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Editorial:

Dear Esteemed Readers,

We are pleased to share with you our latest newsletter covering direct tax & transfer pricing updates in India for March 2016.

First for some good news coming from the North Block. The Finance Ministry has recently announced that it has indeed achieved the fiscal targets for FY 2015-16. As estimated earlier, the fiscal deficit is likely to be below 3.9% and the tax revenue is likely to be collected as targeted viz. ₹ 14.60 lakh crores. It further added that the disinvestment target of ₹ 25,000 crores was also achieved. India's forex reserves provided a cover of 73% to the total external debt, as at end of December 2015.

The Finance Act, 2015 had inserted section 9A to the Act providing that the fund management activity carried-out through an eligible fund manager in India by an eligible investment fund does not constitute business connection in India of the fund and also does not lead to the residence of the fund in India. Rules for operationalization of this section were notified by the CBDT in March 2016, inter-alia providing for a pre-approval mechanism acting more like a safe-harbour rule.

Continuing its remarkable run of concluding APAs, the CBDT, has in March 2016, inked 11 more unilateral APAs taking the total tally to 59, covering transactions such as ITeS, corporate guarantee, overseas distribution of goods manufactured by Indian companies and royalty payment.

Tax updates

In our 'Tax Controversy' series, this time, we take a look at certain aspects of taxability of share premium which has generated great interest, especially amongst the tax intelligentsia.

We have examined the meaning and relevance of the 'scope of total income' in our 'Back to Basics' series.

There are two more articles for the benefit of our readers – 1) dealing with the Finance Ministry's scorecard on the recommendations of the Tax Administration Reform Commission(TARC) and 2) how Australia has tried to tax capital gains earned by non-residents from alienation of Australia-based immovable properties.

The Supreme Court has ruled that subsidies in question on account of transport, power, interest and insurance received by the assessee qualify for deduction u/s 80IB and 80IC for the AY 2004-05.

The full bench of the Bombay High Court has very recently given an important ruling on the question as to whether demurrage payments made by the assessee to a non- resident shipping company will attract the disallowance u/s 40(a)(i).

In a judgement impacting housing societies, the Delhi ITAT held that the maintenance charges received by a condominium from owners as well as tenants were not taxable, based on the concept of mutuality. In yet another judgement, the Mumbai ITAT held that the compensation paid to tenants for providing alternative accommodation, not in the nature of rent as defined in section 194I of the Act. The Delhi ITAT has held that a foreign company engaged in outsourcing services constitutes a business connection under the Act. However, in the absence of a PE in India under the India-UK Tax Treaty, its income was not taxable in India.

In the Transfer pricing section, the Mumbai ITAT has held that no transfer Pricing adjustment on account of interest could be done in respect of delay in allotment of shares by the subsidiary company, where the subsidiary was a wholly owned subsidiary.

The coverage of key decisions rendered by various direct tax appellate authorities and the summary of circulars issued by CBDT have been compiled and presented for understanding, in the usual manner.

We hope you find this of interest. As always, we look forward to your feedback and comments which would enable us to further enhance the content of the newsletter.

Happy Reading!

Yours Sincerely,

Knowledgeware Team

B. K. Khare & Co.

Articles:

Tax Controversy

One of the basic concepts that we are taught in elementary accounting education is the imperative need to distinguish between capital and revenue receipts. By and large, it is the revenue receipt which forms the bedrock or basis for chargeability to income-tax. In the midst of this backdrop, one question which has generated great interest, especially amongst the tax intelligentsia, is that of the treatment of share premium that corporates collect while issuing equity shares.

It is commonplace for corporates to collect certain premium while issuing shares, especially to new investors. This is akin to some kind of additional entry fee for permitting the investor to partake the benefits of corporate ownership. The premium is a result of the fair valuation of share which is typically calculated based on generally accepted valuation principles (Discounted Cash Flow, Net Present Value Earnings, Asset Backing, etc.) which, in general, take into account factors such as the profitability of the corporate venture, credentials of the management, future business plans and viability thereof and so on. In order to keep a check on the share premium so collected and prevent misuse of this patently valid corporate concept, section 78 of the erstwhile Companies Act, 1956 sought to regulate the utilization of the share premium amount only for certain purposes. These purposes include writing off preliminary expenses and issuing bonus shares and so on, in a way discouraging its rampant usage. Under extant accounting principles which are generally accepted, share premium collection is treated as a capital receipt by the corporate.

The Hon'ble Supreme Court had in its judgement in the CIT Vs Standard Vaccum Oil Co. [59 ITR 685] laid down the ratio that share premium realized from the issue of shares is capital in nature and forms part of the share capital of the company and therefore cannot be taxed as a revenue receipt. It was also a settled proposition of law that any expenditure incurred for the expansion of the capital base of a company is to be treated as a capital expenditure as has been held by the Hon'ble Supreme Court in the case of Punjab State Industrial Corporation Ltd. vs. CIT [225 ITR 792] and in the case of Brooke Bond India Ltd. vs. CIT.

So, where is the controversy?

Certain observations made by the Hon’ble Mumbai ITAT in the case of M/s Green Infra Ltd. vs. ITO, Mumbai [ITA No. 7762/Mum/2012] pose some questions and therein lies the controversy.

The matter pertained to AY 2009-10. M/s Green Infra Ltd. (‘GIL’) was incorporated on April 3, 2008 with the main object of financing, investing, sourcing, operating, green or clean technology products and services that optimize the use of natural resource or reduce the negative environmental impact of infrastructure projects and/or related assets.

The subscribers to the Memorandum of Association of GIL had subscribed to 50,000 equity shares of Rs. 10, at par value, each amounting to Rs. 5,00,000, this being the initial paid-up capital contribution from promoter shareholders. During the PY relevant to the impugned AY, GIL has collected the share premium of Rs. 47,97,10,000 on allotment of shares of face value of Rs. 10 each at a premium of Rs. 490

per share. As for the shareholding pattern as on March 31, 2009, IDFC Private Equity Fund-II, a SEBI registered VC Fund floated by IDFC Ltd., held 98% of the equity shares in GIL and was the chief contributor to the share premium account. In fact, the creation of this Fund was announced by the Finance Minister while presenting the Union Budget of 2002-03. The main contributors to the IDFC PE Fund-2 were LIC, Union bank of India, Oriental Bank of Commerce, Indian Overseas Bank and Canara Bank. The Government of India held 18% stake in IDFC Ltd.

GIL treated the share premium as capital receipt and did not offer the same to tax. The Assessing Officer ('AO') did not agree with this tax treatment and proceeded to treat it as income in the hands of GIL as 'income from other sources' u/s 56(1) of the Act. To fortify his actions, the AO further treated the entire transaction of share issue between GIL and its shareholders as sham on the ground that it lacked commercial substance. In the end, the AO also invoked the long-reach of section 68 of the Act to this transaction.

Aggrieved by this addition made by the AO, GIL strongly agitated the matter before the Ld. CIT(A) but without any success. The matter then reached the Hon'ble ITAT at the behest of GIL.

The usual arguments….

As expected in litigation involving share premium, the usual set of arguments could be seen from the two parties to the dispute. Thus, the Revenue put forth the following arguments in support of its actions to bring the share premium to tax:

- It was beyond any logical reasoning, to the point of defying commercial prudence, that a company, in its first year of incorporation, with no worthy assets in its balance sheet, could garner Rs. 490 per share premium from its subscribers.
- GIL had failed to substantiate the genuineness of share premium and section 56(1) was wide enough to cover all the cases of residuary nature not falling u/s 4 & 5 of the Act.
- The pre-requisite of the transaction for issue of shares at a premium was substantial increase in the worth of the company from the point of departure. It was mainly the profitability, credibility, goodwill of the concern which created the opportunity and requirement of premium and all these aspects were lacking in the case of GIL.
- The valuation was devoid of merits and hence, liable to be rejected.
- This transaction should be judged within the parameters of section 68 of the Act.

Countering the above points, the taxpayer i.e. GIL put forth the following key arguments:

- The issuance of shares at a premium was a commercial decision and did not require any justification under any law for the time being in force.
- Section 56(1) seeks to bring '**income** of every kind, which was not to be excluded from total income under the Act.' The emphasis is on the word 'income'. In other words, the amount sought to be brought to tax must have some character of 'income'.
- Section 68 casted an initial onus upon GIL to establish identity, genuineness of the transaction and the capacity of the investor. The subscribers to the share capital were all companies. The confirmations of the transactions had been received by the AO by issuing notice u/s 133(6) of the Act & therefore, the identity had been established beyond all reasonable doubts nor did the Revenue authorities question the identity of the shareholders. The genuineness of the transaction could also be safely concluded since the entire transaction had been done through the banking channels duly recorded in the books of account of GIL duly reflected in its financial

statements. Even the capacity of the investors was not called into question by the Revenue, as IDFC Ltd. was a Government-backed enterprise.

The controversial aspect of the Judgement

By and large, the Hon'ble ITAT was convinced that the taxpayer's arguments carried more weight in the impugned facts and circumstances of the case. However, the Hon'ble ITAT observed that the shareholders of GIL were related to the Government of India, directly or indirectly and hence, the bonafide of the transaction could not be called into question. With all due respect to the judgement, which, in our humble view, had the correct conclusion, what was unsettling was the aspect drawing link to Government control. This observation of the judgement begs the question whether the finding would have been different a) if the shareholder/s were not controlled by the Government of India and b) what would be conclusion if the shareholder were to be a non-resident?

Our Comments

Before we proceed to share our thoughts on this important subject, it must be pointed out that share premium has been made taxable by a legal fiction under section 56(2)(viib) of the Act w.e.f. April 1, 2013 and the same is now enumerated as 'income' in Section 2(24)(xvi) of the Act. However, what is bought into the ambit of income is the premium received from a <u>resident</u> in excess of the fair market value of the shares. It may be worth mentioning that the subject premium received from a non-resident is beyond the ambit of income u/s 2(24)(xvi) r.w.s. 56(2)(viib) of the Act.

In a sense, one could always contend that the conclusions are reached on a wholesome consideration of the totality of facts and circumstances of the case. Each case would be a different one and therefore, the conclusions reached in one may not apply wholesale to the facts of the another. However, an equally apposite yet compelling argument could be that the judgements carry 'obiter dicta' value and therefore, the comments while reaching any conclusion have a persuasive value to shape the judicial thinking on the subject.

