubtful debts*

      The CBDT clarified that the adjustments relating to provision for diminution in the value of any assets should not be considered for the purpose of computation of the transition amount. However, MTM gains/losses in the value of assets forming part of FVTPL financial instruments would form part of the transition amount.
    - *Reclassification of capital reserves or securities premium reserve under Ind AS*

      The capital reserves or securities premium reserves existing as on the convergence date as per the erstwhile Indian Generally Accepted Accounting Practices (GAAP) which are reclassified to retained earnings/other reserves under Ind AS and vice versa, should not be considered for the purposes of computation of transition amount. It is further clarified, that even after such reclassifications, the amount of revaluation reserve should continue to be considered as a revaluation reserve for the purposes of computation of book profit and should also include transfer to any other reserves by whatever name called or capitalised.

❖ *Changes to share application money*

The CBDT clarified that share application money pending allotment which is reclassified to 'other equity' on transition date should not be considered for the purpose of computing transition amount.

- **Items that would be included in profit/transition amount**
  - ***Interest/dividend on preferences shares (liability)***

    The CBDT clarified that for the purpose of computation of MAT, profit/transition amount should be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

  - ***Equity component of financial instruments***

    The CBDT clarified that items such as equity component of financial instruments like NCDs, interest-free loans, etc. would be included in the transition amount.

  - ***Service concession arrangement adjustments***

    The adjustments for service concession arrangements would be included in the transition amount and also on an ongoing basis.

- **Revaluation or fair value model of property, plant and equipment**

  The CBDT clarified that the book profit of the previous year in which the items of Property, Plant and Equipment are retired, disposed of, realised or otherwise transferred should be increased or decreased, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset.

- **Deduction for brought forward losses and unabsorbed depreciation**

  The CBDT has clarified that for AY 2017-2018, the deduction of lower of depreciation or losses would be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of accounts drawn as per Ind AS would be considered for computing lower of loss brought forward or unabsorbed depreciation.

- **Accounting period other than March 2017**

  The CBDT has clarified that in view of the second proviso to Section 115JB(2), companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period. For example, a company following December year end will be required to prepare, accounts for MAT purposes under Indian GAAP for nine months upto December 2016 and under Ind AS for three months thereafter. The transition amount will be calculated with reference to 1 January 2017.

- **Overview of the proposal for amendment to Section 115JB**

  To have parity between the transition adjustment and ongoing adjustments on account of items adjusted to other equity, the committee recommends that the amendment is required to be made with effect from 1 April 2017 i.e. the effective date of the amendment made by the Finance Act, 2017.

CBDT Circular No. 24/2017, dated 25 July 2017

For further details, please refer to our Flash News dated 26 July 2017 available at this link

R&D – Weighted deduction

R&D expenditure incurred prior to DSIR approval are eligible for weighted deduction under Section 35(2AB) of the Income-tax Act

The taxpayer is an automobile company in India. It has two Research & Development centres (R&D centres), one at Gurgaon and one at Rohtak, Haryana. On 30 March 2011, the taxpayer made an application to the Department of Scientific and Industries Research (DSIR)[3] seeking approval for Rohtak R&D Centre under Section 35(2AB) of the Act. On 31 October 2011, the taxpayer filed an application for certification of its R&D expenditure with the DSIR claiming that an expenditure of INR395 crores (which included a sum of INR124.78 crores incurred on the Rohtak R&D Centre) has been incurred for AY 2011-12. Though the subject line of this application mentioned the Gurgaon centre, the auditor's report accompanying this application gave the break-up of the expenditure incurred for both the Gurgaon and Rohtak R&D centres separately. On January 2014, the taxpayer submitted an application, to the DSIR seeking recognition for the Rohtak R&D centre as its 'crash test facility' had become operational from November 2013. On 26 March 2014, the DSIR granted recognition to both the R&D centres. Since by then the taxpayer's Rohtak R&D centre was accorded recognition by the DSIR.

On 26 March 2015, the taxpayer sought a clarification from the DSIR that the total amount claimed as R&D expenditure for the AY 2011-12 was INR395 Crores, which included a sum of INR124.78 crores incurred on the Rohtak R&D Centre and sought inclusion of the Rohtak R&D centre in the said certification of expenditure. The taxpayer claimed that since the R&D expenditure was incurred by it in AY 2011-12, it is entitled to a deduction in AY 2011-12 itself and thereafter in subsequent years for both its Gurgaon and Rohtak R&D centres, under Section 35(2AB) of the Act. DSIR has issued a corrigendum dated 7 May 2015 amending and modifying the said Form 3CL dated 9 March 2015, whereby the amount of R&D expenditure eligible for deduction under Section 35(2AB) of the Act, relevant to AY 2011-12, was reduced by the said amount of INR 124.78 crores. The DRP relying on the impugned corrigendum directed that the AO should consider the R&D expenditure of the taxpayer only with respect to its Gurgaon R&D centre. The taxpayer was not entitled to a deduction in respect of the capital expenditure incurred for its Rohtak R&D centre. Pursuant to the directions of the DRP, the AO passed an assessment order denying any deduction for the AY 2011-2012, in respect of its Rohtak R&D centre. Similarly, for AY 2012-13 and AY 2013-14, the DSIR disregarded for certification of R&D expenditure.

High Court's decision

- A perusal of the correspondence between the taxpayer and DSIR, it indicates that on 31 October 2011, when the Rohtak R&D centre was still being set up, the taxpayer, while applying for certification of R&D expenditure, had submitted the details about its Rohtak R&D centre to the DSIR, and all the relevant documents were also filed therewith. The auditor's report accompanying the letter dated 31 October 2011, has a clear note and further delineates and differentiates the expenditure for the Rohtak centre in a tabular form.

- It was the DSIR which communicated to the taxpayer on 26 April 2013 that the application for the Rohtak R&D centre was premature. This then led to the filing of a second application. Though, the taxpayer made an error in its application for certification of R&D expenditure, by not mentioning the Rohtak R&D centre in the subject line, from the correspondence, it does not appear that there was any intention to mislead the tax department. The taxpayer has candidly informed the requisite details of both the R&D centres since inception.

- Both the R&D centres have been granted recognition, and the entire R&D expenditure was certified for AY 2011-12, but in the certification dated 9 March 2015, only the Gurgaon R&D centre found a mention. The non-addition of the Rohtak R&D centre and instead deletion of the

[3] DSIR is the prescribed authority for the purpose of claim of deduction under Section 35(2AB) of the Act

expenditure incurred on the same by way of issuance of the corrigendum dated 7 May 2015, from the certification dated 9 March 2015, is clearly unsustainable. Such an act on behalf of the DSIR results in completely depriving the taxpayer from claiming deductions of R&D expenditure qua its Rohtak R&D centre.

- The legislative intent behind provision to Section 35(2AB) of the Act is to encourage innovation, research and development in India and non-grant of the benefit under Section 35(2AB) of the Act defeats the legislative intent. The auditor's certificate on record is categorical that the taxpayer is maintaining separate sets of accounts for the Gurgaon and the Rohtak centres and the necessary details of the expenditure incurred therein have also been submitted as far back as on 31 October 2011 and even thereafter.

- Even Form 3CM which was issued by the DSIR under cover letter dated 2 February 2015, states both the Gurgaon and the Rohtak R&D centres. Just because the taxpayer sought a correction in the certificate of expenditure which was issued to it, the complete removal of the R&D expenditure of the Rohtak R&D centre in the certification issued by the DSIR is wholly unsustainable. The taxpayer has fulfilled all the necessary conditions for availing the benefit under Section 35(2AB) of the Act in view of the settled position in the case of Sandan Vikas[4] and Claris Lifesciences[5].

- Section 35 (2AB) clearly provides that any expenditure incurred by a party on its R&D facility except, insofar as it relates to land and building is liable to be allowed to be claimed as a deduction (twice the amount of expenditure). A perusal of the scheme of the Act especially Sections 35(2AB), 35A and 35AB reveals in no uncertain terms, that the purpose behind these provisions is to provide the impetus for research, development of new technologies, obtaining patent rights, copyrights and know-how.

- In the present case, there has been no lapse of time, unlike in Apollo Tyres[6] wherein the recognition was granted on 31 March 2004, and the Form 3CK application was made only on 21 August 2008. Thus, the present case is distinguishable from the facts in Apollo Tyres. The High Court held that the taxpayer is entitled to a deduction under Section 35(2AB) of the Act for the expenditure in respect of its Rohtak R&D centre as per the provisions of Section 35(2AB) for AYs 2011-12, 2012-13 and 2013-14. Accordingly, the corrigendum issued by DSIR, dated 7 May 2015 is set aside, and the DSIR is directed to issue a fresh certification in Form 3CL in respect of the expenditure on scientific research on the Rohtak R&D centre.

Maruti Suzuki India Limited v. UOI [2017] 250 Taxman 113 (Del)

For further details, please refer to our Flash News dated 10 August 2017 available at this link

DSIR amends guidelines for approval of in-house R&D centres and submission of report under Section 35(2AB) of the Income-tax Act

In August 2017, the DSIR has amended the existing guidelines[7] for approval of in-house R&D centres and submission of prescribed report. The key amendments to the guidelines are as follows:

- Expenditure incurred on manpower engaged in non-R&D activities such as attending consultation meetings shall not qualify for deduction under Section 35(2AB) of the Act.

- Expenditure reported as Capital Work-in-Progress (CWIP) will not be eligible for weighted deduction. Company to submit list of capital equipments, with date of purchase/installation and cost. Further vehicles purchased for reference and testing purpose will not be admissible for weighted deduction.

[4] CIT v. Sandan Vikas (India) Ltd [2011] 335 ITR 117 (Del)
[5] CIT v. Claris Lifesciences Ltd [2010] 326 ITR 251 (Guj)
[6] Apollo Tyres v. UOI [2010] SCC Online Del 1599
[7] Source - http://www.dsir.gov.in/

- Manpower under the category of trainees and manpower on contract (may include trainees based on employment status) will not be admissible for weighted tax deduction.

- The pre-amended guidelines provide that the expenditure eligible should necessarily be reported in the audited financial statement prepared for the purpose of published annual report as well as for the purpose of income tax returns.

  As per the new guidelines it should be reported in the audited financial statement prepared for the purpose of published annual report or to be filed with the Registrar (RoC) as per Companies Act 2013.

- As per the guidelines, where a company has incurred INR 10 million by way of capital expenditure[8] on R&D centres are eligible to claim weighted deduction in the preceding financial year of application for approval under Section 35(2AB) of the Act. Such companies are either not having DSIR recognised R&D centres but applied for approval under Section 35(2AB) of the Act or having R&D centres already recognised by DSIR, but have applied for approval under Section 35(2AB) of the Act. The amended guidelines provide that such companies should;

  - Submit the request for claim of such expenditure in the covering letter at the time of application in Form 3CK for approval under Section 35(2AB) of the Act.

  - Provide complete break up and details of capital equipment investment on R&D of more than INR 10 million excluding expenditure on land and building, in the financial year preceding the year in which the firm applied to the prescribed authority for the approval.

- In line with amendment to the rules, similar forms have been incorporated in the amended guidelines issued by DSIR. Under the amended guidelines, the DSIR has asked for an additional information under Annexure I for each R&D centre.

Source - http://www.dsir.gov.in/

For further details, please refer to our Flash News dated 16 October 2017 available at this link

Depreciation

While computing a deduction under Chapter VI-A, it is mandatory to claim deduction by way of depreciation

The taxpayer is engaged in the business of manufacture of master batches and compounds. For this purpose, it had manufacturing undertakings at Daman Units I and II. Units I and II began to manufacture article or things during the AYs 1994-95 and 1995-96 respectively. For AY 1997-98 profits of the business of both the undertakings were eligible for 100 per cent deduction under Section 80-IA of the Act. The taxpayer did not claim depreciation[9] while computing its income under the head profits and gains of business. Though, the taxpayer had not claimed deduction in respect of depreciation, the AO allowed deduction on this account while computing the profit and gains of business. Subsequently, the CIT(A) upheld the taxpayer's contention that claim for depreciation is optional, based on the Tribunal's order in its own case for AY 1996-97 and hence allowed the appeal. However, the Tribunal reversed the order of the CIT(A). The Full Bench of the Bombay High Court held that, whilst computing a deduction under Chapter VI-A, it was mandatory to grant deduction by way of depreciation. Even assuming that the taxpayer had an option to disclaim current depreciation in computing the business income, depreciation had to be reduced for computing the profits eligible for deduction under Section 80-IA of the Act.

[8] Excluding expenditure on land and building

[9] Prior to 2001, there was a controversy of whether claim of depreciation is the choice of the taxpayers or it has to be mandatorily taken into consideration while computing the business income

Supreme Court's decision

- The decision of the Full Bench is based on the decisions of the Supreme Court and there is no reason to disagree with the same. The Supreme Court decisions are rightly analysed and ratio thereof is correctly understood and applied. Therefore, the Supreme Court agreed with the Full Bench decision of the Bombay High Court.

- The decision of the Supreme Court in the case of Mahendra Mills Limited[10] cannot be applied while interpreting Section 80-IA of the Act. The decision in Mahendra Mills Limited was rendered while construing the provisions of Section 32 of the Act, as it existed at the relevant time. However, in the present case the Supreme Court was concerned with the provisions of Chapter VI-A of the Act.

- The Supreme Court made it clear that Section 80-IA of the Act not only contains substantive but procedural provisions for computation of special deduction. Thus, any device adopted to reduce or inflate the profits of eligible business has to be rejected.

- The taxpayer cannot claim 100 per cent deduction, without taking into consideration depreciation. Further, the taxpayer cannot utilise depreciation claim in the subsequent years. This would be anathema to the scheme under Section 80-IA of the Act which is linked to profits and if the contention of the taxpayers is accepted, it would allow them to inflate the profits linked incentives provided under Section 80-IA of the Act which cannot be permitted.

- The Supreme Court agreed with the High Court that while computing a deduction under Chapter VI-A, it was mandatory to grant deduction by way of depreciation.