Perhaps, the answer to some of the niggling points that lingered since the GIL judgement (supra) could be discovered in the landmark judgement of the Bombay High Court in the case of M/s Vodafone India Services Pvt. Ltd. vs. Union of India [WP No. 871 of 2014]. Incidentally, this matter also pertained to AY 2009-10, same as that in case of GIL matter (supra). In this case, Vodafone India Services Pvt. Ltd. ('VISPL') issued 2,89,224 equity shares of the face value of Rs. 10 each on a premium of Rs. 8,509 per share to its holding company, which was a non-resident entity. However, the Transfer Pricing Officer ('TPO') in this case, re-computed the net-worth of VISPL based on tax and transfer pricing adjustments made during earlier tax assessments and worked out the fair market value of shares of VISPL at Rs. 53,775. Thus, there was a deficit of Rs. 45,256 viz. VISPL had under-received share premium to the extent of Rs. 1,309 crores (for 2,89,224 equity shares). Based on the TPO's recommendations, the AO proceeded to tax the deficit in share-premium as shortfall in ALP u/s 92CA of the Act. The Tax authorities upto the level of the DRP concurred with this line of thought, until VISPL placed the matter before the Bombay High Court.

The Hon'ble Court held that a) share premium was a capital receipt and could not be brought to tax and b) even post April 1, 2013, the Legislature has brought to tax only the premium received from a resident in excess of the fair market value of the shares. As a corollary, receipt of share premium below the fair market value of the shares cannot be taxed, even post April 1, 2013, where the definition of income now included share premium of the specified kind.

Wisely so, the Tax department has not preferred an appeal against this order of the Bombay High Court. Is there an amendment to the tax law in the offing, ostensibly to plug this so-called 'tax-hole'?

Back – to – Basics

Scope of total income

Along with the charging section, (section 4), section 5 which defines the scope of the term 'total income" too is critical to a proper understanding of the Income-tax Act. At the end of the day, when it comes to the crunch, we have to remember that income-tax is levied on **the total income** of the assessee for the previous year.

The section reads as under:

Scope of total income.

5. *(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—*

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or

(c) accrues or arises to him outside India during such year :

Provided *that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6)* of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.*

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

Section 2 (45) very succinctly reminds us that figure of total income is to be arrived in the manner laid down under the Act.

Under section 5 itself, in the case of a person who is resident and ordinarily resident in India, this includes all incomes belonging to person which during the previous year:

i. Accrue or arise in India
ii. Are deemed to so accrue or arise in India
iii. Are received in India
iv. Are deemed to be in received India
v. Accrues or arises outside India

In the case of a person who is resident but not ordinary resident, total income would exclude income which accrues or arise outside India, unless it is derived from a business controlled in India, or a profession set up in India.

In the case of a person who is a non –resident, total income shall include only incomes which:

i. Accrue or arise in India;
ii. Are deemed to so accrue or arise in India;
iii. Are received in India; or
iv. Are deemed to be received India

In other words in the case of a non-resident incomes which accrue or arise and are received abroad will ordinarily not form part of his total income, unless such income can be deemed to accrue or arise or be received or deemed to be received in India.

" Subject to other provisions of the Act":

This section starts with and is itself governed by the expression "**subject to other provisions of the Act."** This means that even if an income is prima facie includible in the total income, it may yet have to be excluded if it fulfills the conditions for exemption stipulated under sections 10 to 13 (*see CIT v. Khambaty 159 ITR 203).* Thus in the case of a resident, an income may in the first instance fall within the scope of section 5 but may yet have to be excluded because it is exempt. Agricultural income derived from land situated in India which is specifically exempted u/s 10(1) is an important example.

A distinction needs to be drawn between those incomes which are exempt and those which are not specifically exempt but deductible. The practical result may well be the same in both the cases, but it must be remembered that when an income is exempt, it will not enter into the computation of total income at all. On the other hand, when it is not exempt as such but is deductible from the gross total income of the assessee, it will first enter the computation, form part of gross total income and then be allowed as a deduction. Deductions stipulated in Chapter VI-A, Part- C are a case in point. Currently, this chapter allows deductions, for example, of certain profits and gains derived by enterprises engaged in infrastructure development (s.80-IA) or certain other industrial undertakings (s. 80-IB).

Finally, we need to note that an income specifically falling within the scope of s. 5 may yet not form part of the total income if a notification is issued u/s 90 to implement a Double Taxation Avoidance

Agreement with another country. Such a notification, ruled the Supreme Court in *UOI v. Azadi Bachao Andolan* 263 ITR 706, may have the effect of overriding chargeability of such income to tax u/s 4 and its includibilty in total income u/s 5.

"From whatever source derived"

In the celebrated case of *CIT v. Shaw Wallace 6 ITC 178 (PC),* it was held *inter alia* that all taxable income must necessarily have a source. But where the source is situated is irrelevant if the income falls within the ambit of the scope of total income, as stipulated in this section. Also, the word "source" is not a legal concept but it is something which a man of commerce would regard as such (*CIT v. Kanchanbai 77 ITR 123 (SC)*).

"Received or deemed to be received in India"

All receipts received in India or deemed to be so received are taxable irrespective of the residential status of the assessee. He could be a resident, not ordinarily resident or non- resident; so long as the income is received in India or is deemed to be so received it would fall within the ambit of total income and be liable to tax, unless specifically exempted or deductible. (Turner *Morrison v CIT 23 ITR 152, 161(SC))*. If an income is received or deemed to be received in India, it will attract tax irrespective of the place of accrual; it will be taxable in India, even if it accrues or arises outside India. If a receipt is actually received in India, or is deemed to be so received, charge cannot be avoided by carrying it to a suspense account, or by means of any other accountancy device. It will also attract tax even if it is not received by the assessee but on his behalf by an agent. Once income is received in India, the whole of it becomes taxable, without there being any question of apportioning the same, as may be the case of income which accrues in India or is deemed to so accrue in this country.

A receipt may be either in money or money's worth. A constructive receipt of money by way of adjustment of cross claims, settlement of account, exchange effected through book entries, would be tantamount to receipt of money although no money may pass between the parties (*see Indermani v. CIT 19 ITR 342 affirmed in 35 ITR 298 (SC)*). A constructive receipt such as the one received by an agent, a broker or a bank on behalf of the assessee, is as good as a receipt received by the latter directly. (*Pereira v. CIT 61 ITR 371*). Likewise, income tax, insurance premium or provident fund contributions paid by an employer on behalf of an employee would also constitute part of the salary income of the employee (*Richardson v. Lyon 25 TC 297; IR v. Forster 19 TC 278*).

"Accrue or arise or deemed to accrue or arise in India "

The words "accrue" and "arise", observed Mukerji J. in *Rogers Pyatt Shellac v. Secretary of State* (*1 ITC 363, 372*) seem to denote the same idea or concept; namely, both the words are used in contradistinction to the word "received" and indicate a right to receive. The distinction, if any lies only with reference to the point of time. Profits of business may accrue at one point of time, when the assessee becomes legally entitled to receive the receipts in question; they will arise only when the method of accounting followed by him recognizes them in the shape of income. It is also possible to conceive a situation where income accrues prior to its actual quantification.(*CIT v. Thiagaraja 24 ITR 55 (SC)*).

Thus there are three points of time, indicated by the Privy Council *in CIT v. Kameshwar Singh 1 ITR 94* which the law recognizes for the levy of tax:

- the point of **accrual** when the assessee becomes legally entitled to the receipt in question;
- the point when the profits could be said **to arise,** by, and according to, the method of accounting followed by the assessee;
- And, finally the point of **actual receipt**.

The earlier freedom which the assessee had to follow the method of accounting of his choice now stands considerably circumscribed by the Income Computation and Disclosure Standards (ICDS) notified by the Government under section 145(2).

Extremely relevant to the discussion of **accrual** or arising of income are three issues:

- The person to whom the income accrues
- The place of accrual and,
- time of accrual

Each of the issues is a separate subject in its own right and would thus require a very detailed discussion. It would therefore have to be the subject matter of a separate article.

Connotation of “deemed” to accrue or arise in India or “deemed” to be received In India

In law, something is deemed to be so if it is not actually so in reality. That is why it has to be considered to be real by virtue of a legal fiction (*CIT V. Bombay Trust Corp. 4 ITC 312 (PC))*. Such fiction is ordinarily limited to the purpose for which it is created *(Keshav Mills Ltd v. CIT 23 ITR 230 (SC*)).

S. 9(1) deems certain income to accrue or arise in India. For example:

- S. 9(1)(i): subject to limitations contained in this provision, all incomes arising to a person through or from a business connection, property or source of income, or transfer of a capital asset, situated in India;
- S. 9(1)(ii): Salary income earned in India, including the salary paid for any leave period either before or after the commencement of service
- S. 9(1)(iii): Dividend paid by an Indian company outside India
- S. 9(1)(vi): certain incomes by way of royalty or technical fees payable by:
  - the Government;
  - a resident except where the payment relates to his business or a source of earning income situated outside; and
  - a non-resident if the payment relates to a business or source of income in India

The short point is that ordinarily some of the aforesaid incomes may not have accrued or arisen in India; but by fiction of law, unless specifically exempted, they do. And s.5 then takes this fiction through to its logical conclusion by stipulating that such incomes will form part of total income.

In a similar fashion, s. 7 deems certain incomes to have been received during the relevant previous year whereas in actual fact they may not have been so received during that year. e.g.:

- annual accretion to the balance of the credit of an employee in excess of the limits laid down u/r 6 of Part A of the Fourth Schedule of the Income-tax Act;
- Balance transferred in a recognized provident fund in excess of the limits laid down u/r 11(4) of Part A of the Fourth Schedule

These incomes again will form part of total income. Here again the important point to remember is that the income in question may not actually have been received by the assessee, but is deemed to be so u/s 7 and is made includible in the total income by virtue of s. 5.

Conclusion

It remains for us to conclude that Explanation 2 below s. 5(2) gives statutory recognition to an important first principle of taxation, namely that an income can only be taxed once. Thus if income has been taxed on the basis of accrual or deemed accrual, it cannot be taxed again on the basis of receipt or deemed receipt. This principle was judicially recognized in *Re Kamdar 14 ITR 10, 52* with reference to the 1922 Act when there was no statutory provision to give effect to this principle.

Finance Ministry's Scorecard on TARC recommendations

The Finance Ministry has recently accepted a large number of recommendations of the Tax Administration Reform Commission(TARC); some of these have also been implemented. The current status of some of the more important recommendations, insofar as they directly affect taxpayers, is as follows:

One of the more important recommendation relates to generating more **customer focus in the department's policies. In this connection the Commission has recommended** providing **a pre-filled tax return facility to taxpayers** in the most comprehensive and feasible manner via the online / offline modes. Around 1.77cr (over 50%) taxpayers have availed this facility in the current year. In accordance with the recommendations of the Commission the Central Board of Direct Taxes (CBDT) has set up a dedicated vertical for delivery and monitoring of Taxpayer Services within the Organization. The Board have also accepted the recommendation for online tracking of grievances. So far 250 buildings have such Aayakar Seva Kendras or ASK Centres; and 58 more buildings will be covered shortly.

Under project INSIGHT, the Central Board of Direct Taxes (CBDT) has sought to enhance its analytical capability through an **integrated Data Warehousing and Business Intelligence** (DW&BI) **platform** that enables the use of wide ranging analytics methods. This includes descriptive analytics, diagnostic analytics, predictive analytics and prescriptive analytics.

As recommended by the Commission, the Income-tax department is already following a **collaborative and solution oriented approach towards dispute management** and resolution. Currently, almost 99% of tax returns filed by taxpayers are accepted while only a miniscule number of returns are picked for scrutiny based on specific computer generated criteria in which no taxman has any discretion. Although the Board concedes that there are no time limits for disposal of appeals, it has issued instructions that appeals should be disposed off within fifteen days of the last hearing.

One of the recommendations of the TARC relates to **e- payment of taxes**. The Finance Ministry have explained that it is not possible at the moment to permit taxpayers to use credit cards for making tax payments because credit card companies levy a merchant charge which may not be acceptable to taxpayers. Taxpayers however have been enabled to make their payments through net banking or ATM cards.

The TARC has recommended that the number of effective **taxpayers** should double from 30 million to 60 million during the course of the next 3 years. The total number of taxpayers currently stands at 54.8 million. The department intends to augment this number by 10 million by the end of 2106-17.

This will at least partially be achieved through the **integration of data available to the administrations of CBDT and CBEC.** These two Boards have already undertaken data exchange and matching of service tax and commercial tax data. Further, the two Boards also contemplate a streamlined automatic exchange mechanism between the two Boards as part of Project INSIGHT.

As desired by the TARC, the two Boards have already started **customer satisfaction surveys**. The first such survey was undertaken by CBEC in coordination with FICCI and KPMG. Both the Boards have earmarked sufficient funds for customer research particularly customer service.

Other major recommendations relate to the internal procedure of the department for evaluation of performance of officers etc. These are not being commented upon, because they do not affect taxpayers very much

II

The summary in section I will show *inter alia* that the taxpayer and other stakeholders will be impacted in a number of broad areas. The first of these relates to greater **customer focus**. The importance which is now being attached to this area marks a significant change from the past. The Board has very recently set up a new vertical for monitoring performance in this important area. It has also set up two computer processing centres in recent times for processing returns and TDS information. By all accounts both seem to be functioning well. The Board has also commissioned two studies on:

i. barriers to compliance that prevent taxpayers from complying with the law; and,
ii. the costs they incur for this purpose.

Regardless of the results these studies throw up, that the Department has now become sensitive to this important issue is itself a very positive development. This is because the experience the world over suggests that when costs incurred by taxpayers to comply with the law become unacceptably high, low compliance is the direct outcome. In India today, the latest available statistics appear to suggest that the administrative cost of collecting income tax is about 0.6% of the revenue collected. This statistic is acceptable even by OECD standards. Practically no work, however, has been done so far on the costs incurred by taxpayers (compliance costs) to assess and collect income tax.

if international experience is any guide, such costs are usually very high- in fact many time more than administrative costs. For example they ranged between 7.9% to 10.8% of the revenue collected in Australia during the nineteen nineties.

Together administrative costs and compliance costs constitute the aggregate cost of collecting revenue for the society as a whole; and this figure is quite considerable when compared to administrative costs alone. It will be interesting to see what figure the studies, commissioned by the Board throw up for India.

The second thrust area of the accepted recommendations relates to **expansion of the tax base**. Towards this end the number of effective taxpayers is sought to be increased to 60 million. This is indeed a worthwhile objective to pursue because the narrow tax base which we have in our country has serious consequences for existing taxpayers. Currently the Government is compelled to tax them at much higher rate than what it would have, had there been more taxpayers and the base been broader. At the moment only 2.44% of the total population pays income tax. This figure is very low as compared to the U.S. where nearly 250m returns are filed annually by a total population of 323m people (in words 77.39% of the total population pay tax). Some economists however feel that the number of taxpayers in India is not all that unacceptable a figure, because 68% of the total population lives in rural areas and is largely dependent on agriculture income which does not attract income tax. This leaves a base of only 500 million people. Considering further that only one person in a household of five earns income the taxable base gets reduced to 100 million households of which 30 million (or 30%) actually pay tax. Even by this analysis however there is considerable scope for enlarging the tax base and that is what the Government is attempting- mostly by improving compliance through improved communication strategies and induction of technology.

Much hope is being pinned on the latter. The department has launched Project insight with the intention of building an **integrated Data Warehousing and Business Intelligence** (DW&BI) **platform**. This includes the use of analytics to detect under-reporting and misreporting of incomes and detect no-filers and stop filers of returns. These techniques will be used to select cases for scrutiny and issue of notices u/s 142(1) and where necessary, u/s 147. The whole thrust appears to be directed towards more effective use of TDS and third party information reported to the Department by various sources for carrying out investigations and making more effective scrutiny assessments.

III

This new approach is pretty much in line with international trends. Basically, the approach internationally appears to focus on:

- encouraging voluntary compliance;
- reducing compliance costs;
- increasing the chances of detection of concealment and under reporting of income;
- expanding the tax base by making effective use of third party and TDS information; and
- Improving the quality of taxpayer services

These are all very laudable objectives. The nation would be happy if they were to be achieved; but as we have seen in the past there is always a slip between the cup and the lip. Much will depend upon how these programmes are actually implemented.

Introduction of withholding of taxes in Australia on Capital Gains arising to Non-residents from Real Property/immovable property transactions

Similar to the other taxation systems in the world, the Australian tax regime incorporates taxation of Capital Gains on Foreign Residents. Division 855 was inserted into the Income-tax Assessment Act, 1997 in the year 2006, under which capital gains earned by foreign residents from the disposal of certain Australian assets, were subject to Capital Gains tax, which was consistent with international practice and Australia's international tax treaties. This regime promoted foreign investment in Australia.

Australian assets in this regard include Direct and Indirect Australian Real Property Interests. This was to ensure that interests in an entity are subject to Australian Capital Gains Tax regime if the entity's substantial value was derived from Australian Real Property. However, currently the compliance with these provisions was extremely low and compliance action by Australian Tax Authorities was proving difficult.

Australian Government has therefore introduced new legislation w.e.f. July 01, 2016, which provides for a withholding of tax at the rate of 10% on payments (purchase price) made to foreign residents who have disposed taxable Australian Real properties. The withholding of tax is to be made by the purchaser from the purchase price and he must deposit the said amount with the Australian Tax Office.

Sub-division (Sub-section in terms of Indian Acts) 855-A operates to disregard a capital gain or loss made by a foreign resident unless the relevant CGT asset is taxable Australian real property. Broadly Australian property includes:

- A direct or indirect interest in Australian Real property
- Asset used in carrying on a business through a Permanent Establishment in Australia; or
- Rights and options with regard to these assets.

<u>Categories of Taxable Australian real property</u>:

1. **A Capital Gain Taxable asset would be Taxable Australian Real property if it is:**

- Real property situated in Australia (like land, buildings, residential and commercial property) including leased land situated in Australia.

- A mining, quarrying or prospecting right (only to the extent such right is not real property), if the minerals, petroleum or quarrying materials are situated in Australia.

2. **Indirect Australian Real Property Interests:**

- Indirect Australian real property interest′ includes a non-portfolio interest (an interest of 10 per cent or more) in an entity whose underlying value is principally derived from Australian real property. In such cases, Principle Asset Test is to be satisfied, which is that the sum of the market values of the entity's assets that are Taxable Australian Real Property should exceed the sum of the market values of the assets that are non- Taxable Australian Real Property

3. **An option or a right to acquire the above properties or interest in the above properties**

<u>**Exemptions from the application of the above provisions:**</u>

1. If the value of the Taxable Australian real property does not exceed $ 2 million. This has been enacted to reduce compliance costs and to ensure that residential properties are not affected by these provisions.
2. Transactions conducted through an approved stock exchange
3. If a transaction is already subject to withholding obligations under other provisions.
4. Securities lending arrangement
5. Transactions which involve vendors which are subject to formal insolvency or bankruptcy proceedings.

<u>Additionally the following have been excluded from withholding obligations:</u>

1. Where a vendor has obtained a clearance certificate from the Commissioner. The vendor declarations only exempt a specific vendor and withholding may still apply if the transaction involves multiple vendors. Additionally, it has been provided that where a vendor is not satisfied with the decision of the Commissioner in the matter of issue of clearance then the vendor may record his objections through the forms issued by the Australian Tax offices.
2. In case of other types of property covered by the amendments:
   - Where vendor has made declarations that they are an Australian resident for income-tax purposes.

- Where, if the CGT asset acquired is a membership interest, the vendor has made a declaration that the interest is not an indirect Australian real property interest.

In cases where vendor is not entitled to a clearance certificate, but feels that withholding is not necessary in his case then such vendor may apply for an online variation application. This application is a request to the Australian Tax Office for a lower rate of tax deduction for such vendor.

Our Comments:

These enactments are similar to the provisions in India under Section 194-IA of the Income-tax Act, 1961, providing for deduction of tax at the rate of 1% at the time of purchase/sale of immovable property exceeding Rs. 50 lacs. However, unlike the Australian Income-tax provisions, in India the provisions for application of lower or nil deduction certificate are not applicable to section 194-IA.

Citation: **TAX AND SUPERANNUATION LAWS AMENDMENT (2015 MEASURES No. 6) BILL 2015, Explanatory Memorandum**

Supreme Court:

Various subsidies- such as transport, power, insurance and interest- which directly reduce cost and enter into computation of profit of eligible business qualify for deduction u/s 80-IB and 80-IC

Facts and issue: In this group of appeals Meghalaya Steels Ltd. was treated as the lead case. The assessee is engaged in the business of steel and ferro silicon. It filed its return for the AY 2004-05 declaring a total income of Rs 2,06, 970 after claiming a deduction u/s 80-IB for the profit arising to it from the industrial undertaking owned by it. The industrial undertaking had received the following subsidies:

Transport subsidy -	Rs.2, 64, 94,817
Interest subsidy -	Rs.2, 14,569
Power subsidy -	Rs.7, 00,000
Total -	Rs.2, 74, 09,386

The assessee's stand that the aforesaid receipts formed an integral part of its profits of the eligible undertaking so as to qualify for deduction u/s u/s 80-IB(4) was upheld by the ITAT and later by the High Court. In the Revenue's appeal to the Supreme Court, the only point at issue was whether the aforesaid subsidies would fall within the expression "any profits and gains derived" from the eligible business. There was no dispute that the business itself qualified for deduction.

Decision: The Supreme Court has ruled that subsidies in question on account of transport, power, interest and insurance received by the assessee qualify for deduction u/s 80IB and 80IC for the AY 2004-05. It has thus upheld the orders of the Gauhati , Delhi and Calcutta HC orders and decided the issues referred to it in favour of the assessee.

It applied the 'direct nexus' test laid down by another bench of the Supreme Court in *Sterling Foods (1999) 4 SCC 98,* and held that all the four subsidies were revenue receipts and had direct nexus with profits and gains of the industrial undertaking. The Revenue's stand that the element of directness was missing as the immediate source of subsidies could not be said to be from business, since it was tendered by Government, was rejected.