Plastiblends India Limited v. ACIT [2017] 86 taxmann.com 137 (SC)

For further details, please refer to our Flash News dated 12 October 2017 available at this link

Since lessee is not the owner of the asset, depreciation is not allowed in the hands of lessee

The taxpayer was running a super speciality hospital in Thrissur town in Central Kerala. Earlier the taxpayer was a partnership firm. For its business, the firm started construction of the hospital building. Since it was felt expedient to form a private limited company to run and manage the hospital (then under construction), a company was formed and was incorporated on 30 December 1988. Thereafter, an agreement was entered into between the firm and the company by which it was agreed that the firm would complete the construction of the building and hand over possession of the same on completion, on the condition that the entire cost of construction of the building should be borne by the company. The company took possession of the building on its completion on 18 December 1991 and is running the hospital therein with effect from 19 December 1991. The accounts of the company have been debited with the cost of construction of the building, i.e. INR1.37 crore. The accounts of the firm have also been credited with payments of INR1.06 crore made by the company to the firm for completion of the construction. The balance amount payable by the company to the firm has been carried as the company's liability in its balance sheet, for which the firm had a lien on the building. This amount has also since been paid to the firm. The one time building tax payable by the owner of a building under the Kerala Building Tax Act was also paid by the company. Since the ownership of the land had to remain with the firm, it was also agreed that the land would be given on lease by the firm to the company. Accordingly, the taxpayer entered into an agreement with the firm. The first AY of the company was 1992-1993. The taxpayer filed its return for the said year in which it claimed depreciation on the building part of the said property under Section 32 of the Act, on the ground that it had become the owner of the property. The AO, after construing the provisions of the aforesaid agreement came to the conclusion that

[10] CIT v. Mahendra Mills Limited [2000] 243 ITR 56 (SC) – The Supreme Court observed that it is not mandatory to allow depreciation if the taxpayer does not want to claim that. Provision for claim of depreciation is certainly for the benefit of the taxpayer. If he does not wish to avail that benefit for some reason, benefit cannot be forced upon him. It is for the taxpayer to see if the claim of depreciation is to his advantage. Rather, the tax officer should advise him not to claim depreciation if that course is beneficial to the taxpayer.

the taxpayer had not become the owner of the property in question in the relevant AY and, therefore, rejected the claim of depreciation. The CIT(A) upheld the order of the AO. However, the Tribunal allowed the taxpayer's appeal. The High Court held that the taxpayer had not become the owner of the property in question in the relevant AY and agreement could not confer any ownership rights on the taxpayer.

The Supreme Court is in agreement with the view taken by the High Court. The building which was constructed by the firm belonged to the firm. Admittedly it is an immovable property. The title in the said immovable property cannot pass when its value is more than INR100 unless it is executed on a proper stamp paper and is also duly registered with the sub-Registrar. Nothing of the sort took place. In the absence thereof, it could not be said that the taxpayer had become the owner of the property. As is clear from the plain language of the explanation to Section 32 of the Act, it is only] when the taxpayer holds a lease right or other right of occupancy and any capital expenditure is incurred by the taxpayer on the construction of any structure or doing any work in or in relation to and by way of renovation or extension of or improvement to the building and the expenditure on construction is incurred by the taxpayer, that taxpayer would be entitled to depreciation to the extent of any such expenditure incurred. In the instant case, records show that the construction was made by the firm. It is a different thing that the taxpayer had reimbursed the amount. The construction was not carried out by the taxpayer himself. Therefore, the explanation to Section 32 also would not come to the aid of the taxpayer.

Mother Hospital Pvt. Ltd. v. CIT [2017] 392 ITR 628 (SC)

For further details, please refer to our Flash News dated 27 March 2017 available at this link

Deemed dividend

Deemed dividend is not taxable in the hands of a loan recipient concern if such concern is not shareholder of the lender company

The taxpayer filed the return declaring income of INR1.45 crore under Section 115JB of the Act. During the assessment proceedings, the AO noticed that the taxpayer had received advances of INR6.32 crore by way of book entry from Jackson Generators Private Limited (JGPL) and the shareholders having substantial interest in the taxpayer were also having 10 per cent of the voting power in JGPL. The AO observed that the two shareholders were holding substantial interests in JGPL which had provided loans and advances to the taxpayer and these shareholders had substantial interest even in the taxpayer. Therefore, under Section 2(22)(e) of the Act, the amount received by the taxpayer from JGPL which constituted advances and loans would be treated as deemed dividend within the meaning of Section 2(22)(e) of the Act and added the aforesaid amount to the income of the taxpayer.

The CIT(A) affirmed the order of the AO. The Tribunal deleted the addition made by the AO on account of deemed dividend under Section 2(22)(e) of the Act. The Tribunal held that though the amount received by the taxpayer by way of book entry is a deemed dividend within the meaning of Section 2(22)(e) of the Act, the same cannot be assessed in the hands of taxpayer, as it was not the shareholder in the company JGPL. A dividend cannot be paid to a non-shareholder. It would have to be taxed, if at all, in the hands of the shareholders who have a substantial interest in the taxpayer and also holding not less than 10 per cent of the voting power in JGPL.

Delhi High Court decision

The Delhi High Court held that the intention behind the provisions of Section 2(22)(e) of the Act is to tax dividend in the hands of shareholders. The deeming provisions as it applies to the case of loans or advances by a company to a concern in which its shareholder has substantial interest, is based on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance. Further, it is an admitted case that under normal circumstances, such a loan or advance given to the shareholders or to a concern, would

not qualify as dividend. It has been made so by legal fiction created under Section 2(22)(e) of the Act. It is to be keep in mind that this legal provision relates to dividend. Thus, by a deeming provision, it is the definition of dividend which is enlarged. Legal fiction does not extend to shareholder. Loan or advance given under the conditions specified under Section 2(22)(e) of the Act would also be treated as dividend. The fiction has to stop here and is not to be extended further for broadening the concept of shareholders by way of legal fiction.

The second category specified under Section 2(22)(e) of the Act, i.e., a concern (like the taxpayer herein), which is given the loan or advance is admittedly not a shareholder/member of the payer company. Therefore, under no circumstance, it could be treated as shareholder/member receiving dividend. If the intention of the Legislature was to tax such loan or advance as deemed dividend at the hands of deeming shareholder, then the Legislature would have inserted deeming provision in respect of shareholder as well, that has not happened. It would always be open to the tax department to take corrective measure by treating this dividend income at the hands of the shareholders and tax them accordingly. As otherwise, it would amount to escapement of income at the hands of those shareholders.

Supreme Court decision

The Delhi High Court decision in the case of Ankitech Private Limited is a detailed judgment going into Section 2(22)(e) of the Act which arises at the correct construction of the said Section. The Supreme Court does not wish to add anything to the judgment except to say that it is agree therewith.

CIT v. Madhur Housing and Development Company (Civil Appeal No. 3961 of 2013) – Taxsutra.com

For further details, please refer to our Flash News dated 18 October 2017 available at this link

ICDS

The Delhi High Court decision on the constitutional validity of ICDS

The Delhi High Court in the case of the Chamber of Tax Consultants and Anr[11] (Petitioners) dealt with the constitutional validity of the Income Tax Computation Standards (ICDS). The High Court held that Section 145(2) of the Act, as amended, has to be read down to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial precedents or provisions of the Act. The power to enact a validation law is an essential legislative power that can be exercised, in the context of the Act, only by the Parliament and not by the executive. If Section 145(2) of the Act as amended is not so read down it would be *ultra vires* the Act[12].

The High Court dealt with the specific provisions of the ICDS which are contrary to or seek to overcome binding judicial precedents and held that such provisions are to be struck down as the same are contrary to the law settled by the various decisions of the Supreme Court and High Court and the same are *ultra vires* the Act. The High Court's observations with respect to each ICDS are summarised as follows:

- ICDS I which has done away with the concept of 'prudence' is contrary to the Act and binding judicial precedents and is therefore unsustainable in law.

- ICDS II is also an attempt to overreach the binding judicial precedents by the device of notifications issued by the central government. It is an exercise of excessive delegation of legislative power which is impermissible in law. ICDS II is held to be *ultra vires* the Act and struck down as such.

[11] The Chamber of Tax Consultants & Anr v. UOI [W. P. (C) 5595/2017 & CM APL 23467/2017] – Taxsutra.com
[12] It would also *ultra vires* Article 141 read with Article 144 and 265 of the Constitution

- To the extent ICDS III is interpreted and applied in a manner contrary to the law settled by various decisions of the Supreme Court and the High Courts, it cannot be sustained. The treatment to retention money under Paragraph 10(a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income.

- Further paragraph 12 of ICDS III read with paragraph 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the Supreme Court decision in the case of Bokaro Steel Limited[13] wherein it was held that if the taxpayer receives any amounts which are inextricably linked with the process of setting up of its plant and machinery, such receipts would go to reduce the cost of its assets. The High Court held that Paragraph 12 of ICDS III is to be stuck down.

- Paragraph 5 of ICDS IV requires the taxpayer to recognise income from export incentive in the year of making of the claim if there is 'reasonable certainty' of its ultimate collection. This is contrary to the Supreme Court decision in the case of Excel Industries[14] where it has been held that it is only in the year in which the claim is accepted by the Government that a right to receive the payment accrues in favour of the taxpayer and the corresponding obligation to pay arises in the hands of the Government. Only in such year the income from export incentive can be said to have accrued and can be recognised as income. The High Court held that Para 5 of ICDS-IV is *ultra vires* the Act and struck down as such.

- As per paragraph 6 of ICDS IV, revenue from service transactions shall be recognised by the percentage completion method. This is contrary to certain decisions[15] where the proportionate completion method as well as the contract completion method have been recognised as valid method of accounting under mercantile system of accounting. To the extent paragraph 6 of ICDS-IV permits only one of the methods, i.e. proportionate completion method, it is contrary to the relevant decisions. Therefore, it is held to be *ultra vires* the Act and struck down as such.

- Paragraph 8(1) of ICDS IV has not been shown to be contrary to any judicial precedent. There is also no challenge to Section 36(1)(vii) of the Act. Accordingly, paragraph 8(1) of ICDS-IV is held to be not *ultra vires* the Act. Its validity is upheld.

- ICDS-VI which states that MTM loss/gain in case of foreign currency derivatives held for trading or speculation purposes are not to be allowed. This is contrary to the Supreme Court decision in the case of Sutlej Cotton Mills Limited. This is *ultra vires* the Act and struck down as such.

- ICDS VII provides that recognition of government grants cannot be postponed beyond the date of actual receipt. In other words, income has to be recognised on receipt basis which may not have accrued. Many a times, conditions are attached to the receipt of government grant, non-fulfilment of which may lead to return of such amount. In such instance, it cannot be said that there is any accrual of income although the money has been received in advance. Such provisions are contrary to and in conflict with the accrual system of accounting. To that extent it is held to be *ultra vires* the Act and struck down as such.

- For those entities not governed by the RBI to whom Part A of ICDS VIII is applicable, the accounting prescribed by the Accounting Standards has to be followed. This is different from the ICDS. In effect, such entities will be required to maintain separate records for income tax purposes for every year since the closing value of the securities would be valued separately for income tax purposes and for accounting purposes. Under similar circumstances, ICDS II which deals with valuation of inventories does not prescribe such a 'bucket approach'. CBDT adopted

[13] CIT v. Bokaro Steel Limited [1999] 236 ITR 315 (SC)
[14] CIT v. Excel Industries Limited [2015] 358 ITR 295 (SC)
[15] CIT v. Bilhari Investment Pvt. Ltd. [2008] 299 ITR 1 (SC), CIT v. Manish Buildwell Pvt. Ltd. [2011] 245 CTR 397 (Del), Paras Buildtech India Pvt. Ltd. V. CIT [2016] 382 ITR 630 (Del).

separate approaches at different places for the purpose of valuation of securities. This change is therefore not possible to be effectuated without a corresponding amendment to the Act. To that extent Part A of ICDS VIII is *ultra vires* the Act and is to be stuck down as such.

The Chamber of Tax Consultants & Anr v. UOI [W. P. (C) 5595/2017 & CM APL 23467/2017] – Taxsutra.com

For further details, please refer to our Flash News dated 9 November 2017 available at this link

Goodwill

Depreciation on goodwill is allowed under Section 32 of the Income-tax Act

During the AY 2010-11, the taxpayer had not raised a claim of depreciation on goodwill. However, during the course of assessment proceedings, the taxpayer presented revised computation which included the taxpayer's claim of depreciation of INR71.9 million on the goodwill expanded at the time of amalgamation of the companies. The taxpayer claimed that such claim would be allowable by virtue of the decision of the Supreme Court in case of Smifs Securities Ltd. The AO disallowed the claim on two grounds. Firstly, that the claim was not made in the original return nor did the taxpayer file the revised return. The second ground was that the claim was fictitious and the goodwill has been accounted as a balancing factor in the hands of the taxpayer without acquisition of an intangible asset as contemplated under Section 32 of the Act. The CIT(A) as well as the Tribunal both ruled in favour of the taxpayer. With respect to raising an additional claim without revising the return, the Tribunal relied on the decision of the Bombay High Court in case of Pruthvi Brokers & Shareholders (P.) Ltd.[16]. With respect to the claim of depreciation on the acquisition of goodwill, the Tribunal relied on the decision of the Supreme Court in case of Smifs Securities Ltd.

The High Court held that the issue of the tenability of a claim though not raised in the original return is examined by the courts in various decisions. The Gujarat High Court in case of Mitesh Impex[17] referred to and relied on several decisions of the Supreme Court and High Courts including the decision of Bombay High Court in case of Pruthvi Brokers & Shareholders (P.) Ltd. and observed that if a claim though available in law is not made either inadvertently or on account of erroneous belief of complex legal position, such claim cannot be shut out for all times to come merely because it is raised for the first time before the appellate authority without resorting to revising the return before the AO. With respect to the claim of depreciation, the decision of Supreme Court in case of Smifs Securities Ltd. is applicable. There is no material provided by the AO to hold that the claim of depreciation was fictitious. If the High Court read his entire expression in this respect, the AO seems to be suggesting that being an intangible asset acquisition thereof would not qualify for depreciation. If that be so, the view of the AO was opposed to the decision of the Supreme Court in case of Smifs Securities Ltd. On the other hand, if the observations of the AO can be seen as his findings that the claim itself was baseless, there was no discussion or reference to any material to enable him to come to such a conclusion.

PCIT v. Zydus Wellness Ltd [2017] 87 taxmann.com 82 (Guj)

For further details, please refer to our Flash News dated 16 November 2017 available at this link

Other direct tax development

Disallowance under Section 40(a)(ia) of the Income-tax Act can be made even for the amount paid during the year

The Supreme Court dealt with the issue - whether the provisions of Section 40(a)(ia) shall be attracted when the amount is not 'payable' to a contractor or sub-contractor but has actually been ‘paid’ on which tax has not been deducted.

[16] CIT v. Pruthvi Brokers & Shareholders (P.) Ltd. [2012] 349 ITR 336 (Bom)
[17] CIT v. Mitesh Impex [2014] 225 Taxman 168 (Guj)

The taxpayer is engaged in the business of purchase and sale of LPG cylinders under the name and style of Palam Gas Service. The main contract of the taxpayer for carriage of LPG was with the Indian Oil Corporation. Subsequently, the taxpayer had sub-contracted the same to three persons. The taxpayer had, in turn, got the transportation of LPG done through three persons to whom the taxpayer made the freight payment without deducting tax at source. The AO observed that the taxpayer is liable to deduct tax at source from the payment made to sub-contractors within the meaning of Section 194C of the Act. On account of his failure to do so, the said freight expenditure was liable to be disallowed under the provisions of Section 40(a)(ia) of the Act. The CIT(A) upheld the order of the AO. Subsequently, the Income-tax Appellate Tribunal and the High Court upheld the order of the CIT(A).

The Supreme Court observed as follows:

- As per Section 194C, tax has to be deducted in both the situations, namely, when the amount is credited to the account of the contractor or when the payment is actually made. Section 200 of the Act imposes further obligation on the person deducting tax, to deposit the same with the Central Government or as the Board directs, within the prescribed time.

- A conjoint reading of these two sections suggests that Section 40(a)(ia) covers not only those cases where the amount is 'payable' but also when it is 'paid'. In this behalf, one has to keep in mind the purpose with which Section 40(a) has been enacted. Once it is found that the aforesaid sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself.

- When the entire scheme of obligation to deduct the tax at source and paying it over to the government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be 'paid' and does not cover the cases where the amount is actually 'paid'.

- If the provision is interpreted in the manner suggested by the taxpayer, then even when it is found that a person has violated the provisions of Chapter XVII-B (specifically Sections 194C and 200 in the instant case), it would still go scot free, without suffering the consequences of such monetary default inspite of specific provisions laying down these consequences.

- The Supreme Court referred to the cases of Punjab & Haryana, Madras and Calcutta High Courts[18] where Section 40(a)(ia) has been exhaustively interpreted keeping in mind these aspects.

- Reading of Allahabad High Court's[19] decision reflect that the High Court, after noticing the fact that since the amounts had already been paid, straightaway concluded, without any discussion, that Section 40(a)(ia) would apply only when the amount is 'payable' and dismissed the appeal of the department stating that the question of law framed did not arise for consideration. Though the Special Leave Petition against this decision was dismissed by the Supreme Court, it would not amount to confirming the view of the Allahabad High Court.
- In view of above, the Supreme Court held that the view taken by the High Courts of Punjab & Haryana, Madras and Calcutta is the correct view and the decision of the Allahabad High Court did not decide the question of law correctly.

Palam Gas Service v. CIT [2017] 394 ITR 300 (SC)

For further details, please refer to our Flash News dated 5 May 2017 available at this link

[18] P.M.S Diesels v. CIT [2015] 374 ITR 562 (P&H), Tube Investments of India Ltd. v. ACIT(TDS) [2010] 325 ITR 610 (Mad), CIT v. Crescent Export Syndicate [2013] 216 Taxman 258 (Cal)
[19] CIT v. Vector Shaipping Services (P) Ltd. [2013] 357 ITR 642 (All)

CBDT notifies rules and form with respect to the patent box regime under Section 115BBF of the Income-tax Act

The CBDT has notified Rule 5G and Form 3CFA with respect to the patent box regime under Section 115BBF of the Act (which provides for a concessional tax rate on income derived from patents). New Rule 5G provides that the 'eligible assessee' opting for concessional taxation regime under Section 115BBF shall furnish Form No. 3CFA electronically on or before the return filing due dte specified in Section 139(1) of the Act. In form 3CFA, the 'eligible assessee' needs to provide general details as well as 'eligible patent' details such as description of patent, date of grant of patent, whether patent granted to single persons. Similarly the eligible assesse needs to provide details of royalty income from eligible patent and details of expenditure incurred in India and outside India on eligible patent.

CBDT Notification No. 25/2017, dated 3 April 2017

For further details, please refer to our Flash News dated 4 April 2017 available at this link

CBDT issues a notification prescribing the method for valuation of unquoted shares for the purposes of Section 56(2)(x) and Section 50CA of the Income-tax Act

On 12 July 2017, CBDT has issued a notification in exercise of the powers conferred by Section 50CA and Section 56 read with Section 295 of the Act. The proposed amendment with respect to valuation of unquoted shares is summarised as follows:

- The Fair Market Value (FMV) of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:

  The FMV of unquoted equity shares = (A+B+C+D - L) × (PV)/(PE), where

  - A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;
  - B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;
  - C = FMV of shares and securities as determined in the manner provided in this rule;
  - D = the value adopted or assessed or assessable by any authority of the government for the purpose of payment of stamp duty in respect of the immovable property;
  - L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:
    - the paid-up capital in respect of equity shares;
    - the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
    - reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
    - any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
    - any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

- ❖ any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

- ➢ PV= the paid up value of such equity shares
- ➢ PE = total amount of paid up equity share capital as shown in the balance-sheet;

- For the purposes of Section 50CA, the FMV of the share of a company other than a quoted share, shall be determined in the manner provided in sub-clause (b) or sub-clause (c), of clause (c) of Rule 11UA(1) of the Rules. For this purpose the reference to valuation date in the rule 11U and rule 11UA shall mean the date on which the capital asset, being share of a company other than a quoted share, referred to in Section 50CA, is transferred.

CBDT Notification No. 61/2017, F. No. 149/136/2014-TPL, 14 July 2017

For further details, please refer to our Flash News dated 14 July 2017 available at this link

India signs the third Protocol with Singapore to amend India-Singapore tax treaty

The Government of India has signed the third protocol with Singapore to amend the India-Singapore tax treaty. The protocol is in line with India's treaty policy to prevent double non-taxation, curb revenue loss and check the menace of black money through Automatic Exchange of Information as reflected in India's recently revised tax treaties with Mauritius and Cyprus and the joint declaration signed with Switzerland. The protocol provided for phasing out of capital gains tax exemption in line with the amended India-Mauritius tax treaty, especially with respect to grandfathering, tax rates and fulfilment of LOB conditions under respective tax treaties. Further it has also been provided that the tax treaty shall not prevent a contracting state from applying its domestic law and measures concerning the prevention of tax avoidance or tax evasion.

Notification No. SO 935(E), dated 23 March 2017

For further details, please refer to our Flash News dated 2 January 2017 available at this link

India signs the Multilateral Convention

India is now among the 67 countries signing the Multilateral Convention (the Convention/MLI) in Paris on 7 June, 2017 to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS). More countries are expected to sign the Convention in coming days. The Convention is an outcome of the OECD/G20 Project to tackle BEPS i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI was developed by a group of over 100 countries and jurisdictions. Various developing countries have also shown great interest in signing the MLI and have started their technical preparations to sign. The Convention enables all signatories, inter alia, to meet treaty related minimum standards that were agreed as part of the Final BEPS package. The Convention will operate to modify tax treaties between two or more parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement (CTA). Instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures.

The provisional MLI position of each signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI positions until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations. For example, while 25 Signatories have chosen to apply the MLI arbitration provisions, additional signatories can choose to apply those provisions later.

Source: www.occd.org, dated 7 June 2017

For further details, please refer to our Flash News dated 9 June 2017 available at this link

Transfer Pricing

Final rules on Master File and CbC reporting released by Indian Government

In keeping with India's commitment to implement the recommendations of BEPS Action Plan 13, the Finance Act, 2016 introduced Section 286 of the Act providing for furnishing of country-by-country (CbC) Report in respect of an International Group. The CBDT on 6th October 2017 released draft rules and forms in relation to Master File and CbC report and sought recommendations and suggestions from the relevant stakeholders. After due consideration, on 31 October 2017, CBDT released the final rules and forms in relation to Master File and CbC report.

Master File (MF) - Rule 10DA

Applicability and timelines

Rule 10DA (Sub Rules 1 to 8) has been inserted in the Rules. Sub rule 1 provides a monetary threshold for the maintenance of Master File. Sub rule 2 provides the due dates for filing of the required information. The following table captures these requirements:

Particulars	**Threshold (Sub rule 1)**	**Timeline for filing (Sub rule 2)**
1. Consolidated Group Revenue of the 'International Group' for the **accounting year** exceeds	INR500 crore (USD77 million)	**FY 2016-17** To be filed on or before 31 March 2018. **Subsequent years** To be filed on or before the due-date for filing of Return of Income.
And		
2. Aggregate value of international transaction a. During the accounting year, as per books of accounts exceeds **Or** b. In respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds	INR50 crore (USD7.7 million) Or INR10 crore (USD1.5 million)	

The following forms are prescribed in respect of master file:

Form 3CEAA: The Rules require filing of Master File in Form 3CEAA. The form consists of two parts - Part A is required to be filed by every Constituent Entity (CE) resident in India of any 'International Group' irrespective of the aforesaid threshold. It contains basic details such as name of the group, number of CEs in India, their names and addresses etc. Part B is required to be filed only by those CEs which satisfy both thresholds mentioned in the table above.

Form 3CEAB: Where an international group has more than one CEs resident in India, the group may opt to designate a CE that shall be obliged to file Form 3CEAA (only Part A or both Part A and B, as may be applicable). In such case, the Form 3CEAA has to be filed only by the designated CE and intimation of the same is filed by the designated CE in Form 3CEAB. Form 3CEAB is required to be filed at least 30 days prior to the due date of filing the Form 3CEAA.

CbC Report - Rule 10DB

Rule 10DB (Sub Rules 1 to 8) which provides for filing of CbC report, has been inserted in the Rules. Most requirements are in line with the prescribed requirements under OECD Action Plan 13. The details of filing requirements and filing of relevant forms is provided below:

Threshold: Sub Rule 6 provides the consolidated group revenue threshold of INR5,500 crore of the accounting year preceding the reporting accounting year, for filing of CbC report or the CbC reporting notification, as the case may be.

The requirements and applicable due dates for CbC report is mentioned in table below.

	Category	Requirement	Applicable due date
1	Parent entity or alternate reporting entity, resident in India (*Section 286 (2)*)	File CbC report in Form 3CEAD (for every reporting accounting year)	**For FY 2016-17** - 31 March 2018 **For subsequent years -** Due date of filing tax return
2	CE resident in India, of Parent entity not resident in India (*Section 286 (1)*)	File CbC reporting notification in Form 3CEAC to the Director General of Income-tax (Risk Assessment). Vide this Form the CE intimates • Whether it is alternate reporting entity of the group; or • The details of parent entity or the alternate reporting entity and the country/territory of which said entity is a resident	At least two months prior to the date of furnishing of CbC report in Form 3CEAD *Since the deadline for filing of CbC report for FY 2016-17 has been extended to 31 March 2018, the deadline for filing the Form 3CEAC is 31 January 2018*
3	CE resident in India, of parent entity not resident in India – Specified cases (*Section 286 (4) i.e.* no agreement for exchange of CbC report or systemic failure)	File CbC report in Form 3CEAD (for every reporting accounting year). In case there are more than one CEs resident in India, the international group may opt to designate a CE, wherein the Form 3CEAD has to be filed only by the designated CE. The intimation of the same needs to be filed by the designated CE in Form 3CEAE with the Director General of Income-tax (Risk assessment)	For filing of CbC report in Form 3CEAD - same due dates as mentioned earlier in the table For filing of intimation of designated CE in Form 3CEAE - the due date of filing this form has not been prescribed

CBDT Notification No. 92 /2017/ F. No. 370142/25/2017-TPL dated 31 October 2017

For further details please refer to our Flash News dated 2 November 2017 available at this link

India to accept MAP and bilateral APA even in cases where Article 9(2) of the tax treaty is absent

India does not have Article 9(2) in its tax treaties with some major trading partners including Belgium, Germany and France. Till now, India followed an approach of not accepting applications pertaining to Transfer Pricing (TP) Mutual Agreement Procedures (MAPs) cases and bilateral

Advance Pricing Agreements (APAs) wherein the Associated Enterprise (AE) of the Indian entity is resident of a country with which India has a tax treaty but such tax treaty does not contain Article 9(2) (or its relevant equivalent Article) relating to 'Corresponding Adjustment'. However, in light of the CBDT receiving several references from time to time regarding the acceptance such applications, the CBDT evaluated the matter and has decided to accept TP MAP and bilateral APA applications regardless of the presence or otherwise of Article 9(2) (or its relevant equivalent Article) in the tax treaties.

CBDT press release dated 27 November 2017

CBDT releases first APA Annual Report (2016-17)

The first annual report on APA programme was released by the CBDT of India on 1st May 2017.

Key highlights of the Indian APA programme

- Total of 815 APAs were filed in India till 31 March 2017 including 688 Unilateral APAs (UAPAs) and 127 Bilateral APAs (BAPAs).
- 152[20] APAs were signed as on 31st March 2017 which includes 141 UAPAs and 11 BAPAs. 78 APAs out of 152 signed have Rollback provisions. Of the 11 BAPAs signed, six of them are with the U.K. and five with Japan.
- The U.S. effectively opened its BAPA programme with India in February, 2016; and since then there has been an increase in the number of BAPA applications and also in the number of conversions from UAPA to BAPA applications.
- Comparative analysis of India's APA programme with China and the U.K. shows that India has concluded more APAs within the first five years of its APA programme (152 between FY2012-13 to FY2016-17) as against China (113 in ten years 2005 - 2014) and the U.K.[21] (143 in five years 2009 to 2014)
- Indian APA authorities have performed better (average duration of processing UAPA in India has been 29 months and BAPA has been 39 months) than their U.S. counterparts (average duration 34 months and 51 months for UAPA and BAPA respectively) in terms of concluding APAs.
- Of the total UAPAs entered, service sector dominates with 72 per cent of the total UAPAs signed. Further, Information Technology and Banking/Finance industries lead with almost 50 per cent (70 out of 141) of the total UAPAs. APAs have been concluded with respect to about 20 different industries.
- The nature of transactions covered in UAPAs predominantly include provision of Software Development Services and provision of IT enabled Services followed by intra-group payments and other transactions.
- With regard to BAPAs, the covered transactions predominantly include availing of intra-group services followed by purchase and sale of goods transaction and provision of marketing/sales support services.

CBDT APA Annual Report (2016-17) dated April 2017

For further details please refer to our Flash News dated 4 May 2017 available at this link

CBDT notifies the much awaited revised Safe Harbour Rules

To curb the increasing number of TP audits and prolonged disputes, the CBDT issued the Safe Harbour Rules (SHRs) in September 2013. However, the safe harbour programme received a tepid response from taxpayers in India, due to perceived high margins and ambiguity in the classification of services. On 7 June 2017, the CBDT revised the existing SHRs in India.