The Court clarified that "so long as profits and gains emanate directly from the business itself, the fact that the immediate source of the subsidies is the Government would make no difference, as it cannot be disputed that the said subsidies are only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products." The Court further pointed out that Sec 80IB/IC refer to net profit and net profit can only be calculated by deducting all elements of cost from sale price. Under the circumstances the subsidies in question could be said to be derived from business.

It distinguished the present case from the facts in another Supreme Court ruling in *Cambay Electric Supply Industrial Company Limited 2 SCC 644* which was concerned with distinction between "profit derived from" and "profit attributable to" business.

It also distinguished the facts of the present case from those *in Pandian Chemicals Limited 262 ITR 278* and *Liberty India (2009) 9 SCC 328* which were concerned with interest on deposit and export incentive receipts respectively.

It noted that the present case involved reimbursement of an element of cost. It thus approved the Calcutta HC rulings *in Merino Ply & Chemicals Ltd*. *209 ITR 508* and *Cement Manufacturing Company Limited (unreported judgment dt 15.01.2015)* wherein it was held that transport subsidies were inseparably connected with the business of an industrial undertaking.

It also rejected the Revenue's stand that subsidies received do not qualify for deductions u/s 80IB/IC as they were assessable under the head "income from other sources"

Our views: This case will be memorable in the history of income-tax for the clarity with which it distinguishes profits derived from an eligible business from those profits which can only be attributed to it. It will also be remembered for laying down a clear direct nexus test for deciding the former. Any subsidy which directly reduces cost and increases profit could be said to satisfy such a test because it enters directly into computing the profit derived by the undertaking.

Citation: Commissioner of Income tax …v. Meghalaya Steels Ltd and others (TS-124-SC-2016)

High Court

Disallowance u/s 40 (a) (i) not applicable, where no tax deducted at source u/s 195(1) in respect of payments made to a non-resident in respect of carriage and demurrage charges relating to passengers, livestock or mail shipped at an Indian port- to which s. 172 applies

Facts and issue: The full bench of the Bombay High Court has very recently given an important ruling on the question whether demurrage payments made by the assessee to a non- resident shipping company will attract the disallowance u/s 40(a)(i).

The assessee, V.S. Dempo and Company Pvt. Ltd paid certain demurrage charges to a non-resident shipping company, during the previous years relevant to the AYs 1999-00 and 2000-01. The AO disallowed this expenditure because the assesssee had not deducted tax at source on such payments. In appeal, the CIT(A) rejected the assessee's contention that there was no obligation to deduct TDS as the amount paid to the non-resident shipping company which was governed by Sec 172.

In an earlier judgment rendered in the case of Orient (Goa) Pvt.Ltd., 325 ITR 554, a division bench of the Court had ruled that the scheme stipulated u/s 172 for the taxation of the occasional shipping business of non- residents, was not applicable to the assessee, the payer of the demurrage charges in question, since he was a resident. The assessee was accordingly held liable to deduct tax at source in terms of s.195 of the Act. Failure to deduct such tax would thus attract the disallowance u/s 40(a)(i).

Decision: This argument did not find favour with the full bench in the present case. Overruling a division bench judgment of the same Court in CIT v. Orient (Goa) Pvt.Ltd. 325 ITR 554, the Court held that the disallowance u/s 40 (a) (i) is not applicable, to payments covered by s.172 made out to a non-resident in respect of carriage and demurrage charges relating to passengers, livestock or mail shipped at an Indian port. This is because the assessee is not required to deduct tax at source u/s 195(1) in respect of such payments.

The Court has opined that what is relevant is the residential status of the recipient and not that of the payer of demurrage charges. If the former is a non-resident and if the receipt forms part of his occasional shipping business emanating from an Indian port, it would fall within the ambit of s. 172. This provision lays down a self- sufficient code for the levy, computation, assessment and recovery of tax in the case of non- resident assessees involved in the occasional shipping business emanating from an Indian port. The Court relied upon Union of India vs. Gosalia Shipping (PVT.) Ltd. (1978) 3 SCC 23 and A. S. Clittres D/5 I/S Garonne and others vs. CIT (1997) 9 SCC 546 to reach this conclusion.

There was thus no warrant for applying the provisions relating to deduction of tax at source in Chapter XVII-B-and more particularly s.195- as no ship belonging to a non-resident can leave an Indian port without either paying or making proper arrangements for payment of tax in India. The Court noted that "the apprehensions of avoidance and evasion are both taken care of by the Legislature."

Insistence on TDS on non-resident shipping companies, the Court pointed out, would lead to two difficulties. First, there is no mechanism by which such companies can claim credit for TDS, they, being under no obligation to file a return of income on the basis of which they can claim credit for the tax payments deducted from their receipts. Second, for this very reason they would be subject to double payment first u/s 172 and then again u/s 195 of the Act. They would thus be compelled to file returns and claim refunds- an optional procedure stipulated u/s 172(7). Making the companies concerned resort to such a procedure is bound to affect their business as well as that of the residents who make such payments.

The court relied upon GE Technology Centre Pvt. Ltd. v. CIT 10 SCC 299 (SC) to come to the conclusion that there is a difference between s.195(1), which imposes an obligation to deduct tax only when the amount being remitted is, properly speaking, chargeable to tax under the Act; and some of the earlier provisions of the Chapter (such as section 194C) where the obligation to deduct tax on the remittance arises *ipso facto* the moment the remittance is made.

Our views: A perusal of Circular no 723 dt. 19/09/1995 also fully supports the decision taken by the Full bench of the Bombay High Court. This too clearly stipulates that s. 172 is a self-contained code for non-resident shipping companies and supersedes s.195, insofar as they are concerned.

This circular, like all other circulars of the Board is always binding on the Revenue. A large number of Supreme Court judgments have held as much. (See Navnitlal Jhaveri v. Sen 56 ITR 198 (SC), Ellerman Lines v. CIT 82 ITR 913(SC), Verghese v. ITO 131 ITR 597(SC), UCO Bank v. CIT 337 ITR 89 (SC)).

Accordingly the disallowance stipulated in s.40(a)(i) will not extend to payments made u/s 172 to non- resident shipping companies for demurrage or for carriage of goods, passengers, mail and livestock at Indian ports. This is because such payments are not liable to TDS u/s 195(1).

Citation: CIT v. V.S. Dempo and Co. Pvt. Ltd. TS-45-HC-2016 (BOM) (FB)

Contractor sub-contracting work irrelevant for TDS credit , Dismisses Revenue's 'no real-work' plea- Held, credit for TDS must go to the person from whose income tax was deducted and not the sub-contractor who carried out the work on behalf of the assessee and to whom the assessee transferred the entire income earned in question in a separate back to back contract.

Facts and issues:

IVCLR-KBL, a joint venture entity and the assessee in the present case, was in the business of implementing civil contracts. It entered into an agreement with the Government of Andhra Pradesh for the execution of certain irrigation projects and utilized the services of one of its constituents as a sub-contractor. The two contracts ran concurrently and separately. During the A.Y. 2012-13 it returned a total income of Rs nil and claimed the tax deducted at source by the Andhra Pradesh Government u/s 194-C as refund. The A.O. held that the assessee had not carried out any real work. It could not therefore claim to have earned any income and could not for that very reason claim any refund ot tax for TDS deducted on its behalf. Within the terms of rule 37BA (2) (i), credit for TDS ought to have gone to the sub- contractor hired by the assessee to whom the assessee had passed on the entire consideration received by it in back to back transactions. Aggrieved with this decision, the assessee filed a writ petition before the Andhra Pradesh High Court challenging this position.

Before the High Court, the assessee contended that the two contracts in question-one executed between the irrigation department and assessee, and the other between the assessee and the sub-contractor- were separate independent contracts Each of them created separate sets of rights and liabilities between the parties.

The assessee further submitted that under the terms of the contract concluded by it with the Government of Andhra Pradesh it alone was responsible for execution of the project. It was best equipped to decide how to discharge this responsibility cast upon it by the Government of Andhra Pradesh. It had earned the income in question and had a statutory obligation for filing its return of income, and for being assessed under the Act. The assessee argued that as its income was “Nil”, the tax deducted at source, from its bills, was liable to be refunded to it alone, and not to the sub-contractor. The latter had executed the work on its behalf and tax had been separately deducted in accordance with law from the amounts paid to the sub-contractor.

The Revenue, on the other hand, argued the joint-venture was merely a device to route the work from the Government to the sub-contractor. The latter completed the work in its entirety. The assessee routed the entire amount received by it to the latter. The income resulting from the work executed under the contract in question, was thus properly speaking, assessable only in the hands of the sub-contractor, and not the assessee. As such, it was the sub-contractor who was entitled to receive the credit for the tax deducted at source by the Government from the bills submitted by the assessee.

Decision

The AO denied credit to the assessee for TDS on the payments made to it on the basis of Rule 37BA (2)(i), which was formulated to give effect to the provisions of s. 199(3) which enable a person, other than the person who received the income in question, to get credit for the tax which was deducted at source.

The High Court observed , “*It is settled law that Rules, made under the Act, should be interpreted in conformity with the provisions of the Act* and *not the other way round….. It cannot be interpreted in a manner as to come into conflict with the parent Act, in which case the Act will prevail*.” The court followed I*spat Industries vs CIT , Customs 1) (2006) 12 SCC 583, Bombay Dyeing & Mfg. Co. Ltd. v . Bombay Environmental Action Group (2006) 3 SCC 434, Laghu Udyog Bharati v. Union of India (1999) 6 SCC 418 , Onkarlal Nandlal v. State of Rajasthan 1985) 4 SCC 404, State of U.P. vs. Babu Ram Upadhya, Central Bank of India v. Workmen AIR 1961 SC 751* to come to this conclusion.

Section 199(1) stipulates that credit for tax deducted at source and under sub-section (1) any deduction made in accordance with the provisions of chapter XVII and paid to the Central Government shall be treated as payment of tax on behalf of the person from whose income the deduction was made. In the present case tax was deducted by the Andhra Pradesh Government from the income of the assessee and not the sub- contractor. No amount was due to the latter. Accordingly, the assessee alone was entitled to get the credit for the same.

Under Rule 37BA (2)(i)(b), a person other than the deductee shall get credit if he is assessable in respect of the same, but that is not so in the present case. The contracts between assessee and the Government of Andhra Pradesh and between the assessee and constituent member who was the sub-contractor for the assessee were two separate contracts, independent of one another. The contractual receipts emanating from the first contract belonged to the assessee. As such, the income arising out of the said contract, was assessable only in its hands, and not those of the sub-contractor.

The Court further ruled that the conditions stipulated in Rule 37B(2)(i) read with the proviso thereto had not been fufilled in that the subcontractor had never filed a declaration that the income from which tax was being deducted at source belonged to it. Neither did the deductor file a statement before the tax authorities that income belonged to the sub-contractor.