[20] 186 APAs signed as on 1 December 2017 as per CBDT press release dated 1 December 2017
[21] Transfer Pricing statistics: 2013 to 2014 dated 6 March 2015 - published by HM Revenue & Customs

Key highlights

The revised SHRs apply for AY 2017-18 and two immediately following AYs i.e. upto AY 2019-20. The earlier SHRs were applicable from AY 2013-14 and four immediately following AYs i.e. upto AY 2017-18. For AY 2017-18, the taxpayer can choose from old or new rules whichever are more beneficial.

Upper turnover threshold of INR200 crore has been introduced for all contract service providers [Information Technology (IT), Information Technology enabled services (ITeS), Knowledge Process Outsourcing (KPO), R&D for IT and generic pharmaceutical drugs]. For AY 2017-18, since the taxpayers have an option to choose from old or new rules, even the taxpayers with relevant international transactions of more than INR200 crore can opt for safe harbour as per the old rules.

The SHRs for receipt of low value-adding intra-group services (LVIGS) have been introduced which are largely in line with the guidelines issued by BEPS Action Plan 8-10. However, in definition of LVIGS, there are certain deviations. A prescribed list of ten categories of services have been specifically excluded from the ambit of LVIGS i.e. services like IT (software development), KPO BPO services. The revised SHRs also require applicant to get the method of cost pooling, exclusion of shareholder costs and duplicate costs from cost pool and the reasonableness of the allocation keys used for allocation of costs, certified by an accountant.

The revised SHRs have introduced safe harbour rates based on London Inter-bank Offer Rate (LIBOR) for loans advanced to AEs denominated in foreign currency.

CBDT Notification No. 46/2017/ F. No. 370142/6/2017-TPL dated 7 June 2017

For further details please refer to our Flash News dated 09 June 2017 available at this link

Sales to two customers which constitutes more than 20 per cent of total sales of the taxpayer shall constitute 'dominant influence'; AE relationship upheld

The taxpayer, subsidiary of Hospira Pte, Singapore, is incorporated by acquiring the generic injectable pharmaceuticals business of M/s. Orchid Chemicals & Pharmaceuticals Ltd (Orchid India) as a going concern on slump sale basis. The agreements entered into by Orchid India and various distribution partners (DPs) were inherited by the taxpayer termed as legacy agreements. The business model of the taxpayer with its DPs is on profit sharing basis.

Transfer Pricing Officer (TPO) proposed adjustment on account of deficiency in pricing of supplies to Hospira Group, profit shared on sale on the pharma products with its AEs and interest paid by the AE on the Inter Corporate Convertible Debentures (ICCD) issued by the taxpayer to its AE.

While proposing these adjustments, the TPO concluded that Apotex Corp and Apotex Inc. Signet (DPs) were AEs, by relying on the settlement commission order of Orchid India for AYs 2006-07 to 2010-11.

Tribunal's ruling

- The Tribunal relied on the ruling of Orchid Pharma Limited[22] for interpreting section 92A(2)(i) of the Act, from which it is understood that 92A(2)(i) envisages a dominant influence, which automatically leads to a de facto control over the enterprise.
- The Tribunal held that as per Sec 92A(2)(i) influence implies dominant influence where "a person who purchased more than 1/5th of the total sales of the taxpayer would have a distinctly dominant influence on the pricing and can exercise a de facto control".
- More than 20 per cent of the taxpayer's sales are to Apotex entities, which creates a dominant influence on the taxpayer by Apotex entities. The Tribunal held that Apotex entities are to be considered as AEs of the taxpayer.
- With regard to the profit share of 60:40 determined by the lower authorities relying on the settlement commission order of Orchid India, the Tribunal held as follows:

[22] Orchid Pharma Limited v. DCIT (ITA No. 771/Mds/2016 - AY 2011-12)

- The lower authorities erred in determination of the profit share by merely relying on the settlement commission order without analysing the facts and circumstances of the taxpayer.
- Further, Rule 10B(d) of the Rules is not properly applied by the lower authorities while determining the profit share between the taxpayer and DPs.

- Thus, the Tribunal set aside the orders of lower authorities in relation to determination of profit share, deficiency in pricing of supplies to Hospira Group and interest paid on ICCDs and accordingly, remanded the same back to the AO/TPO for fresh consideration.

Hospira Healthcare India Private Limited vs DCIT (ITA No. 821/Mds/2016 - AY 2011-12)

For further details please refer to our Flash News dated 15 March 2017 available at this link

'De Facto' or 'De Jure' participation in the management, capital or control by itself is not relevant in establishing AE relationship in terms of Section 92A of the Income-tax Act

The taxpayer, is a partnership firm, wherein the partners were three brothers (say Mr. A, Mr. B and Mr. C) along with their respective wife and children. The taxpayer had entered into certain international transactions with a Belgian entity i.e. Blue Gems BVBA, which was owned and controlled by another brother (say, Mr. D) (brother of Mr. A, Mr. B and Mr. C), along with his family.

The AO contended that since the Belgian entity is controlled by another brother i.e. Mr. D (along with his family), it falls under the definition of an AE in terms of Section 92A(2)(j) of the Act and accordingly, made a reference to the TPO, who made an adjustment.

The CIT(A) without discussing the primary issue of existence of an AE relationship in terms of Section 92A of the Act, proceeded to examine the correctness of the arm's length price (ALP) and deleted the adjustment.

The Tribunal ruled in favour of the taxpayer holding that the taxpayer and the Belgian entity are not AEs.

High Court's ruling

- The High Court agreed with Tribunal's observation that none of the provisions of Clauses j, k and l of sub-section 2 of Section 92A(2) of the Act are applicable in the present case and therefore, the taxpayer and Blue Gems BVBA are not AEs. The High Court observed as under:
  - Clause (i) would apply in a case where goods or articles are manufactured or transferred by one enterprise and in the present case, Blue Gems BVBA does not either manufacture or process any articles. It merely purchases rough diamonds from the international markets and supplies it to the taxpayer.
  - Clause (j) would apply when an enterprise is controlled by an individual. In the present case, both the enterprises are partnership firms and hence it can be said that they are not controlled by any individual.
  - Clause (l) would apply in a case where the enterprise is a partnership firm. However, for the applicability of the said clause, there has to be an enterprise in the nature of a firm and another enterprise who holds not less than 10 per cent interest in such firm, which is not applicable in the present case.

- In view of the above, the High Court held that the Tribunal has committed no error in holding that the taxpayer and Blue Gems BVBA are not AEs and hence the question of applying TP formula would not arise.

Pr. CIT v. Veer Gems [2017] 249 Taxman 264 (Guj)

For further details please refer to our Flash News dated 12 July 2017 available at this link

Quasi capital transaction, not an interest simplictor and notional interest adjustment deleted

The taxpayer entered into various international transactions with its AEs. The TPO made adjustment on account of various international transactions including inter alia charging of notional interest on optionally convertible loan and guarantee fees.

The taxpayer advanced optionally convertible loans to its subsidiary, Zydus International Pvt Ltd, Ireland (ZIPL). The tenure of these loans was five years and the lender had an option for repayment of loan along with interest from the date of grant of loan or for conversion of loan into equity at par at any time during the tenure of the loan. No repayment had taken place during the year under consideration and accordingly no interest was recorded in the books.

The taxpayer provided certain corporate guarantee to the bankers, in respect of borrowings by its AE and charged guarantee commission at 1 per cent from its AEs. However, in case of two of its AEs, the taxpayer did not charge any guarantee fees, contending that these loans had been availed by AEs for strategic acquisitions which had benefited the taxpayer rather than its AEs.

Tribunal's ruling

Notional interest on convertible loan

- The Tribunal held that the transactions are not simple loan transactions. The amounts advanced to the AE are attached with an obligation on AE to issue share capital, in case the taxpayer exercises such an option, on certain conditions, which are admittedly more favourable to the taxpayer, and at an agreed price, which is admittedly much lower, vis-à-vis the conditions and prices which independent enterprise would normally agree to accept. The lending was considered to be in the nature of quasi-capital in the sense that substantive reward, or true consideration, for such a loan transaction is not interest simplictor on amount advanced but opportunity to own capital on certain favourable terms.
- Reliance was placed on Rule 10B(1)(a) of the Rules and it was held that considerations for extending a loan simplictor are materially distinct and different from extending a loan which is given mainly in consideration for an option to convert the same into capital on certain terms which are favorable vis-à-vis the terms available to an independent enterprise. Thus, Tribunal disregarded the comparison made by the TPO.
- On the TPO's contention that it is wholly immaterial as to whether or not the taxpayer, by the virtue of this transaction, is entitled to subscribe to capital of the AE on certain concessional terms, because, in any case, the AE is a wholly owned subsidiary of the taxpayer and no one else can subscribe to the AE's capital, the Tribunal observed that what has been overlooked, however, in this process of reasoning is that the very concept of ALP is based on the assumption of hypothetical independence between AEs.
- Regarding TPO's contention that since ZIPL has earned huge profits, the taxpayer should have charged interest on commercial rates, the Tribunal observed that it is incomprehensible as to what role profits earned from the funds raised can have in determining arm's length consideration of raising funds itself which is neither the commercial practice nor the case before the Tribunal.
- The Tribunal observed that in case the taxpayer's right to convert the loan into equity comes to an end, the taxpayer is entitled to interest on the commercial rates. Thus, Tribunal directed the TPO to delete the adjustment.

Corporate guarantee fees

The Tribunal directed the TPO to delete the adjustment, by relying on the decision of Micro Ink Ltd[23]. The Tribunal however stated that the case is already pending before the High Court and it is, therefore, no longer in the right forum to sit in judgement whether or not in view of the arguments of the revenue, this decision of Micro Ink needs to be revisited. Accordingly, based on decision of the coordinate bench, the Tribunal deleted the adjustment.

[23] Micro Ink Ltd v. ACIT [2016] 157 ITD 0132 (Ahd)

Cadila Healthcare Limited v. ACIT [2017] 186 TTJ 421 (Ahd)

For further details please refer to our Flash News dated 2 May 2017 available at this link

Deemed brand development is not a separate international transaction

The taxpayer, wholly owned subsidiary of Hyundai Motor Company, Korea (HMC), is involved in manufacturing and sale of cars using the brand 'Hyundai', whose legal owner is Hyundai Motor Korea. The taxpayer is to mandatorily use badge with trademark Hyundai in every vehicle manufactured by it as per the intercompany agreement entered into between the taxpayer and HMC. The TPO referred to the special bench ruling in the case of LG Electronics Pvt Ltd [24] which treated brand building in the local market as an international transaction and was of the view that the taxpayer is neither getting any benefit for developing the brand of the AE nor allowed to create its own brand and logo. The AO proposed an adjustment which the DRP upheld in principle.

Tribunal's ruling

- There is a clear difference between LG Electronics and the taxpayer's case, as it is an undisputed position that the percentage of Advertisement, Marketing and Promotion (AMP) expenses as a proportion of net sales is not an unreasonable high figure and the taxpayer's arguments that there is no excess over and above a market benchmark average in the relevant financial year is accepted.
- No services are rendered by the taxpayer, unlike in LG's case where brand building was due to conscious and focused efforts of the Indian company to do so.
- If the taxpayer, instead of using 'Hyundai' in the name of each of its brand of cars manufactured, was to use a name owned by the taxpayer, the advantage of adding value to a brand, as a result of sale of cars manufactured by the taxpayer, would have gone to the taxpayer, rather than going to the AE. It is this arrangement, for the benefit of the AE, which is stated to be an international transaction.
- The use of brand name, owned by the AE, in the motor vehicles manufactured by the taxpayer does amount to a benefit to the AE of the taxpayer, but is an incidental benefit. The question is whether such an incidental benefit to the AE, even if there be any, can be treated as an international transaction.
- The Tribunal referred to the definition of international transaction under Section 92B of the Act and stated that for intangibles, the definition of international transactions, includes only transactions of purchase, sale or lease of intangible properties. Further, the Tribunal opined that though, 'provision for services' is included in the definition of 'international transaction', accretion in brand value due to use of foreign AEs brand name in the name of the taxpayer's products cannot be treated as service either.
- The Tribunal held that a service has to be a conscious activity and it cannot be a subliminal exercise as is the impact on brand value. Every benefit accruing to an AE, as a result of dealing with another AE, is not on account of service by the other AE. What is benchmarked is not the accrual of 'benefit' but rendition of 'service'. The expressions 'benefit' and 'service' have different connotations, and what is truly relevant, for the purpose of definition of 'international transaction' in Indian context, is 'service' - not the benefit. There is no rendition of service in the present context. The incidental benefit accruing to an AE, therefore, cannot be benchmarked unless it is the result of a specific service by the taxpayer.
- The Tribunal held that the accretion in brand value of the AE's brand name is not on account of costs incurred by the taxpayer, or even by its conscious efforts and it does not result in impact on income, expenditure, losses or assets of the taxpayer. It is not, therefore, covered by the residuary component of definition of 'international transaction' either.

[24] LG Electronics Pvt Ltd v. ACIT [2013] 22 ITR 1 (Del) (Trib)

- The Tribunal held that the accretion of brand value, as a result of use of the brand name of a foreign AE under the technology use agreement which has been accepted to be an arrangement at ALP, does not result in a separate international transaction to be benchmarked and therefore, deleted the adjustments.

Hyundai Motor India Limited v. DCIT [2017] 187 TTJ 97 (Chen)

For further details please refer to our Flash News dated 16 May 2017 available at this link

Transfer Pricing adjustment on account of marketing intangibles by factoring AMP Intensity in the profit rates of comparables upheld

The taxpayer is a part of Luxottica group, a leader in design, manufacture and distribution of sun glasses and prescription frames in mid and premium price categories. The TPO made adjustment for AY 2010-11 and AY 2011-12 in respect of AMP expenses incurred by the taxpayer by applying bright line test (BLT), which was largely approved by the DRP. The TPO also made adjustment for AY 2012-13 for AMP expenses by carrying out AMP Intensity Adjustment (AIA) in profit margins of comparable companies.

Tribunal's ruling

AY 2010-11 and AY 2011-12

Noting that the TPO treated AMP as a separate transaction and benchmarked the same using BLT, Tribunal followed the taxpayer's own case for AY 2009-10 and remitted the issue to the files of AO/TPO for fresh determination by applying principles laid down in the case of Sony Ericsson[25].

Tribunal also struck down the taxpayer's alternate proposition to carry out AIA (similar to TPO's action in AY 2012-13) instead of restoring the matter to the AO/TPO. Tribunal noted that if the taxpayer's alternate proposition was accepted, it would amount to setting up of an altogether different case.

AY 2012-13

Tribunal sanctioned TPO's action of undertaking AIA and rejected taxpayer's proposition regarding use of denominator as 'total operating cost' instead of 'total cost of material purchased' stating that there cannot be any item wise difference between composition of numerator and denominator and in case taxpayer's contention to expand denominator was accepted, it would only lead to distorted results.

Tribunal approved the taxpayer's application of Resale Price Method (RPM) over Transactional Net Margin Method (TNMM). Tribunal strongly stressed on carrying out AIA and held that if such an adjustment cannot be done due to any reason, a different suitable method may be adopted to encompass AIA. Tribunal observed that application of RPM as Most Appropriate Method (MAM) was sanctioned by Tribunal and High Court in the taxpayer's own case for AY 2009-10 and this view is also fortified in the case of Sony Ericsson.

Luxottica India Eyewear Pvt. Ltd. v. ACIT [2017] 187 TTJ 157 (Del)

For further details please refer to our Flash News dated 6 June 2017 available at this link

Location savings is relevant for investigating the transaction, cannot be a sole basis for ALP determination

The taxpayer engaged in providing clinical research services in India and has been compensated at cost plus 15 per cent mark-up for the services provided to AEs. The taxpayer used TNMM to benchmark its transaction with AEs.

TPO observed that conducting clinical trial in India through the taxpayer has resulted in location savings to the AEs. Relying on some journals and websites, TPO arrived at location savings and applying profit split method allocated the same on ad-hoc basis i.e. by dividing the location savings equally (50:50) between the taxpayer and its AEs. The DRP agreed with TPO's view.

[25] Sony Ericson Mobile Communications (India) Pvt. Ltd. vs CIT [2015] 374 ITR 118 (Del)

Tribunal's ruling

The Tribunal stated that location saving is one of the primary factors of all cross border trade activities and opined that the benefit of low cost of regulatory and other compliances are relevant factors which lead to location saving for a particular region.

The Tribunal observed that the location savings are available to all the parties operating in that location irrespective of the fact whether the transaction is between related party or unrelated party. Location savings can be a relevant factor for conducting a proper enquiry for ALP determination of the international transactions.

The Tribunal agreed with the OECD BEPS concept that location saving and advantage are universally accepted in cross border transactions so far as they are not entered into solely for the purpose of avoiding tax and particularly, the transactions between the related parties with an intention of tax avoidance and treaty shopping.

Relying on the decisions of Mumbai Tribunal in the case of Watson Pharma Pvt. Ltd.[26] and Syngenta India Ltd.[27], the Tribunal concluded that where comparable uncontrolled price is available, then the location saving or condition cannot itself be the basis for determination of ALP and consequential adjustment cannot be made.

The Tribunal also disregarded the basis for arriving at location savings adopted by the TPO and set aside the matter to TPO/AO for fresh adjudication.

Parexel International Clinical Research Pvt. Ltd. v. DCIT [2017] 84 taxmann.com 15 (Bang)

For further details please refer to our Flash News dated 28 July 2017 available at this link

Individual taxation

Salary received by a non-resident for services rendered abroad accrues outside India – Not chargeable to tax in India

The taxpayer, an Indian citizen, was working as a marine engineer for a foreign shipping company and had rendered services outside India for a period of 286 days during the AY 2011-12. The taxpayer had filed return of income for the AY 2011-12 as a Non-Resident, disclosing remuneration of INR 563,850, in US Dollars.

The taxpayer had received an intimation under section 143(1) seeking to tax such amount, against which the taxpayer had sought a revision from the jurisdictional CIT under Section 264 of the Act. During the course of the proceedings under Section 264, the taxpayer has claimed that he had received INR 27,92,417 from his employer during the AY in question. The CIT had found the income to be assessable under the Act but did not provide for any exemptions thereto, remanding the matter back to the assessing officer.

The taxpayer, relying upon judicial precedents[28], contended that the salary received by him would not be taxable in India as the services were rendered outside India. The taxpayer further contended that such an assessment has to be completed by the CIT.

The Calcutta High Court observed that income will not be treated as taxable in India solely on the basis that such income was received or deemed to be received in India. The place of accrual of income, viz., the place where the services have been rendered becomes material in determining whether the income accrued in or outside India. Since it was not disputed that the taxpayer received salary for services rendered outside India, for 286 days, there was no question of taxing the same

[26] Watson Pharma Pvt Ltd v. DCIT [2015] 168 TTJ 281 (Mum)
[27] Syngenta India Limited v. DCIT [2017] 77 taxmann.com 220 (Mum)
[28] DIT v. Prahlad Vijendra Rao [2011] 198 Taxman 551 (Kar), CIT v. Avtar Singh Wadhwan [2001] 247 ITR 260 (Bom)

in India. The income received by the taxpayer for services rendered outside India has to be considered as income received out of India and treated as such.

The High Court further held that the CIT had the power to set aside the intimation under Section 143(1) and grant appropriate relief to the taxpayer. On the basis above, the High Court allowed the appeal of the taxpayer and set aside orders under both Sections 143(1) and 264 of the Act.

Utanka Roy v. DIT [2017] 390 ITR 109 (Cal)

For further details please refer to our Flash News dated 6 January 2017 available at this link

Claim for exemption in respect of House Rent Allowance rejected where rent paid by married daughter to her mother

The AO during the course of assessment proceedings[29] observed that the taxpayer was claiming both an exemption in respect of HRA and a loss from self-occupied house property during the AY 2010-11. In response to an enquiry from the AO, the assessee explained that she owned a joint property with her spouse, but had also paid rent to her mother, in cash, since she stayed with her mother, to take care of her. Given that the transaction was with her parent, no formal contract was executed but rent receipts were duly collected.

The AO rejected the exemption in respect of House Rent Allowance (HRA). The AO observed that even if the rent was paid to a family member, the relation between the parties was a contractual relation and needs to be supported by documentary evidence to prove the same. Payment of rent to a parent who was old and sick to meet day to day living cost does not entitle the assessee to claim exemption in respect of HRA. An inspection carried out by the AO confirmed that the assesse was actually staying at the owned property and not at the rented property.

Similar adjustments were also made for AY 2009-10 and AY 2011-12. On an appeal before the CIT(A) against the orders passed by the AO, the contention of the assessee was rejected again. The taxpayer filed an appeal before the Tribunal against the orders passed by the CIT(A).

The Tribunal considered the appeals in respect of all three AYs in question together. The arrangement of payment of rent by the assessee to her mother was considered a sham transaction in order to reduce tax liability. The Tribunal placed reliance on the Indian Evidence Act, 1872[30], to hold that burden of proving a fact within the knowledge of a person, would be on him/her and he/she would need to be able to demonstrate all related facts, in this connection. Therefore, the onus lies on the assessee to prove that the payment of rent was a genuine transaction.

The Tribunal set out certain instances of documentary evidence which could arise in the normal course of renting an accommodation, which could have been produced by the assessee, but was not brought on record. These are as under:

- Leave and licence agreement
- Information about tenancy to building a society
- Payments via banking channels
- Cash payments backed by known sources/traceable to specific withdrawals
- Utility bill payments through banking channels
- Correspondence on tenancy
- Disclosure of rental income in landlord's income tax return; and
- Reasonableness of rent paid.

Even disregarding the inspection carried out by the AO in this connection, exemption was not allowable as the payments towards rent were not considered to be legitimate payments, as no substantive/cogent documentary evidence was placed on record to show genuineness of the

[29] Under Section 143(3) read with Section 143(2) of the Act
[30] Sections 6 and 106 of the Act

transaction and occupation of the rented premises by the assessee. Under these circumstances, the orders of the CIT(A) were confirmed and the appeals were dismissed.

Meena Vaswani v. ACIT [2017] 164 ITD 120 (Mum)

For further details please refer to our Flash News dated 5 April 2017 available at this link

Interest accumulated in a recognised Provident Fund account post retirement/end of employment is considered taxable

The taxpayer had ceased to be an employee of Wipro Ltd. in tax year 2001-02 after 26 years of service, and the amount of contributions accumulated in his PF account (including interest) as on date of retirement was INR3.7 million. Nine years later, the taxpayer withdrew the total accumulations from his account, which amounted to INR8.2 million. This withdrawal also included interest accrued post his retirement, amounting to INR4.4 million;

During the year 2010-11, the taxpayer filed his India income tax return (ITR) without declaring the accumulated balance withdrawn from his PF account. The ITR was subject to scrutiny assessment and an order was passed[31], whereby the AO *inter-alia* added the entire balance withdrawn to the total income.

Aggrieved by the order of the AO, the taxpayer had filed an appeal with the CIT(A), who deleted the entire addition made by the AO. Aggrieved by the order of the CIT(A), the Revenue had filed an appeal with the Tribunal.

The Tribunal took cognisance of the taxpayer's contentions and held as under, in relation to the accumulated PF balance as on date of retirement:

- The withdrawal of accumulated PF balance amounting to INR3.7 million (viz. contributions and interest upto retirement) is eligible for exemption[32].
- The said exemption is further reinforced as no taxes were deducted at source[33] on the withdrawn amount by the Trustees of the PF.
- Based on a judicial precedent[34], a mere non-mentioning of exempt income in the ITR cannot be construed as a new claim. The Tribunal had further observed that such claim of exempt income was already put forth by the taxpayer during the course of assessment proceedings.

In relation to interest accrued in the PF account post retirement, the Tribunal observed as under:

- Though there is a provision[35] for the Trustees of the PF to allow the balance accumulated in the fund to be retained even after cessation of employment, the exemption[36] is limited to the accumulated PF balance due and payable to the taxpayer only upto the date of cessation of employment. Any further interest accrued (post cessation of employment) cannot be construed as earned in the capacity of an employee;
- Given the above, in the instant case, the accumulated interest post retirement amounting to INR4.4 million is not eligible for exemption[37].
- Further, the said interest income should be offered to tax in the respective TYs in which such income actually accrued, as the taxpayer followed a mercantile system of accounting.

ACIT v. Shri Dilip Ranjrekar [ITA No 858 (Bang) 2016]

[31] Section 143(3) of the Act
[32] Section 10(12) of the Act read with Rule 8 of Part A of Fourth Schedule
[33] Rule 10 of Fourth Schedule
[34] NTPC Ltd. v. CIT [1998] 229 ITR 383 (SC)
[35] Sub-rule 3 of Rule 5 to Fourth Schedule
[36] Section 10(12) of the Act
[37] Section 10(12) of the Act

For further details please refer to our Flash News dated 27 November 2017 available at this link

State taxes paid in the United States of America are eligible for foreign tax credit in India

The taxpayer was a Director in a pharmaceutical company and had received salary of INR6.21 million from a US based entity, during the relevant tax year 2009-10, which was doubly taxed both in India and the USA. On such taxable income, the taxpayer had *inter-alia* claimed a credit of state taxes paid in the USA amounting to IN0.53 million while filing his India income tax return.

The Assessing Officer rejected the claim on the ground that Article 2 of the Agreement for avoidance of double taxation of income with USA (the tax treaty) covers only federal income tax in the USA. On appeal, the CIT(A) noted that there was a Mumbai Tribunal decision[38] on the same issue, in favour of the taxpayer, but declined to follow the said decision on the ground that it had been challenged before the High Court, and thereby upholding the order of the AO. Aggrieved by the order passed by the CIT(A), the taxpayer had filed an appeal with the Ahmedabad Tribunal.

The Tribunal relied extensively on the Mumbai Tribunal decision which was disregarded by the CIT(A). The Mumbai Tribunal decision had upheld foreign tax credit in respect of State income-taxes paid in the USA, on the following basis:

- Section 90 of the Act deals with relief of taxes paid in a country with which India has entered into an Agreement, and Section 91 of the Act deals with relief of taxes paid in any country with which there is no agreement under Section 90 of the Act;
- Section 90(2) of the Act provides that the provisions of the Act shall apply only to the extent they are more beneficial to that taxpayer;
- A Circular[39] issued by the CBDT specifically clarifies that any beneficial provision in the law would not be denied merely because a corresponding provision in the Treaty is less beneficial;
- In view of the above, it is possible to treat Section 91 as having general application, even in a case where Section 90 would typically apply;
- In the instant case, the Treaty provides that tax credits are admissible only in respect of Federal taxes and not State taxes. Conversely, provisions of Section 91 of the Act permits credit for all income taxes paid abroad- whether state or federal;
- Therefore, even in a case covered by the Treaty, the provisions of Section 91 of the Act would be applicable to the extent it is more beneficial to the taxpayer;
- As Section 91 does not discriminate between state and federal taxes and in effect, provides for both these income-taxes to be taken into account for the purpose of tax credit in India, the assesse would be entitled in principle, to such tax credits in India.

Relying on the above, the Ahmedabad Tribunal held that the taxpayer is entitled to credits on both federal (under Section 90 of the Act) and state taxes (under Section 91 of the Act) paid in the USA. However, tax credit would need to be restricted to actual income tax liability in India, in respect of such doubly taxed income.

Dr. Rajiv I. Modi v. DCIT [2017] 86 taxmann.com 253 (Ahd)

For further details please refer to our Flash News dated 10 November 2017 available at this link

Overseas taxes and Medicare would not constitute taxable salary in India

The taxpayer was an employee of Fidelity Business Services India Pvt. Ltd who was transferred to Fidelity Investments Systems Inc, USA from 07 October 2010 to 21 June 2012. The taxpayer derived income from salary during the FY 2010-11. The taxpayer was an ordinary resident (ROR)

[38] Tata Sons Ltd. v. DCIT (ITA No 3461 of 2009, dated 28 January 2011)
[39] Circular 621 dated 19 December 1991

in India during the said FY. Further, in the United States (U.S.) he was a non-resident during the year 2010 and a resident in 2011. The taxpayer had offered the actual salary income received in U.S. as taxable in his India tax return and claimed FTC[40] in respect of the Federal Tax withheld from his overseas salary

The AO in his order added the Federal Tax claimed as FTC to the income of the taxpayer. The CIT(A) upheld the order passed by the AO and enhanced the amount of Federal Tax so added to income. Furthermore, the CIT(A) added Medicare paid in the U.S. and State Tax withheld in the U.S., to be part of the total income of the taxpayer, considering the same as benefit in his hands. Aggrieved by the order passed by the CIT(A), the taxpayer had filed an appeal with the Tribunal.