Our comments

This judgment brings out an important principle of taxation indeed all modern legislation: a rule framed to give effect to the provisions of an act must be read to conform to the latter, and not vice versa: in other words, the statutory provision should not be strained so as to conform to the rule framed thereunder.

Also, equally importantly, a proviso to a provision creates an exception- it cannot construed to be the general rule.

Citation

M/s IVRCL-KBL (JV) v. Assistant Commissioner of Income Tax TS-146-HC-2016(AP)

International Tax & Transfer Pricing

Delhi ITAT confirms deletion of penalty under section 271(1)(c) on transfer pricing adjustment despite the assessee not filing further appeals to avoid unnecessary litigation.

Facts and issues: The assessee was engaged in promotion, marketing, sales and distribution of a wide range of cardio-vascular products, related medical instruments and equipments manufactured by the Boston group.

During the assessment proceedings for AY 2006-07 and 2007-08, the assessee had only one business segment, namely, distribution of medical equipment which were imported from the AE. This was the only international transaction in the years under consideration.

Proceedings before the TPO

For AY 2006-07, the assessee selected Resale Price Method ("RPM") as the most appropriate method (MAM) and had selected 6 comparable companies in its TP study. The TPO rejected RPM and applied TNMM as done in earlier AY 2005-06. The assessee contended that in earlier AY, it had 2 segments viz, marketing support segment as well as the distribution segment and therefore, RPM was adopted as MAM. The TPO rejected the assessee's explanation and adopted TNMM for determination of ALP. Based on 6 comparables (3 out of original selection of the assessee and 3 additionally suggested by the assessee subsequently), the TPO proposed addition of Rs. 3.46 crore using single year data. For AY 2007-08, the TPO adopted TNMM and proposed an addition of Rs.1.52 crore based on selection of 9 comparables using single year data.

Proceedings on the penalty matter

The assessee for both the years accepted the transfer pricing adjustments and did not file appeal against the assessment order. The AO initiated penalty proceedings under section 271(1)(c) invoking Explanation 1 to section 271(1)(c) for both the years. The assessee explained that transfer pricing adjustments were accepted as the assessee wanted to avoid unnecessary litigation. The AO rejected the assessee's explanation on change of MAM, use of single year data and rejection of the assessee's comparables. The AO levied penalty in both the years.

Observation of the ITAT

Explanation 7 to section 271(1)(c)

- The AO wrongly invoked Explanation 1 instead of Explanation 7 to section 271(1)(c). As per Explanation 7 any addition made by way of transfer pricing adjustment would be deemed to be concealed income. Only exception carved out is where the assessee proves that the price charged or paid in such transaction were computed in accordance with section 92C of the Act and in the manner prescribed under that section, in good faith and with due diligence.

Selection of method, selection of comparables and use of multiple year data

- The assessee had taken a consistent stand that method was changed from TNMM in AY 2005-06 to RPM in AY 2006-07 and 2007-08, as the assessee had discontinued dealing in one segment. Additions made in the assessee's case were based on comparables offered by the assessee using single year data as against multiple year data used by the assessee initially. The TPO had accepted 3 of assessee's comparables for AY 2006-07. The TPO also accepted 3 additional comparables subsequently offered by the assessee. For AY 2007-08, the TPO accepted 6 out of 9 comparables selected by assessee.
- The CIT(A) had given an observation that where 6 comparables originally selected by the assessee for AY 2006-07 and 9 comparables for AY 2007-08 were considered using single year data, the transactions were at ALP under both the method i.e. RPM and TNMM. For AY 2007-08 the assessee's margin was within 5% range of arm's length margin of 9 comparables using single year data under TNMM while for AY 2006-07 the assessee's margin was higher than that of comparables under TNMM.
- The assessee's explanation for using RPM instead of TNMM was found to be acceptable as the income tax authorities had not rebutted it by some fact or argument to the contrary. No malafide had been alleged by the income tax authorities to show that the selection of the said method was with a deliberate attempt to defraud the income tax authorities and the said method could never have been selected in good faith with due diligence in the given facts.
- Mere change of method by the TPO by itself was not enough. Since the assessee had given sufficient and cogent reasons relying on facts and law in support of its selection of

method, the onus shifted to income tax authorities to demonstrate that even on best efforts basis, RPM could not have been selected. The income tax authorities failed to demonstrate that requirement of due diligence and good faith had been breached.

Decision: The assessee based on the facts of the case, met the standards specified under Explanation 7 to section 271(1)(c) i.e. requirement of due diligence and good faith. In addition, selection of method, selection of comparables and use of multiple year data were also in good faith. Accordingly, the penalty under section 271(1)(c) was not sustainable.

Citation: Boston Scientific India Pvt Ltd [TS-73-ITAT-2016 (DEL)-TP]

No Transfer Pricing adjustment on account of interest can be done in respect of delay in allotment of shares by the subsidiary company, where the subsidiary was a wholly owned subsidiary

Facts and Issues: The assessee was an investment holding company which had invested in various companies through its wholly owned subsidiary based in Mauritius. During AY 2009-10, the assessee entered into an international transaction with its wholly owned subsidiary, i.e. AE, in respect of contribution to share capital and reimbursement of expenses.

During the assessment proceedings, the TPO required the assessee to show cause as to why ALP adjustments should not be made in respect of share application money paid to its subsidiary. The TPO was of the view that the transaction was that of a loan under the garb of share application money, and since there was delayed allotment of shares by the subsidiary, the assessee should be compensated by charging notional interest considering SBI prime lending rate. The assessee before the TPO contended that contribution towards share capital was a capital account transaction and had no impact on income or expense. The fact that there was a delay in the allotment of shares would not mean that interest had to be charged for the period of delay in allotment of shares. The assessee further argued that the remittance was made in foreign currency with due approval of the RBI. Accordingly, interest, if applicable, should be on the basis of LIBOR and a minimum of 180 days be allowed as grace for acquiring the share certificate, as permitted by the RBI.

The TPO took note of the fact that there was a delay in allotment of shares. As the subsidiary had used the money for advancing loans to step-down subsidiary, the TPO re-characterized the share application money as loan and applying CUP, made adjustment of Rs. 8.41 crores on the basis of notional interest @ 15.5% on share application amount. The TPO also made adjustment towards outstanding receivables in respect of reimbursement of expenses on which no interest was charged.

The DRP confirmed the TP adjustment on account of share application money. The DRP however, deleted adjustment towards notional interest on receivables.

Observations of the ITAT

The shares were actually issued to the assessee in October 2010 and the entire payment so made by the assessee was on account of the shares so allotted. The RBI approval for the remittance of the amount was also for capital contribution. Allotment of shares does not make any change to the position of the assessee, as the subsidiary was a wholly owned subsidiary of the assessee. A delay in allotment of shares by the subsidiary company, as long as the subsidiary is a wholly owned subsidiary, does not prejudice the interests of the assessee. As the assessee was the only shareholder of the subsidiary company, beneficial owner of all the earnings and all the assets of the company, non-allotment of shares did not prejudice the assessee’s position anyway.

Decision: Very foundation of the TP adjustment made by the AO, being wholly devoid of legally sustainable merits and factually correct assumptions, TP adjustment towards interest on delay in allotment of share by the subsidiary, was deleted. Of course, the crucial factor was that was that the subsidiary was a wholly owned subsidiary.

Citation: ITO vs. Sterling Oil Resources Pvt Ltd [TS-72-ITAT-2016(Mum.)-TP]

A foreign company engaged in outsourcing services constitutes a business connection under the Act. However, in the absence of a PE in India under the India-UK Tax Treaty, its income was not taxable in India.

Facts and Issues: The assessee, a company incorporated in UK, was a non-resident engaged in providing outsourcing services to its clients in finance, utility and public sector. The main service provided by the assessee was customer management outsourcing business, service outsourcing and transfer of technology. Vertex India was an Indian entity in the group which carried on outsourced work for the assessee. This outsourced work was in relation to contracts of the assessee with PowerGen Retial Ltd. and Last Minute Networks Ltd. The total revenue earned by Vertex India from the assessee was Pound 47,35,037/-. Over and above, sum of pound 60,528/- was retained by the assessee as cost incurred by the assessee in UK and recovered from the customers. The balance amount was remitted to Vertex India. The assessee also allowed Vertex India, right to use certain equipment located outside India and claimed reimbursement of expenses incurred by the assessee on behalf of Vertex India.

The assessee filed its return of income in India and offered the sum received from Vertex India for right to use equipment outside India, as royalty as per Article 13 of India-UK Tax Treaty. It was claimed that cost reimbursement was non-taxable as it was on cost to cost basis with no profit earned.

The AO held that the assessee had a PE in India as per India-UK Tax Treaty and business connection as per the Act. The AO computed profit of Rs. 3,06,26,180/- as attributable to such PE. Cost reimbursement of Rs. 5,24,52,014/- was also considered as business profits of the PE in India. Further, royalty from Vertex India was also taxed as business profit of the PE in India.

The CIT(A), on an appeal filed by the appellant held that:

The assessee has a "Business Connection" within the meaning of section 9(1)(i) of the Act.

The assessee had a fixed place PE in India in terms of Article 5(1) of the India-UK Tax Treaty. The assessee did not have a service PE or a Dependent PE in terms of Article 5(2) of the India-UK Tax Treaty. The assessee did not have a sales outlet in terms of Article 5(2) of India-UK Tax Treaty.

Royalty income declared by the assessee could not be taxed as business income. Reimbursement of expenses on account of 3rd party cost of Rs.2,79,40,955/- was not chargeable to tax in India as it was directly relatable to Vertex India demonstrated by submission of documentary evidence. Balance sum of Rs.2,45,11,059/- being cost allocated to Vertex India, was chargeable to tax in India, as business profits of the PE.

Business Connection

Observation of the Tribunal

As per section 9(1)(i) of the Act, any income earned, whether directly or indirectly, through or from any business connection in India, would be deemed to accrue or arise in India and hence, would be taxable in India. The term 'Business Connection' has not been defined in the Act. The Bombay High Court in Blue Star Engg. Co. (Bom) (P) Ltd v CIT (73 ITR 283) (Bom), following the principle laid down by the SC in CIT v R D Aggarwal & Co. (56 ITR 20, 24) (SC), had held that since there is no precise definition of the term "Business Connection", the solution to the question must depend upon the particular facts of each case.

As held in the SC decision in a case of CIT vs. R D Aggarwal & Co (56 ITR 20), a business connection may take several forms viz. it may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in India, which facilitates or assists the carrying on of that business.

The Bombay High Court in CIT vs. National Mutual Life Association of Australia (I ITR 350) held that all that is necessary for a business connection to exist is that there should be (i) a business in India; (ii) a connection between a non-resident person or company and that 'business'; and (iii) Non-resident person or company has earned income through such connection. There are various factors which need to be looked in to while determining whether a business connection exists in a particular situation, or not.

The Andhra Pradesh High Court in the case of GVK Industries Ltd vs. ITO (228 ITR 564) compiled the ratios of various other decisions and laid down the following principles of business connection viz. the essence of business connection is the existence of close, real, intimate relationship and commonness of interest between the non-resident and the Indian person and to constitute 'Business Connection ' there must be continuity of activity or operation of the non- resident with the Indian party and a stray or isolated transaction is not enough to establish a Business Connection.

The connection of the assessee with the Indian entity should be continuous in order to have a business connection. There must be a real and intimate connection between the activity carried on by the non-resident outside India and the activity carried out in India. Further, such activity must be one, which contributes to the earnings of profits by the non-resident in his business. To conform with the requirements of the expression "Business Connection" it is necessary that a common thread of mutual interest must run through the fabric of the trading activity carried on outside and inside India and the same could be described as real and intimate connection. The commonness of interest may be by way of management control or financial control or by way of sharing of profits. It may come into existence in some other manner but there must be something more than mere transaction of purchase and sale between “principal to principal” in orders to bring the transaction within the purview of business connection.

Decision: There was a continuous relationship between the assessee, its affiliates and Vertex India. The contract entered by the assessee and its affiliates outside India was carried out in India. The responsibilities of the assessee vis-a-vis its customer were concluded in India. The responsibility of the assessee could not be segregated and would not get completed, unless Vertex India provided services to the customers. In this case, the assessee secured orders on behalf of Vertex India and outsourced the job to it. The assessee had continuous revenue generating business activities with Vertex India. There was real and intimate relationship between the activities of non-resident outside India and those inside India. Accordingly, the assessee had a business connection in India under section 9(1) (i) of the Act.

Fixed Place PE

Observations of the Tribunal

The assessee had entered into service contracts with PowerGen Retial Ltd. and Last Minute Networks Ltd., its overseas customers. As per the said contract, the assessee could sub-contract whole or part of the services only to its subsidiary in India. Accordingly, these contracts were sub-contracted to Vertex India.

For establishing a Fixed Place PE, the following conditions should be satisfied cumulatively:-

There is a place of business (Place of Business Test)

Such Place of business is at the disposal of the assessee. (Disposal Test)

Such place of business is fixed (Permanence Test)

The business of the entity is carried on wholly or partly through such fixed place of business. (Activity Test)

In the case of the assessee, place of business test was satisfied as Vertex India was the place of business. Whether those premises were at the disposal of the assessee or not was an important parameter to decide as to whether Vertex India constituted a PE of the assessee. It was not necessary that the premises need to be owned or even rented by the enterprise. All that was required was that the premises should be at the disposal of the enterprise.

It was not established that premises were made available to a foreign enterprise for the purposes of carrying out particular work on behalf of the owner of the premises. In that situation, the space provided was not at the disposal of the enterprise since it had no right to occupy the premises but was merely given access for the purposes of the work and hence disposal test was not satisfied.

Decision:

In substance, Vertex India was operating as if it were a branch of the non-resident assessee. Vertex India was virtual projection of the assessee in India, in-spite of its having an independent legal status. It can be said that the premises of Vertex India were at the disposal of the assessee. The business of the assessee was carried on almost wholly through fixed place in India represented by Vertex India.

However, the second requirement of article 5(1) of the DTAA was not satisfied as regards back office functions. As Vertex India would be merely providing back office services, in view of the SC decision in the case of DIT V Morgan Stanely Inc Co., the assessee could not be said to have a Fixed Place PE in India.

Dependent Agent PE

Observations of the ITAT

The AO had held that the assessee constitutes a dependent agent PE as per Article 5(4) of the India-UK Tax Treaty. The AO further alleged that the Indian and UK employees co-ordinated with each other for business development as well as marketing. They also secured orders for its parent company either in India or abroad. The AO has also stated in his order that they negotiated with customers and secured contracts for Vertex India and its affiliates.

Though the AO made all these allegations, no material had been brought on record. All these allegations were denied by the assessee in its detailed submissions, whereas the AO in his remand report had simply contended that the assessee was not an agent of independent status.

Decision:

In view of the business model of the assessee and in the absence of material to suggest that the conditions mentioned in Article 5(4) were satisfied, Vertex India would not constitute a dependent agent PE of the assessee in India.

Reimbursement of GBP 654,982 treated as Royalty as per India-UK DTAA

Facts: The assessee had claimed reimbursement of expenses from Vertex India of Rs.5,24,52,014, as not taxable on the ground that the same was reimbursement of expenses, not subject to tax in India in accordance with the India-UK Tax Treaty. The AO asked to explain the details of reimbursement of expenses and the nature of services provided for these reimbursement. The assessee submitted that the reimbursement of GBP 654,982 represented the amount spent by assessee to facilitate Vertex India in delivering its services to the customers in UK including support in treasury, taxation, finance, etc.

The AO was of the view that it was the responsibility of Vertex India to render services to the customers on the behalf of the assessee. Therefore, the disbursement of above expenses on behalf of Vertex India did not arise. Therefore, if the reimbursement of expenses was reduced from the services fee actually received by the Indian company, then profit from Indian operations will enhance by the same value i.e. the reimbursement of expenses paid by the Indian company to the other. In the same logic, royalty and fees for technical services received by the assessee and its affiliates would have the effect of reducing the fee actually paid to the Indian company. Therefore, royalty and fees for technical services were taxable as business profit.

Observations of the ITAT

The assessee had put forward three contentions viz. 1) that the reimbursements were on cost to cost basis and hence there was no income; 2) the said amount did not qualify as FTS under the Tax Treaty; and 3) the said amounts were not effectively connected with the PE.

Out of total reimbursement of GBP 654,982 (Rs. 52,452,014), amount aggregating to GBP 348,906 (Rs. 27,940,955) pertained to third party costs directly relatable to Vertex India and the balance of £ 306,076 (Rs. 24,511,059) pertained to costs that had been allocated to Vertex India. The assessee had submitted a declaration along with copy of documentary evidence in the form of invoices. The argument of the assessee that there was no element of income in the entire amount of reimbursements could not be accepted, as it could not be said with certainty whether the amount of GBP 306,076 allocated by the assessee was on cost to cost basis or not. However, for the third party costs of GBP 348,906 directly relatable to Vertex India fact of reimbursement had been demonstrated in the form of documentary evidence.

Decision: GBP 306,076 (Rs. 24,511,059) pertained to access circuits, network bandwidth etc. These amounts pertained to use of equipment outside India and would constitute “Royalty” as defined in Article 13.3(b) of India-UK Tax Treaty.

In respect of remaining amount of GBP 348,906 (Rs. 27,940,955) representing third party costs directly relatable to Vertex India, contention that it was a case of reimbursement was accepted.

Citation: Vertex Customer Management Ltd. [TS-115-ITAT-2016(DEL)]

Income liable to be taxed as business income must first be subject to test of existence of Permanent Establishment.

Facts of the case:

Forbes Container Line Pte. Ltd. ('Assessee') was a company incorporated in Singapore, engaged in the business of operating ships in International traffic across Asia and Middle East. It was a wholly owned subsidiary of Forbes & Co Ltd. ('FCL'), incorporated in India and commenced operations in 2006

The assessee filed its Return of Income which was then selected for scrutiny. The AO concluded the assessment determining the total income of the Assessee at Rs. 2.97 crores, holding that the business of the assessee was covered by the provisions of section 44B of the Act.

FCL appointed Volkart Flemming Co ('VCL') as an agent in India vide an agency agreement w.e.f. 01/01/2007. VFFSL demerged its shipping agency divisions into FCL w.e.f. 01/04/2008. VFFSL was also a 100% subsidiary of FCL.

The AO held that the assessee being a Non-Vessel Operating Common Carrier (NVOCC) was not eligible for exemption under Article 8 of the India Singapore DTAA. AO further held that income which arose/accrued from the operation of ships from international traffic was taxable in India per provisions of Section 5 of the Act and hence the provisions of section 44B were applicable for the income being considered by the AO. AO referring to Article 7 & 5 of the DTAA also held that the office of the agent was the assessee's place of business in India, since the assessee did not have any other agent in India except FCL and FCL could conclude contracts on behalf of the assessee, etc. the AO taxed the income under consideration under provisions of section 44B, dealing with computation of profits and gains of shipping business of non-residents, r.w.s. 5(2) of the Act @ 7.5% of the gross receipts.

The CIT(A) upheld the order of the AO. Aggrieved by the order of the CIT(A) the assessee further appealed before the ITAT

Arguments:

The DR argued that the assessee had a business connection in India owing to the following:

- Agency was entered into with associated concerns and that there was real and intimate connection with the income;
- FCL secured the business from India for the assessee;
- The principal and agent had common control;
- Promoters created assessee as 100% subsidiary;

- One of the directors of the assessee was also a director of FCL and permanently resided in India looking after policy matters of the assessee; and
- Control mechanism of both entities resided in India; and
- Existence of Indian Bank accounts.

In respect of the existence of Service PE aspect the AR argued that:

- Assessee did not hold any Indian Bank Accounts;
- No fixed place of business in India;
- Assessee was a subsidiary of FCL;
- Per provisions of of DTAA there was no PE in India.
- Only 2.9% of the total revenue was received from FCL and substantial income was from sources other than FCL; and
- Assessee was an independent entity and made its own decisions from Singapore.

In respect of the chargeability of income in India the AR argued that:

- Assessee had not claimed any exemption under Article 8
- AO himself held that assessee was in the business of non-vessel operating activities and thus not in the operating of ships, making application of Section 44B infructuous.

<u>Ruling of the ITAT:</u>

Primary questions for adjudication raised before the ITAT related to the chargeability of income u/s 44B of the Act and the existence of Permanent Establishment.

The ITAT noted that neither the AO nor the CIT(A) proved the existence of Indian Bank Accounts. Whereas, the assessee proved that its books were maintained at Singapore and that the bank account existed in Singapore and all transactions were effected from that very account. The assessee also placed emails on record which proved that business activities were carried out from Singapore only.

The ITAT stated that, the fact that one of the directors stayed in India or only one meeting was held during the year or location of parent company could not be used for determination of residential status. The assessee received substantial portion of its income from Middle Eastern countries, etc., its business was being handled from Singapore was factually correct.

The ITAT stated that since, the assessee had not claimed exemption under Article 8 of the DTAA, as it was not in shipping business, the income of the assessee was to be assessed under the Article dealing with business income. ITAT stated that application of Section 44B was incorrect since the AO himself admitted that the assessee was not in shipping business, neither did the assessee own or charter or take on lease any vehicle or ship. The assessee only provided container services to its various clients.

In view of the above discussion the ITAT held that income under consideration was liable to be taxed under business profits and since there was an absence of PE in India, no income could be brought to tax in India.

Our Comments:

A company will be said to be resident of India either if it is an Indian company or control and management of its affairs are wholly situated within India. Thus, in the instant case, it was proved beyond doubt that the control and the management of the affairs of the assessee was done from Singapore and not India. This also disproved the existence of PE. Thus, in such instances, documentation would be of paramount importance to show that the control and management of affairs of a company lies outside India. Though, the CBDT has recently released draft POEM guidelines to tackle this issue, the final guidelines are yet awaited.