The Tribunal observed that as per Section 5(1)(c) of the Act, the Federal Tax and State Tax withheld in the U.S. would not constitute income that accrues or arises outside India as the same is not actually received by the taxpayer. Accordingly, the Tribunal has accepted the claim of the taxpayer by relying on one of the judgments[41] referred by the taxpayer, drawing reference to Section 5(1)(c) of the Act, which enables taxability of actual income that is received by the taxpayer outside India

Therefore, Federal Tax and State Tax were not considered taxable in the hands of the taxpayer and the net income after giving effect to deduction of taxes was considered taxable in India. The claim of FTC was remanded to the AO to determine the quantum of FTC as per Article 25 of the DTAA. The FTC claim shall, however, be restricted to the tax payable on the total income before giving effect to FTC. With respect to Medicare paid outside India by the employer, the Tribunal agreed with the taxpayer's contention having regard to one of the judicial precedents[42] referred by him. Accordingly, the same was not considered as a taxable perquisite.

Shri Sunil Shinde v. CIT [2017] 85 taxmann.com 297 (Bang)

For further details please refer to our Flash News dated 12 September 2017 available at this link

Indirect taxes

Goods and Service Tax

Goods and Services Tax (GST) implemented with effect from 1 July 2017

Notifications/Circulars/Press Releases

GST Return Filing

- The return filing process simplified by allowing all taxpayers to file return in FORM GSTR-3B along with payment of tax by 20th of the succeeding month till March, 2018.

  Taxpayers with annual aggregate turnover up to Rs. 1.5 crore need to file GSTR-1 on quarterly basis.

  Taxpayers with annual aggregate turnover more than Rs. 1.5 crore to file GSTR-1 on monthly basis.

  Filing GSTR-2 and GSTR-3 for the months of July, 2017 to March 2018 is suspended till further notice.

  Late fee charged for delay in filing Form GSTR 3B for the month of July 17, August 17 and September 17 has been waived and late fee already paid to be re-credited to their electronic cash ledger under "Tax" head to enable taxpayer to utilise the amount re-credited against future tax liabilities.

[40] Section 90 of the Act read with provisions of India-U.S. tax treaty
[41] CIT v. Yawar Rashid [1996] 218 ITR 699 (MP)
[42] CIT v. Lala Shri Dhar [1972] 84 ITR 192 (Del)

Press Release on Recommendations made by the GST Council in the 23rd meeting at Guwahati on 10th November, 2017]

- Letter of Undertaking facility extended to all registered persons who intend to export of goods/services without payment of IGST (including supply to SEZ developer or unit).

Notification No. 37/2017 – Central Tax New Delhi, 4 October 2017

Introduction of E way from February 2018

GST Council, in its 24th meeting have decided to introduce Electronic-Way Bill or E Way Bill.

Rule 138 of the CGST Rules 2017, provides for E Way bill mechanism. Electronic Way Bill (E-Way Bill) is basically a compliance mechanism wherein by way of a digital interface the person causing the movement of goods uploads the relevant information prior to the commencement of movement of goods and generates e-way bill on the GST portal.

The e-way bill provisions aim to remove the ills of the erstwhile way bill system prevailing under Value Added Tax (VAT) in different states, which was a major contributor to the bottlenecks at the check posts. Moreover different states prescribed different e-way bill rules which made compliance difficult. The e-way bill provisions under GST will bring in a uniform e-way bill rule which will be applicable throughout the country. The physical interface will pave way for digital interface which will facilitate faster movement of goods. It is bound to improve the turnaround time of vehicles and help the logistics industry by increasing the average distances travelled, reducing the travel time as well as costs.

Anti-profiteering Rules, 2017

Central Government has made Anti-profiteering Rules 2017. National Anti-Profiteering Authority is a mechanism devised to ensure that prices remain under check and to ensure that businesses do not pocket all the gains from GST.

The purpose of this mechanism is to ensure that any reduction in rate of tax on any supply of goods or services or the benefit of input tax credit should have been passed on to the recipient by way of commensurate reduction in prices and identify the registered person who has not passed on the benefit of reduction in the rate of tax on supply of goods or services or the benefit of input tax credit to the recipient by way of commensurate reduction in prices.

Service Tax

Service-tax applicable on service component in retreading of tyres and not on gross consideration

The issue before the Supreme Court was whether in case of a contract for retreading of tyres, Service tax was payable on the total amount charged including the value of materials/goods or only on the service component, under the provisions of *erstwhile* Service tax regime (i.e. prevailing before 1 July 2012).

The Supreme Court held that the taxpayer was only liable to pay Service tax on the service component which under the State VAT laws was quantified at 30 percent, on the basis of the following rationale –

- By virtue of the provisions of *erstwhile* Service tax regime, the value of goods and materials sold by a service provider to a service recipient in the course of provision of service is exempted from Service tax subject to documentary proof; and

- Further, VAT assessment with respect to payment of VAT on 70 percent of the total value was also not disputed.

Safety Retreading Company (P) Ltd. & Others v. Commissioner of Central Excise, Salem & Others, 2017-VIL-06-SC-ST

Supply of food by employer to workers is not a 'service'

The issue in the instant case was whether the food supplied by an employer to his workers at a subsidized rate would constitute a 'service' and become liable to Service tax.

In this regard, the Andhra Pradesh High Court held that the said activity of supply of food to workers cannot be construed as a 'service' on the basis of the following rationale –

- The food supplied by the employer to its employees forms part of the wages in terms of the provisions of Industrial Disputes Act, 1947 and therefore such remuneration paid to employees is outside the purview of the definition of 'service';
- The employer had already discharged Value Added Tax on the value of food supplied to employees and thus, once the State Authorities have treated the supply of food as 'sale', it cannot be treated as a service.

Bhimas Hotels Pvt. Ltd. v. Union of India [2017-VIL-213-AP-ST]

Lease Deed reigns over statutory provisions of service tax – lessee to discharge service tax liability despite lessor's liability.

In this case, the issue before the Supreme Court pertains to onus of discharging the Service Tax liability under a lease arrangement between the Government (Lessee) and Bengal Shrachi Housing Development Ltd (Lessor).

A Writ Petition was filed before the Calcutta High Court over a dispute as to who was liable to pay service tax under a lease transaction. Calcutta HC held that service tax essentially being indirect tax, the user of the premises who availed the services had to bear it.

However, referring to the relevant statutory provisions i.e. The Finance Act & Service Tax Rules, Supreme Court observed that it the provider of the service alone, who is liable to pay service tax and accordingly rejected the lessors contention that service tax being nothing other than VAT on consumption of service would fall upon lessee. Supreme Court reiterated that taxable event and taxable persons are distinct concepts and in the present case, taxable event is provision of services of renting immovable property, while taxable person is person liable to pay tax i.e. service provider viz. Lessor.

However, in light of sanction letters issued by government (Lessee) undertaking to bear registration charges, stamp duty, service tax etc. towards hiring of lease premises , refuses to pass order in favour Government (Lessee) but also set aside the order of the single Bench Calcutta High Court.

Union of India & Ors. v. Bengal Shrachi Housing Development Limited & Ors [TS-330-SC-2017-ST]

Service qualifies for export of service, if the recipient of service is located outside India

Verizon India (Taxpayer) is engaged in providing connectivity services to its parent company abroad i.e. Verizon US. Verizon US is providing telecommunication services to its customers globally by utilizing the services of taxpayer. The Taxpayer raises invoice to Verizon US for the services. Taxpayer is claiming refund of said services on the ground that the services qualify as 'export of services'.

The Revenue contended that as the final users of the said services are the subscribers located in India, place of provision of such services shall be in India, therefore rejected the refund application for the period from January 2011 to September 2014.

The High Court held that as per the export of service rules as amended on 27 February 2010 and further replaced by rule 6A of service tax rules 1994 on 1st July 2012, the service qualifies for export of service if the recipient of service is located outside India which in instant case is the location of Verizon US. It is the location of service recipient that is to be seen and not the location of users or the service consumption. Accordingly, services to be claimed as 'export' since the POPOS lies outside India and all the conditions specified under Rule 6A are satisfied.

Verizon communication India Pvt Ltd v. A.C, Service tax [2017-TIOL-1863-HC-DEL-ST]

Classification of services has to be made on the basis of essential character of the services rendered

The taxpayer was a service provider and registered with the Service Tax Department under the taxable category of 'Goods Transport Agency'. The taxpayer carries on the activity of transportation of commercial and household goods. In case of transportation of household goods the taxpayer carry on certain ancillary activities such as packing/ unpacking/ loading as per the requirement of the customers.

The Department alleged that the above services provided by the taxpayer for loading, unloading, together with shifting/transportation of household goods falls under 'Cargo Handling service' instead of 'Transportation of Goods by Road Service' on the ground that the essential characteristic of service is to provide safety of the goods by adopting means of loading, unloading, packing and unpacking.

In this background the CESTAT held that pursuant to section 65A(2)(b) in case of composite services consisting of combination of different services which cannot be classified in specified manner, the classification has to be made on the basis of their essential character. As per Section 65(50b) of the Finance Act, 1994 a person qualifies to be GTA if he issues a consignment note in relation to transportation of goods.

Also, the contractual relationship between the taxpayer and its customers are primarily confined to transportation of household goods and the customers never approach the taxpayer only for loading, unloading, packing or unpacking of goods. Thus, the modus operandi adopted by the taxpayer transpires that the principal aim and objective is for transportation of goods and providing of other services is incidental/ancillary to the main purpose of transportation. Thus, in the given case the services provided by the taxpayer merits classification under the GTA Service.

DRS Logistics Pvt. Ltd. v. CST [2017-TIOL-3237-CESTAT-DEL]

Service tax paid on Pest Control services to preserve the records is admissible as CENVAT Credit

The only dispute in the present appeal was whether the service tax paid on pest control services shall entitle the tax payer to avail CENVAT credit of the tax so paid.

Pest control being necessary to preserve the records, there is an inextricable link between the input service and the business. Therefore, it was held that CENVAT credit claimed by the tax payer was admissible.

JSW Steel (Salav) Ltd [2017-TIOL-3623-CESTAT-MUM]

In the absence of statutory provisions, CENVAT credit cannot be denied merely on the ground that serial no. on the invoices were hand written.

The facts of the case was that, credit was denied on the ground that the serial number on the invoices on which the credit was taken was hand written. The tax payer argued that there is no provision in law which mandates that the serial number has to be pre-printed. The impugned order relied on para 3.2 of Chapter 4 of CBEC Manual of supplementary instructions, which is not a statutory provision and therefore, credit cannot be denied on account of the said instructions.

In this background the CESTAT has held that, the impugned order do not identify any statutory provision which mandates the pre-printing of the serial number. Para 3.2 of Chapter 4 of CBEC manual, thereof are merely departmental instructions and therefore, in the absence of any statutory provision, the credit cannot be denied. On this count, the appeal is consequently allowed.

AA Trailers [2017-TIOL-3621-CESTAT-Mum]

CENVAT credit in respect of service tax paid on group health insurance for the family members of employees held eligible

The issue involved in the said case was that whether the tax payer being manufacturer was entitled for CENVAT credit in respect of service tax paid on group health insurance for the family members of the employees.

Commissioner of Central Excise (CE) filed the said application for rectification of mistake (ROM) in the Tribunal's order on the ground that all the judgments relied on by the tax payer was related to the insurance for the employees of the Company and not for the family members of the employees. Therefore there was a mistake in the Tribunal's order.

After considering the above grounds the CESTAT held that, CENVAT credit availed in accordance with rule 2(l) of Cenvat Credit Rules, 2004 on the group health insurance for the family of the employees was admissible. It further made clear that the family members are covered by the insurance scheme because that insurance not only cover the employees risk but also the family members of the employees.

In the findings of Tribunal order, it is clearly stated that the decision cited by learned Counsel has already decided the issue in hand. Therefore the issue is no longer res integra. Accordingly, the ROM application of Commissioner of CE is not maintainable and the same was dismissed and Cenvat claimed by the tax payer was held to be eligible.

Mercedes Benz India Private Ltd [2017-TIOL-4005-CESTAT-Mum]

CENVAT credit on GTA service towards transportation of goods from factory gate to depot and to the port of shipment is held admissible

The fact of the case was that the tax payer had availed CENVAT credit in respect of Good and Transport Agency (GTA) services used for clearances of finished goods from Roha factory to Bhivandi, Ahmedabad and Udaipur for further sale. They also availed the credit on GTA service towards transportation of goods from factory to port of shipment. The Commissioner of Central Excise (CCE) denied the CENVAT credit on the ground that the CENVAT credit on GTA from factory gate onwards was not admissible.

The taxpayer submitted that, in both the cases i.e. supply of goods a) up to depot and b) to the port of export, the place of removal was not factory gate but it was port, or depot, as the case may be, where the goods are sold/exported. The tax payer placed reliance on the judgment of *Menon Pistons ltd Vs. CCE, Kolhapur [2015 (40) STR 283 (Tri. Mum)] = 2013-TIOL-243-CESTAT-MUM.*

In this background, the CESTAT has held that in case of depot, the place of removal was depot and in case of export, the place of removal was port of export. Therefore, CENVAT credit was admissible on GTA service up to the place of removal i.e. depot/port of export. Accordingly, impugned order was set aside and appeal was allowed.

Rathi Dye Chem Pvt Ltd [2017-TIOL-3638-CESTAT-Mum]

CENVAT credit on services of erection, commission and installation for constructing temporary shed within factory premises for storage of final product admissible as covered within the definition of Input Services

Taxpayer claimed CENVAT credit of service tax paid on the services of erection, commission and installation received for the purpose of making a temporary shed which was constructed to store the final products.

The Revenue denied the CENVAT credit on the said services on the ground that the service of erection, commission and installation is not used in or in relation to the manufacture of final product. The Tax payer preferred an appeal with the CESTAT and contended that the erection, commission and installation service received in respect of setting up of temporary shed was used for storage of final product of the Tax payers during the rainy season and thus the said services are rightly covered within the definition of ‘input services’ under rule 2(l) of the Cenvat Credit Rules (CCR), 2002.

In this background the CESTAT held that, the services of setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage up to the place of removal,

are in the inclusion category of definition of 'input service'. The setting up of the factory also includes the storage place in the factory premises. Therefore, in the said case the service received for setting up of storage was held as admissible input service.

Balmer Lawrie & Co Ltd [2017-TIOL-2723-CESTAT-MUM]

CENVAT credit of service tax paid on freight charges from the depot to customer's premises was allowable when delivered on FOR basis

The taxpayer was manufacturer of cement and claimed CENVAT credit of service tax paid on freight charges from the depot to the customer's premises. The Taxpayer claimed that they are eligible for such CENVAT credit as their sales are on FOR destination basis.

The Tax Department was of the view that such CENVAT Credit will not be allowable after the amendment of the definition of input services under Rule 2(l) of the CENVAT Credit Rules 2004, wherein after the amendment of the definition on 1st April 2008, the credit for the input services would be allowable only up to the place of removal.

The taxpayer submitted that, they were required to cover the risk of loss or damage of the goods upto the premises of the customer, hence the CENVAT Credit was eligible. The revenue authorities contested that from the copies of documents in the record, it was not evident that the goods are being supplied on FOR destination basis.

CESTAT on perusal of the purchase orders submitted as part of the appeal, observed that the goods were delivered on FOR basis by the Tax payer. Further, the amended definition on input services w.e.f 1st April 2008 allows CENVAT Credit on input services only upto the place of removal. In the present case, since the delivery was on FOR basis, the place of removal is to be considered as the customer's premises. Consequently, the service tax paid on freight up to the customer's premises was eligible for CENVAT credit. In this case, the reliance was also placed on the judgement on Hon'ble High Court and Tribunal in the case of *Madras Cements Ltd - 2015-TIOL-1682-HC-KAR-CX.* Accordingly, the benefit of CENVAT credit of Service Tax paid on freight charges from depot to customer's premises was allowed.

Mangalam Cement Ltd [2017-TIOL-2782-CESTAT-DEL]

No service-tax on transshipment goods transported to Indian Customs station from overseas

The Central Board of Excise and Customs (CBEC) has clarified that Service tax would not be applicable on transshipment of goods through India (through a vessel) to any country outside India if the same is mentioned in import manifest / import report and the goods are transshipped in accordance with procedure prescribed under the Customs law.

Circular No. 204/02/2017-Service Tax, dated 16 February 2017

Advance ruling machinery for Service tax merged with Income tax

The Central Government has amended the Service tax law to merge the advance ruling machinery for Service tax with the machinery provided under Income tax.

Notification No. 12/2017 - Service tax, dated 31 March 2017

Liability shifted on 'importer' for transportation by vessel services from non-taxable territory

The Central Government has amended the Service tax law to shift the liability of discharging Service tax on 'importer' (as per Customs law), for services of transportation of goods by a vessel provided by overseas service provider to a customer located outside India from outside India up to the Customs clearance station in India. The Government has also granted an option to such importers to pay an amount calculated at 1.4 percent of the CIF value of imported goods. Further, the point of taxation for such services has been prescribed as the date of bill of lading of such goods in the vessel at port of export.

Notification No.16/2017-Service Tax dated 13 April 2017, Notification No. 14/2016-Service Tax dated 13 April 2017, Notification No.15/2017-Service Tax dated 13 April 2017 and Circular No.206/03/2017-ST dated 13 April 2017

Central Excise

No requirement for the service tax to be deposited by service provider before availment of credit by service recipient

In the present case, the taxpayer, engaged in the manufacture of pistons, piston rings etc. classifiable under HS Code 8409 claimed CENVAT credit on certain input services procured. During the course of Excise Audit, the Audit team raised objection and issued Show Cause Notice demanding the CENVAT credit availed since, there was delay in depositing the service tax by the service provider.

Based on the submissions of the parties, the Bangalore Tribunal mentioned that the taxpayer, who has paid the service tax to the service provider is entitled to avail the credit without finding whether such service tax paid by him to the service provider stands further deposited by him to the Exchequer. It is neither possible nor practical for any service recipient to verify the fact of payment of service tax by the service provider. Accordingly, the appeal was allowed.

Federal Mogul TPR (India) Ltd v. Commissioner of Customs and Service Tax (2017-TIOL-163-CESTAT-BANG)

Once the final product is treated as dutiable and duty is paid by the assessee, there is no question of reversal of CENVAT credit

In the present case, the appeal has been filed by revenue against the order of CESTAT wherein CESTAT had held that when the CENVAT credit is availed on the inputs stand utilized for payment of duty on the final product, there would be no requirement for reversal of the said credit. Even, if the activity undertaken does not amount to manufacture.

In this regard, the Hon'ble Karnataka High Court relying on the judgement in the case of *Creative Enterprises 2009 (235) E.L.T. 785 (Guj.)* held that it is an undisputed position that the final product is treated as dutiable and duty is paid by the assessee. When the duty is paid treating the activity as 'Manufacture', there arises no question of reversal of CENVAT credit.

CCE v. Vishal Precision Steel Tubes & Strips Pvt Ltd (2017 – TIOL – 613 – HC – KAR-CX)

Education Cess & Secondary Education Cess paid held refundable when basic duty is nil

In this case, the tax payer was engaged in the manufacture and clearance of malted milk food and had set up its factory in the state of Assam. As per the special package for the north eastern regions, new industrial units were entitled to 100% excise duty exemption for a period of 10 years from the date of commencement of commercial production.

Pursuant to the said industrial policy, the Central Government issued Notification No. 20/2007-Ex. dated 25 April, 2007. The methodology which was adopted and prescribed in the said notification was that the manufacturer was initially supposed to pay the excise duty leviable on such goods at the time of clearance as per the Tariff Act and thereafter claim the refund.

Further, vide Finance Act, 2004, the Education Cess (EC) and Secondary Higher Education Cess (SEC) was imposed, which are surcharge on the excise duty. These EC & SEC was levied and collected from the manufacturers who had set up their units in the aforesaid areas, along with the excise duty. However, while refunding the excise duty paid by these manufacturers, the EC & SEC that was paid by the manufacturers along therewith was not refunded.

As the tax payers were denied refund of the EC & SEC, they challenged the order of the Assessing Officer by filing appeal before the Commissioner (A). However, these appeals was dismissed by the Commissioner and the order of the Commissioner was upheld by the CESTAT. The Tribunal

relying on the judgment in case of *Jindal Drugs Ltd. 2009-TIOL-2562-CESTAT-DEL* held that the Excise department was under no obligation to refund the EC & SEC as the notification exempted only the excise duty and, therefore, it was the excise duty which was to be refunded.

In this background, the Hon'ble Supreme Court noted to take cognizance of the department view regarding EC & SEC which was payable as surcharge on the excise duty, once the excise duty was exempted. Also extracting the circular dated 10 August, 2004 which clarifies that EC is part of excise and circular dated 8 April, 2011 issued by the CBEC on the subject "EC & SEC - reg.". Accordingly, the Hon'ble Supreme Court observed that the Government itself has taken the position that where whole of excise duty or service tax is exempted, even the EC as well as SEC would not be payable. These circulars are binding on the department.

Accordingly, Supreme Court held that when basic duty itself is Nil, EC and SEC paid by the tax payer was refundable.

SRD Nutrients Pvt Ltd v. CCE [2017-TIOL-416-SC-CX]

When credit was reversed prior to utilization, interest cannot be demanded

In the said case, the appeal was filed against the demand of interest on credit reversed by the appellant without utilizing the same.

The taxpayer relied on the decision of the High Court in the case of Bill Forge Pvt. Ltd. 2012 (279) ELT 209 (Kar.), 2011-TIOL-799-HC-KAR-CX, wherein it was held that, where the credit was reversed before utilizing, then interest cannot be demanded.

The Department had relied on the decision of the Supreme Court in case of Indswift Laboratories Ltd. 2011(265) ELT 3, 2011-TIOL -SC-CX to assert that the interest can be demanded even in the circumstances when the credit has not been utilized.

In this background, the CESTAT had held that, where the credit was reversed prior to utilization thereof, interest cannot be demanded. In the instant case, it was seen that the show-cause notice confirmed that the assessee had not utilized the said credit. In view of the above, the demand of interest on the credit reversed before utilizing the same was set aside.

HYT Engineering Company Pvt Ltd. [2017-TIOL-3344-CESTAT-MUM]

CENVAT credit availed on basic excise duty can be utilized towards discharging liability of Education Cess and Secondary & Higher Education Cess

The appellant had utilized the CENVAT credit availed on Basic Excise Duty (BED) towards Education Cess (EC) and Secondary & Higher Education Cess (SEC).

Alleging that utilization of said credit was irregular and contrary to the provision of Rule 3 of the Cenvat Credit Rules, 2004 (CCR), a show cause notice was issued for recovery of the said credit along with interest and penalty. On adjudication, the demand was confirmed with interest and penalty under Rule 15(1) of the CCR. Aggrieved by the said order the Assessee filed appeal before the Commissioner (Appeals), who in turn, rejected the appeal.

The taxpayer filed an appeal against the said rejection, wherein it was submitted that, the issue of utilization of BED in discharging liability of EC and SEC was no more res integra and was covered by the decision of the Gujarat High Court in the case of C.C.E. & S.Tax, Vapi vs. Madura Industries Textiles - 2012-TIOL-1094-HC-AHM-CX.

The Department submitted that, since the appellant had availed area based exemption, the CENVAT credit availed on BED cannot be utilized in discharging their liability towards EC and SEC.

In this background the CESTAT had held that, the issue was no more res integra being settled by the judgment of Hon'ble Gujarat High Court in the case of Madura Industries Textiles (supra), wherein it was observed that CENVAT credit availed on BED can be utilized towards discharging liability of EC and SEC.

Electrotherm India Ltd [2017-TIOL-3174-CESTAT-AHM]

Goods cleared for export under Bond destroyed before the same could be exported would be eligible for remission of duty

The taxpayer was in appeal against denial of remission of duty on goods destroyed in the warehouse after the same were cleared from the factory for the purpose of export.

The appellant had pointed out that identical issue had been decided by the Larger Bench of the Tribunal in the case of Honest Bio-Vet Pvt. Ltd. vs. CCE, Ahmedabad-I - 2014 (310) ELT 526 (Tri.-LB) 2014-TIOL-2286-CESTAT-AHM-LB. In the said order, following has been observed:-

"14. We are of the view that the goods cleared for export under Bond which were destroyed before the same could be exported, can be treated as having been destroyed before removal only. This would be the fair interpretation of the Rule 21 of the Central Excise Rules, 2002. Thus, primary lcondition of eligibility of Remission of duty on the destroyed goods is fulfilled as required u/r 21 of Central Excise Rules, 2002. Appellant is eligible for the Remission of duty in respect of goods for export under Bond which were destroyed before the same could be exported."

In view of above judgement the CESTAT had held that, the said issue was squarely covered by the decision of the Larger Bench of the Tribunal. Consequently, the appeal was allowed and Assessee was allowed remission of duty.

Metropolitan Eximchem Ltd [2017-TIOL-CESTAT-Mum]

Customs

"Nil" rate is also a rate of tax, which is payable on sale, but for the exemption:

Notification No. 102/2007 – Customs grants exemption to SAD, subject to fulfilment of certain conditions itemized therein. One of the requisite conditions for claiming refund of SAD is that "the importer shall pay on sale of the said goods, appropriate sales tax or value added tax, as the case may be".

In this regard, a refund claim filed by the taxpayer in respect of 4% of additional duty of customs (SAD) under Notification No. 102/2007 – Customs was denied on the ground that the imported goods were sold goods at Nil rate of VAT/ ST.

The taxpayer has filed an appeal before the CESTAT against the above, wherein it was held that, sale of footwear attracts payment of Value Added Tax. However, the said goods are exempted from payment of VAT on its sale, by virtue of the Notification issued by the State Government. Since, the goods imported by the appellant attract "Nil" rate of VAT and the appellant did not pay VAT in view of the exemption Notification, it cannot be said that the appellant had violated the conditions mentioned in the Notification inasmuch as, "Nil" rate is also a rate of tax, which is payable on sale of subject goods, but for the exemption.

Thus, "Nil" rate should not dis-qualify the phrase "appropriate sales tax or VAT" as contained in the Notification. Further, it was held that the case is no more res integra in view of the decision of the Tribunal in the case of *Gazal Overseas vs. CC, New Delhi - 2016 (332) E.L.T. 767 (Tri. - Del.) = 2015-TIOL-2454-CESTAT-DEL*. Accordingly, appeal was allowed in favour of the taxpayer.

A P Traders v. CC (2017-TIOL-1976-CESTAT-DEL)

Exempts goods imported by EOUs from integrated tax and compensation cess

Integrated tax and compensation cess leviable thereon under sub sections (7) and (9), respectively of Section 3 of the Customs Tariff Act for EOU's is being exempted till 31st March 2018, thereby amending principal notification no. 52/2003 – Customs dated 31st March 2003 and last amended notification no. 59/2017 – customs dated 30th June 2017.

Notification No. 78/2017 – Customs dated 13 October 2017

Implementing Electronic Sealing for Containers by exporters under self-sealing procedure

In order to ensure that electronic seals deployed are of a reliable quality, the Board has adopted international standards laid down under ISO 17712:2013 for high security seals and prescribed that vendors intending to offer Radio Frequency Identification (RFID) seals should furnish certifications required under the ISO standard. Further, the data elements prescribed under para 4 (a) of circular 36/2017-Customs have to be incorporated.

As a measure of data integrity and security of sealing, vendors are also required to ensure that the Tag Identification (TID) number is captured in their data base and the IEC code of the exporter is linked to the same at the time of sale of the seals. Upon reading at the Port / ICD, the software application shall ensure that the seal's identity is checked with its TID.

Amendment to Customs valuation rules – Notification No.91/2017 (NT) dated 26th September 2017

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (CVR) contain the detailed provisions for arriving at the transaction value of the imported goods, on which the customs duty is levied.

The Government has amended the CVR vide Notification No. 91/2017 (NT) dated 26th September, 2017, as explained below:

Definition of the term 'place of importation'

The term "place of importation" has been used in the CVR; however, the term was not defined. To bring in clarity, the "place of importation" has been defined as:

"Place of Importation" means the customs station where the goods are brought for being cleared for home consumption or for being removed for deposit in a warehouse".

In view of the above definition, the transaction value of the imported goods in terms of section 14 of the Customs Act, 1962 would include the costs incurred up to the place of importation, as defined above.

Treatment of the loading, unloading and handling charges

By virtue of the amendment now carried out to the CVR, 2007, the loading, unloading and handling charges associated with the delivery of the imported goods at the place of importation, shall no longer be added to the CIF value of the goods. Thus, only charges incurred for delivery of goods "to" the place of importation (such as the loading and handling charges incurred at the load port) shall now be includible in the transaction value.

Computation of freight and insurance

Now, the 2nd & 4th provisos to Rule 10 (2) impart more clarity in computation of transport and insurance charges, when actuals of each individual element are not known, but the cumulative value of FOB and freight, or, FOB and insurance charges are known.