Citation: **Forbes Container Line Pte. Ltd. [TS-126-ITAT-2016(Mum)]**

A standard notice issued under section 143(2) was no bar on admission of application by the AAR. Where the notices contained a question which referred to a specific questionnaire, the issue would be considered as 'pending before the income tax authority' in terms of section 245R of the Act.

The assessee, a Korean company, was a comprehensive energy solution provider. Pursuant to an agreement with Power Grid Corporation of India Ltd. ('PGCIL') the assessee supplied equipment for setting up sub-stations in various locations in India. PGCIL while making advance payment to the assessee deducted TDS and the assessee claimed refund for the same on the ground that its income was not chargeable to tax in India.

The assessee filed an application before AAR for 2008-09 to 2010-11. In the interim, the assessee had received notice under section 142(1) for AY 2008-09 and 2009-10. Therefore the applications for AY 2008-09 and AY 2009-10 were preferred after notices under section 142(1) was issued, applications for AY 2010-11 were preferred before issuance of such notices. The assessee's applications before the AAR were rejected on the ground that same were barred in accordance with the clause (i) of proviso to Section 245R(2) which provides that where question involved in the applications are already pending before the AO, then AAR could not entertain the applications.

Contention before the High Court

Mere issuance of a notice under section 143(2) could not amount to the question raised in the applications being pending before the income tax authorities. The assessee further argued that clause (i) of the proviso to Section 245R(2) was discriminatory as it exempted PSUs notified by the Central Government from the bar imposed by the said clause. However, the assessee contended that said proviso be made applicable to non-residents also.

Decision:

When can a question be termed as 'pending' before the Income Tax Authority?

HC held the mere fact that a notice under section 142(1) of the Act was issued prior to the filing of the application by the Petitioner before the AAR would not constitute a bar on the AAR entertaining and allowing the applications. However, the notices issued to the assessee which were accompanied by a questionnaire, raised the question of supply contracts which according to the assessee were executed overseas. Section 142(1) notice issued for AYs 2008-09 and 2009-10 raised the questions that formed subject matter of the applications and since they were issued prior to the filing of the applications, rejection of the applications by the AAR in respect of AYs 2008-09 and AY 2009-10 were not erroneous.

With regards to application made for AY 2010-11, the High Court opined that what was relevant was not the date of consideration of the application by the AAR but the date of filing of such application before the AAR. Interpreting the words 'already pending' appearing in Section 245R(2). If on the date of filing of the application before the AAR, the question raised therein was already the subject matter of proceedings before the income tax authorities, then the bar in terms of the proviso to Section 245R(2) of the Act would apply. If such application was not already pending on the date of the application, and was the subject matter of a notice issued thereafter by the income tax authority, it cannot be said that such question was 'already pending before such income tax authority'.

Non-discrimination

Merely declaring the exception carved out for PSU Bank, as unconstitutional would not benefit the assessee unless the benefit of such exception is also extended to the assessee as a non-resident. Referring to the India-Korea Tax Treaty and the provision of Section 90 of the Act, even if the exception carved out only for resident PSU was invalidated, the bar would apply equally to both a resident and a non-resident. The same would serve no purpose to declare the same as violative of Article 14.

Citation : Hyosung Corporation Vs. AAR [WP. (C) 5818/2013](Delhi High Court)

The Tribunal confirmed the deletion of penalty imposed by the TPO under section 271AA of the Act on factual issues

Facts and issues: The assessee was engaged in development of software and online software support services. During the course of transfer pricing assessment proceedings for AY 2006-07, the TPO observed that the assessee had not used recent contemporary data for the purpose of benchmarking its international transaction.

The TPO directed the assessee to conduct fresh search for comparables. The assessee provided 9 company cases as comparables. However, these 9 companies were the same companies which the assessee had used for FY 2004-05. For providing the information required by the TPO the assessee updated margins for the same companies and stated that the updates were dated 25 August 2006. The TPO used 5 companies out of 9 provided by the assessee for determining the ALP. The TPO's objection was that the assessee utilized the results of the same process as had been undertaken in the FY 2004-05 and provided the updated margins for the same comparables. The TPO recommended penalty proceeding under section 271AA. The TPO observed that no fresh search for comparables or analysis using contemporaneous data had been made by the assessee.

Accordingly, the AO levied 2% penalty on value of each international transaction determined by the TPO on the ground that the assessee had failed to maintain records relating to international transactions as required under Rule 10D of the Rules.

Contention of the assessee

The service rendered to the AE by the assessee was same as provided in the FY 2004-05. Further, the assessee had updated the comparables before due date of filing of return and out of 9 comparables submitted, the TPO had used 5 comparables for deciding ALP of international transactions. As the same comparables were considered in AY 2004-05, the assessee contested levy of penalty.

Observation of the ITAT

The assessee had disclosed international transaction made with AE and the Tribunal had decided that no upward adjustment was required in the ALP disclosed by the assessee. Whatever information was asked by the TPO had been furnished before him i.e. 9 comparable companies data were furnished out of which the TPO had selected 5 companies.

Decision: The CIT(A) had rightly deleted the penalty under section 271AA on the ground that comparable companies applied for FY 2004-05 were relevant to the transactions made during the FY 2005-06, the same was updated by the assessee and filed before the TPO.

Citation: ACIT vs Integrated Decisions & Systems (India) Pvt. Ltd. [TS-84-ITAT-2016(JPR)-TP]

Non consideration of material on record would constitute a mistake apparent from record for the DRP. The DRP was justified in modifying its direction given at the time of passing of original order

Facts and issues: The assessee, was engaged in trading of power tool products like drills, grinders, saws, hammers etc. During the course of assessment proceedings for AY 2010-11, the TPO found that the assessee had incurred huge expenses in the nature of advertisement and market promotion (AMP). After analyzing the AMP expenditure incurred by comparables chosen by the assessee, the TPO found that average expenditure incurred by 3 comparables was only 2.44% of sales, whereas the assessee had incurred AMP expenditure of 9.81% of sales. The TPO, therefore treated excess expenditure of 7.37% of sales as expenditure incurred by assessee for development of intangibles owned by AE. The TPO also suggested a mark-up of 24.8% on AMP expenditure.

Before the DRP, the assessee contended that it had not incurred AMP expenditure on behalf of its AE. Selling expenses like trade discount, sales discount, warranty expenses and packing expenses could not be treated as AMP expenditure. The DRP, while passing order under section 144C of the Act noted that the assessee’s contention to exclude selling expenses from AMP expenditure could not be accepted as it had failed to furnish specific information / details in respect of the claim.

The assessee filed a petition under section 154 of the Act before the DRP for rectifying the above directions issued under section 144C of the Act, as the assessee had placed on record full details relating to nature of AMP expenditure before the TPO and the DRP. The DRP passed an order under section 154 r.w.s. 144C that the assessee had filed full details relating to AMP expenditure which included trade discount sales discount, warranty expenditure and packing expenditure.

The DRP accordingly directed the AO to exclude these expenses from AMP expenditure in view of the law laid down by the Special Bench ruling in LG Electronics.

Decision: It was an undisputed fact that the assessee had filed full details of the expenditure incurred by it which were considered as AMP expenditure by the TPO. The expenditure incurred included sales discount, selling expenditure, warranty expenditure. These details were not considered by the DRP at the time of passing the original directions under section 144C of the Act. When this fact was brought to the notice of the DRP, the DRP modified its directions to exclude those items from the AMP expenditure, following the law laid down by the Special Bench ruling in the case of L. G. Electronics. Non-consideration of material on record would constitute a mistake apparent from record. The DRP was justified in assuming jurisdiction under section 154 of the Act.

Citation: Stanley Black & Decker India Ltd. [TS-89-ITAT-2016(Bang)-TP]

Assessee not liable to deduct TDS in respect of year end expense provisions reversed subsequently since no income accrued to the assessee

Facts: The assessee was engaged in the business of manufacture and sale of injection equipments, auto electric items, portable electric power tools etc. During the year assessee had made provisions for expenses amounting to Rs. 1.79 crores in accordance with Accounting Standard-29 (AS-29) issued by Institute of Chartered Accountants of India. The said provision to the extent of Rs. 1.79 crores was subsequently reversed in the beginning of the next financial year as no invoice was received by the assessee. The assessee while filing income tax return for AY 2012-13 made suo-moto disallowance u/s 40(a)(i) and 40(a)(ia) in respect of provisions on which no TDS was made.

During the course of proceedings under section 201 the assessee contended that since the provision was reversed in the beginning of next year no TDS was required to be deducted. However TDS officer held that the system of accounting followed by assessee was faulty and does not enable any verification. The TDS officer also held that since the assessee was following the mercantile system of accounting TDS should have been deducted on the provision made. Thus the TDS officer held the assessee as assessee in default u/s 201 and raised a demand of Rs 17.93 Lakh toward tax and Rs 4.24 Lakh towards interest.

Decision: Before the Tribunal, the assessee submitted that – (i) no income had accrued to the payees and a mere provision was made in the books of accounts at the end of the year; (ii) payees as well as the exact amount payable to them was not identifiable; (iii) existence/accrual of income in the hands of payee was a pre-condition to fasten the liability of TDS in the hands of the payer; (iv) Sec 195 stipulates that the payer has to deduct TDS at the earlier point of time either at the time of crediting the sum to the payee account or at the time of payment and thus both the events i.e. crediting the amount to payee's account and payment to the assessee must necessarily occur. The assessee thus contended that in absence of payment the question of deducting TDS at the time of crediting did not arise.

Revenue argued that as per plain reading of Sec 195, the liability to deduct tax at source had arisen the moment the amount was credited in the books of accounts, irrespective of whether the amount was paid or not. Revenue also submitted that the provisions of taxing statutes should be construed strictly.

Tribunal held that "the liability to deduct tax at source arises only when there is accrual of income in the hands of the payee." The Tribunal noted that the SC in the case of GE India Technology Centre P. Ltd. [327 ITR 456] had held that if payment was not assessable to tax then there was no question of TDS being deducted. The Tribunal further held that no income had accrued in the hands of the payee considering the fact that the provisions made at year-end were reversed in the beginning of the next accounting year.

ITAT also relied on SC ruling in CIT vs. Shoorji Vallabhdas & Co. [46 ITR 144] wherein it was held that "Mere entries in the books of accounts does not establish the accrual of income in the hands of the payee"

Accordingly, ITAT held that there was no liability in the hands of the assessee company to deduct TDS, merely on the provisions made at the year end and therefore the assessee company cannot be treated as 'assessee in default' for not deducting TDS on a mere provision.