Treatment of transshipment costs

In the erstwhile 4th proviso to Rule 10(2), while the transshipment charges with respect to a container being moved from port to an ICD and CFS were excluded from the transaction value of the goods, there was no mention of a similar treatment to transshipment of goods by sea or air. Now, by virtue of the 6th proviso to Rule 10 (2), costs related to transshipment of goods (from ports to ICDs; port to port, port to CFS, Airport to Airport etc.) within India will be excluded, providing uniform treatment to different modes of transshipment.

Circular No.39/2017 Customs, dated 26 September 2017

Pilot Implementation of Paperless Processing under SWIFT – Uploading of Supporting Documents

Para 8 of Board's circular no.10/2016 dated 15th March 2016 stated that, CBEC was in the process of procuring IT infrastructure to capture digitally signed copies of the supporting documents. Under

project “Saksham”, CBEC has upgraded its IT infrastructure, which would inter alia be used for the introduction of paperless processing under SWIFT.

With the objective of reducing physical interface between Customs/regulatory agencies and the trade and to increase the speed of clearance it is proposed to introduce a facility to upload digitally signed supporting documents on a pilot basis to be launched shortly at Air Cargo complex, New Delhi and Chennai Customs House. The pilot will cover all types of imports under ICES. After the completion of the pilot, the facility will be extended to all ICES locations.

Circular No. 40/2017 Customs, dated 13 October 2017

Implementing Electronic Sealing for Containers by exporters under self-sealing procedure prescribed

The Board has approved the procedure which shall be adhered by the exporters opting for self-sealing. The new self-sealing procedure shall come into effect from 1st October 2017. Till then the existing procedure shall continue.

The procedure, standard specification of the seal, application, record keeping and data retrieval system are clarified by the Board. Officer of the rank of Superintendent shall be responsible for coordination of the arrangements for installation of reader-scanners, whether fixed or hand-held for the self-sealing procedure.

Circular 36/2017 – Customs, dated 28 August 2017

DGFT- Trade Notice:

Changes in IEC with the introduction of GST

Changes have been made in IEC, with the introduction of GST. Since, GSTIN would be used for purposes of credit flow of IGST on import of goods and refund or rebate of IGST related to export of goods, it has been decided that the importer/exporter would need to declare only GSTIN (wherever registered) at the time of import and export of goods. Usage of IEC would continue for importer/exporter not registered under GST.

Further, with a view to keep the identity of an entity uniform across the Ministries/Departments, it has been decided that PAN of an entity will be used for the purpose of IEC. Accordingly, for new applicants, PAN will be authorized as IEC. For existing IEC holders, necessary changes are being made in the system, so that their PAN becomes their IEC. IEC holders are required to quote their PAN in all future documentation w.e.f. implementation date of GST.

Trade Notice 9/2017, dated 12 June 2017

Establishing, ‘Contact@DGFT’ service as single point contact for all foreign trade related issues

‘Contact@DGFT’ system has been activated at the Directorate General of Foreign Trade (DGFT) website (www.dgft.gov.in) as a single point contact for resolving all foreign trade related issues.

Exporters/Importers are requested for using this facility for resolution of foreign trade related issues either directly concerning DGFT (headquarters or regional offices) or concerning other agencies of the Central or State Governments.

A reference number will be issued for each request so that the status of action taken can be tracked.

Trade Notice 17/2015-2020, dated 6 September 2017

DGFT Public Notice

Onetime condonation of time period in respect of obtaining block wise extension in Export Obligation period under EPCG Scheme

As a onetime measure, it has been decided that the Regional Authority (RAs) concerned may consider the requests for block-wise Export Obligation period extension for the requests already

submitted but submitted beyond the time on payment of additional composition fee of INR 5,000/- in addition to payment of regular composition fee as applicable , subject to the following:

- The capital goods have been installed within the period of 18 months from the date of imports but the installation certificate has been submitted to RA beyond 18 months from the date of import.
- The authorization holder submits to RA bonafide reasons for delay in submission of installation certificate.
- The installation certificate is submitted to RA on or before 31 March 2018.
- The EPCG authorization is not under investigation/adjudicated by RA/customs authority/any other investigating agency.

The RAs may also consider the requests that may be received up to 31 March 2018 under this facility. This shall be subject to the condition that the case is otherwise in order and submission of installation certificate for the capital goods imported to the RA concerned. This facility is for EPCG authorizations issued from 1 September, 2004.

The EOP extension would be granted as per the relevant provisions of Hand Book of Procedure (HBP) applicable on the date of issue of authorization in continuation of the original/extended expiry period, and would be subject to fulfillment of all other relevant conditions of the Foreign Trade Policy (FTP) and HBP.

Public Notice No. 35, 36 & 37 /2015-2020, dated 25 October 2017

VAT

Retrospective amendment in the Act is valid when intent of legislation is apparent from statutory provisions, irrespective of its faulty implementation mechanism

In the present case, the taxpayer had opted for the Packaged Scheme of Incentives, 1993 (PSI Scheme) and were entitled to claim VAT exemption on the production carried out by eligible units. The Scheme originally stated that, fixed assets acquisition outside the scheme if accepted can be considered for purpose of proportionate incentives. Thereafter, in 1994, vide a Government Resolution, the word 'proportionate' was deleted, thereby giving an impression that entire acquisition of new assets would be considered for purpose of incentives.

Subsequently, a Trade Circular was issued in 1998 by the Commissioner of Sales Tax, stating that incentive would be given in proportion of expansion capacity to total capacity and not on entire production of an eligible unit. However, the Maharashtra Sales Tax Tribunal rendered the circular as invalid on the basis that an administrative circular contrary to the scheme could not be issued as the scheme was statutory in nature. The Hon'ble High Court upheld the order of Tribunal. Thereafter, the State Government amended the Bombay Sales Tax Act, 1959 (BST Act) and introduced provision on proportionate incentives to an Eligible Unit overriding the PSI Scheme. Similar provision also continued under Maharashtra Value Added Tax, 2002 (MVAT Act). However, no rules were framed in relation to computation of such proportionate turnover till the year 2009.

In 2009, the aforesaid section of the MVAT Act was amended retrospectively from 1 April 2005, and the ratio in proportion to which benefit could be availed under PSI Scheme was introduced, requiring the assesse, who had already availed of exemption benefit on entire turnover, to pay VAT on proportionate turnover from the period 2005. The taxpayer filed a writ petition with the High Court challenging constitutional validity of the amendment. It was contended exemption was available on entire turnover as no rules were framed to restrict the exemption only up to proportionate turnover under BST Act and MVAT Act and allowing exemption only on proportionate turnover amounts to a fresh levy with retrospective effect, thereby violating the Article 14 of Constitution of India.

The High Court observed that, the legislature has the power to enact a law prospectively as well as retrospectively and where a law suffers from an infirmity, it is constitutionally permissible for the legislature to cure the same by removing the defect in the earlier legislation. The provisions

restricting the exemption to proportionate turnover, were overriding the PSI Scheme, however, Government did not prescribe the ratio to calculate the proportionate turnover in order to avail the exemption. Also, retrospective operation of such amendment is permissible as it was in the nature of a valid legislation and it is permissible for the legislature to remedy the defect by curing it. Thus, HC rejected the taxpayer's contention that a new levy was imposed with retrospective effect and dismissed the writ petition.

Thereafter, the taxpayer filed an appeal before the Supreme Court, and argued that High Court has failed to appreciate the consequences and practical impact of the retrospective amendment on the industrial units, which did not recover any VAT from their customers and if VAT would have been recovered from customers during such period, it would have been considered as illegal and constituted as criminal offence. Referring to various judgments, the learned counsel of the State submitted that, Legislature is empowered to enact a law, either prospectively or retrospectively and also empowered to nullify the effect of a judicial decision by changing the law retrospectively by removing the basis on which the decision was pronounced. Also, retrospective enactment cannot be impugned on the ground that the retrospective levy did not afford any opportunity to the dealers to pass on the tax to consumers.

Supreme Court affirmed that where law suffers from an infirmity, it is permissible for the legislature to cure the same. This is known as legislation of validating nature, which is constitutionally permissible in as much as such validating law is in the nature of removing the defect in the earlier legislation. Further, in connection to trade circular issued by Commissioner of Sales Tax, the SC stated that the Government did prescribe ratio for computation of proportionate turnover eligible for exemption under PSI Scheme but have chosen incorrect method by issuing administrative circular rather than issuing statutory notification in the form of rules. Such mistake is rectified by way of amending the MVAT Act and therefore it was not a new levy. The SC also mentioned that it is concluded in various judgments of this court that the legislature had given power to the State Government to prescribe the ratio/proportion in which the benefit was to be given. It was also observed that, it is also settled position in law that the dealer upon whom the tax is imposed is not in a position to pass on tax on the consumers, is of no relevance to the competence of the legislature.

M/s. Exurotex Industries & Exports Ltd. and ANR v. State of Maharashtra and ANR, TS-116-SC-2017

Supreme Court upholds double input tax credit reduction on furnace oil, natural gas and light diesel oil used in the manufacture of goods, once in the case branch transfer outside state and again during usage as fuel for the purpose of manufacture

The taxpayer is a registered dealer under the Gujarat Value Added Tax Act, 2003 (GVAT Act) and is engaged in the business of manufacturing of polymers and chemicals in the state of Gujarat, by consuming raw materials such as furnace oil, natural gas and light diesel oil. VAT, at the applicable rates, is paid by the tax payer on raw materials purchased. Manufactured goods are transferred for sale to various branches of the tax payer, located across the country.

Section 11(1) of the GVAT Act entitles a registered dealer to claim tax credit on taxable goods purchased, subject to the provisions of sub-section (2) to (12) of the said section. Extract of Section 11(3)(b), which is relevant in the present case has been reiterated below:

"Notwithstanding anything contained in this section, the amount of tax credit shall be reduced by the amount of tax calculated at 4 per cent on taxable turnover of purchases within the State-

i. Of taxable goods consigned or dispatched for batch transfer or to his agent outside the State, OR
ii. Of taxable goods which are used as raw materials in the manufacture, or in the packing of goods which are dispatched outside the State in the course of branch transfer or consignment or to his agent outside the State.
iii. Of fuels used for the manufacture of goods."

The AO has contended that the raw materials purchased by tax payer falls under both the sub-clauses i.e. (ii) and (iii), for the reason that same is used for the manufacture of goods by tax payer

and involves purchase of fuels, respectively. Accordingly, input tax credit shall be reduced at the rate of 8 per cent. (4% + 4%)

Aggrieved by the order of the AO, the tax payer filed an appeal before the Joint Commissioner of Commercial Taxes (JCT). The JCT also upheld the order of AO on similar grounds. Thereafter, tax payer preferred an appeal before the Gujarat Value Added Tax Tribunal ('Tribunal'). The Tribunal concluded in the favour of tax payer on the grounds that the deduction can be at 4% only and there cannot be double reduction in tax credit. Further, the High Court ('HC') also upheld Tribunal's order on the grounds that, proviso to section 11(3)(b) states that if the input tax credit available to a dealer is less than 4%, then the reduction should be limited to such credit and thus, legislature does not have any intention to reduce the input tax credit beyond 4%.

Against such order, State ('appellant') filed an appeal before the Supreme Court on the contention that the High Court has failed to understand the scheme of tax credit and its related provisions, which clearly mentions that input tax credit shall be reduced by 4% when a case is covered under sub-clause (ii) and again at the rate of 4% when the matter is covered under sub-clause (iii). Further, the appellant also contended that sub-clause (ii) as well as sub-clause (iii) are attracted in different circumstances and, therefore, the reduction stipulated therein could not be treated as double taxation. Thus, legislature's intent is very clear to reduce input tax credit in each of the circumstances.

In response to the above, the tax payer contended that reduction rate cannot be more than the eligible input tax credit. Hence, in respect of furnace oil, where the VAT is payable at 4% if the contention of the appellant is accepted, deduction there on would be at the rate of 8% (4% under sub-clause (ii) and 4% under sub-clause (iii)) and it would result in an anomalous position as tax credit earned on the said furnace oil is only 4%.

The Supreme Court examined that submissions of both the parties and referred to the provisions of relevant section and also, various judicial pronouncements. Basis this, the Supreme Court held that there is no question of overlap between sub-clause (i) and sub-clauses (ii) and (iii) since this is separated with disjunctive 'or'. However, in case of sub-clauses (ii) and (iii), where there is a possibility of overlap, there is no word 'or' used between sub-clauses (ii) and (iii). Sub-clause (ii) finishes with punctuation mark full stop and then sub-clause (iii) starts. SC stated that this depicts the intention of the Legislature that reduction of input tax credit is not confined to the one sub-clause. Further, the SC also relied upon various judgments which pronounced the manner in which punctuations are to be interpreted.

In view of the above, the Supreme Court held that reduction of 4% would be applied whenever a case gets covered by sub-clause (ii) and again, when similar case is covered under sub-clause (iii). However, Supreme Court has clarified that it would be subject to one limitation i.e. reduction shall be limited to the amount of input tax credit available in respect of a particular item.

State of Gujarat v. Reliance Industries Limited [TS-282-SC-2017-VAT]

Circulars

- Commissioner of Delhi VAT Department has extended the due date for filing online return in Form 9 to 31 December 2017 for the FY 2016-17. Before such amendment, as per rule 4 of Central Sales Tax (Delhi) Rules, 2005, the dealers were required to file such reconciliation return within the period of 6 months from the end of financial year. Further, such return is required to be filed by the dealers who have made interstate sales at concessional rate against 'C-Forms' or stock transferred against 'F- Forms' or sold goods against H Forms to dealers (other than Delhi) or claimed deduction from taxable turnover against E-I/E-II Form or I/J Form etc.
- The dealers who have not made any sales as mentioned aforesaid during the FY 2016-17, are not required to file reconciliation return under Form 9.

Circular No. 16 of 2017-18

Entry Tax

Entry Tax imposed by States on goods coming in from other States is constitutionally valid; States are well within their powers to legislate Entry tax

In this landmark judgement, nine-judge bench of the Supreme Court of India with a majority verdict of 7:2 has upheld the constitutional validity of entry tax imposed by all the States. The Supreme Court Held that Article 301 of the Constitution does not apply to taxes. Therefore, imposition of entry tax cannot be said to be restriction on freedom of trade and commerce.

The majority judgement also overruled the concept of compensatory taxes holding that the concept does not have any juristic basis. It has further been held that Article 304(a) & 304(b) of the Constitution of India are distinctive and the States do not require Presidential assent to pass the entry tax law.

Jindal Stainless Ltd &Anr. v. State of Haryana & Ors - 75 taxmann.com 137 (SC)

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