Our comments: Bangalore ITAT in case of IBM India Private Ltd [TS-305-ITAT-2015(Bang)] had held that assessee was liable to deduct TDS on quarterly expense provisions entries through credit in suspense account as per its global group accounting policy. Bangalore ITAT had thus held that "statutory provisions dealing with collection and recovery of tax under Chapter XVII of the Act envisage TDS collection de hors charge u/s. 4(1) of the Act".

The decision in this case was based on Supreme Court decisions in case of GE India Technologes and Shoorji Vallabhdas which were not discussed in the decision of IBM India Private Limited. Further the present decision is based on the fact that income is not taxable in the hands of the recipient in the year under consideration whereas in IBM Tribunal had held that once the income is taxable even in subsequent year in the hands of payees provision of TDS would be applicable.

However, Mumbai ITAT in the case of Pfizer Ltd. [TS-812-ITAT-2012(Mum)] had held that Revenue cannot invoke provisions of Sec 201(1) once assessee made suo-moto disallowance u/s 40(a)(i)/(ia).

Citation: Bosch Limited, ITA 1583/Bng/2014, Bangalore Tribunal

No TP adjustment can be made by deducing from the difference between AMP expenditure incurred by assessee-company and AMP expenditure of comparable entity, if there is no explicit arrangement between the assessee-company and its foreign AE for incurring such expenditure.

Facts: Assessee was engaged in engaged in the business of trading in finished, semi-finished opthalmic lenses, optical meters and processing of semi-finished ophthalmic lenses. It was a wholly owned subsidiary of Essilor International SA, France and therefore, became its Associated Enterprise ("AE"). Assessee purchased ophthalmic lenses from the AE and sold them after some processing. Assessee and its AE had a royalty-paying relationship for licence to use AE's technology in India in its business.

The matter related to AYs 2009-10 & 2010-11 wherein the fact pattern was almost similar. In fact, the ruling discussed the facts of AY 2009-10 and applied the same conclusion to the facts of AY 2010-11.

Broadly, the assessee reported international transactions with its AEs and adopted Transactional Net Margin Method (TNMM) as the 'most applicable method' with operating profit margin to the turnover as the Profit Level Indicator ('PLI') for benchmarking the transactions.

For AY 2009-10, Assessee computed own margin at 13.45% and claimed that the same was comparable with mean margin of (-) 3.31% earned by comparable companies viz. GKB Opticals Ltd. and Techtran Polylenses which were engaged in the similar line of business. However, TPO observed that assessee had incurred expenditure on account of sales promotion and advertisement (more commonly known by as 'advertisement, marketing and promotion' or the 'AMP') to the tune of Rs. 16.24 crores which was about 14.2% of total revenue. He held that this was more than the 3.33% of the turnover, **which was the average AMP expenditure that the comparables selected by assessee had incurred**. Therefore, the TPO adopted 3.33% of the turnover to bench mark the transaction of the AMP with its AE and taxed the excess/difference. The TPO also worked out the operating margin on the total operating cost at 20.22% after excluding the additional expenditure incurred on AMP. TPO thus, proposed TP adjustment of Rs. 10.66 crores, which the AO duly incorporated in his draft assessment order.

Assessee contended before DRP that the entire AMP expenditure cannot be added as TP adjustment, only expenditure beyond 3.34% of the revenue can be treated as excess expenditure. Further, it was claimed that for the purpose of calculating mark-up and AMP expenditure, depreciation should be treated as operating cost in which event, profit on the operating cost would work out to 11.47%. DRP remitted the issue to the TPO to reconsider in the light of Special Bench decision in LG Electronics India [2013] 29 taxmann.com 300 (Delhi) (SB) with direction to determine the cost of services provided by the assessee-company to its AE in the form of AMP expenditure incurred for promoting the brands of AE after determining the cost of the services so provided, and to determine the margin on these services by applying cost plus method. The Special Bench of the ITAT had in the LG case (supra) ruled that the "Bright Line test" can be applied to determine whether AMP expenses incurred by assessee are excessive & for the benefit of the brand owner.

Aggrieved by the DRP's order, assessee preferred an appeal before ITAT.

Issue before the ITAT:

The TP issue in appeal before the ITAT was whether AMP expenses incurred by assessee can be said to be incurred not only for the benefit of the assessee-company but also by way of rendering services of promoting the brand of foreign AE viz. Essilor International SA, France.

Key arguments:

Assessee argued that international transactions cannot be presumed on incurring AMP expenditure **in absence of tangible material to show that the two parties 'acted in concert'.** Assessee contended that the expenses such as convention expenses, loyalty programme expenses and merchandising expenditure should not be treated as advertisement marketing expenditure, as they were only incurred in connection with sales and should be treated as selling expenses.

Revenue pleaded that the matter may be restored to the file of the TPO for fresh adjudication in the light of the law laid down by the Delhi HC ruling in the case of **Sony Ericsson Mobile Communication** [374 ITR 118 (2015)] wherein it was held that AMP expenses indeed constituted an international transaction.

ITAT's decision:

At the outset, the ITAT distinguished the facts of the case from the Sony Ericsson ruling (supra). The ITAT noted that in the Sony Ericsson ruling (supra), the assessees were distributors of products manufactured by the foreign AE, and not manufacturers themselves. ITAT also noted that in the Sony case, the assessee did not appear to have questioned the very existence of international transaction with foreign AE, nor was it disputed that incurring AMP expenditure could be subject matter of TP adjustments under section 92 of the Act.

Noting assessee's objections on existence of international transaction on account of incurring AMP expenditure, ITAT rejected Revenue's contention to apply HC decision in Sony Ericsson to assessee's case.

Instead, the ITAT preferred to apply the rulings of the Delhi HC in Maruti Suzuki (ITA 110/2014), Whirlpool of India, Bausch & Lomb, Yum Restaurants & Honda Siel, wherein the very existence of international transaction on incurring AMP expenditure and the method of determination of ALP was the subject matter of appeal before HC. The HC, in these cases, had held that in the absence of agreement between Indian entity and foreign AE whereby the Indian entity was obliged to incur AMP expenditure of a certain level for foreign entity for the purpose of promoting the brand value of the products of the foreign entity, no international transaction can be presumed.

Therefore, if there was no explicit arrangement between the assessee-company and its foreign AE for incurring such expenditure, no TP adjustment could be made by deducing from the difference between AMP expenditure incurred by assessee-company and AMP expenditure of comparable entity. The fact that the benefit of such AMP expenditure would also ensued to its foreign AE was not sufficient to infer existence of international transaction. The ITAT further held that the onus lay on the Revenue to prove the existence of international transaction involving AMP expenditure and further, in the absence of machinery provisions to ascertain the price incurred by the assessee-company to promote the brand values of the products of the foreign entity, no TP adjustment can be made by invoking the provisions of Chapter X of the Act.

ITAT thus remitted ALP determination of assessee's international transactions to the file of AO/TPO for consideration of AMP expenditure in the operating cost of assessee.

Our Comments: This is a welcome judgement from the Bangalore ITAT, which seeks to a) make distinction in the AMP expenditure pattern between a distributor and a manufacturer, thereby distinguishing the Sony Ericsson judgement (supra) and b) continue to trend emanating from the Maruti Suzuki judgement (supra) to the effect that AMP expenditure does not constitute an international transaction and that, in the absence of the machinery provisions, TP code cannot be applied on imaginary basis viz. the bright-line test.

Citation: Essilor India Pvt. Ltd. vs. DCIT, Bangalore [IT (TP) A Nos. 29/Bang/2014 & 227/Bang/2015] reported in TS-88-ITAT-2016(Bang)-TP

Actual stay of the employees has to be considered for computing continuous stay for determining Supervisory PE

Facts and Issue: The assessee, a Germany company was engaged in the business of rendering consulting services in the field of exploration, mining and extraction. During AY 2002-03, the assessee entered into 3 contracts with Indian mining companies. Income earned by the assessee was offered to tax as "fees for technical services" under Article 12 of India-Germany Tax Treaty. The AO observed that the project undertaken by the Indian companies lasted for more than 6 months. The AO, accordingly requested the assessee to explain as to why it does not have a PE in India as per Article 5(2)(i) of India-Germany Tax Treaty. The AO held that the assessee had a Supervisory PE in India and accordingly applied higher rate of Income tax as per Article 7 of the Tax Treaty.

Contention of the assessee

The assessee argued that supervisory activities had lasted for less than six months' period and therefore, no Supervisory PE was triggered. In 2 contracts, only one employee had visited India whose stay in India was only for 64 days and no supervisory activities were booked for the year under appeal.

Observation of the ITAT

For determining Supervisory PE, stay of employees had to be considered and not the contract period. The assessee had deputed one of its employees in India and his stay in India did not exceed 180 days to trigger Supervisory PE.

Decision: Invoices raised by the assessee proved that it had rendered services that were of consultancy nature and therefore, the same was governed by the provisions of Article 12 of the

Tax Treaty. Payments received by the assessee should be assessed as fees for technical services as per the provisions of Article 12 and not as per Article 7 of the India-Germany Tax Treaty, in absence of Supervisory PE in India.

Source: Rheinbraun Engineering Und Wasser GmbH [TS-113-ITAT-2016(Mum)]

Where the assessee failed to prove in benchmarking of the international transaction in good faith and other vareful due diligence, penalty under section 271(1)(c) was confirmed read with Explanation 7 to section 271(1)(c) of the Act.

Facts and Issue: The assessee was engaged in manufacturing and trading of pharmaceutical products. During AY 2003-04, the assessee recorded international transactions with AEs at Cyprus, UK and Switzerland. The assessee had benchmarked its international transactions with its AEs using Cost Plus Method (CPM). As the assessee's Gross Profit (GP) margin was 58.4% as against industry margin of 55%, the assessee contended that its international transactions were at ALP.

The TPO observed that the AEs of the assessee were also engaged in buying the same products from unrelated parties for sale to Ukraine. The AEs had further sold goods to the buyers at Ukraine. The TPO observed that those transactions would constitute CUP and therefore objected to the assessee's TP analysis in not benchmarking transactions individually by using CUP as Most appropriate Method (MAM). Accordingly, the TPO made an transfer pricing adjustment of Rs. 2.05 lakhs. Considering the quantum of the transfer pricing adjustment, the same was accepted by the assessee.

The AO initiated the penalty proceedings under section 271(1)(c) on the above adjustment. In the explanation provided before the AO, the assessee only explained its requirement of having AEs in Cyprus, UK and Switzerland, but failed to explain the reason of not using CUP as the MAM for benchmarking each transaction separately. The assessee further submitted that there was no concealment of income or furnishing of inaccurate particulars as the assessee had agreed for the additions which arose due to price difference when compared with the unrelated parties.

Explanation 7 to section 271(1)(c) states that penalty would be leviable in case of addition/disallowance in case of international transaction, unless the assesse proves to the satisfaction of the AO that the transaction was entered in good faith and with due diligence.

The CIT (A) held that the assessee failed to prove its "good faith and due diligence" as laid down in Explanation 7 to section 271(1)(c) of the Act.

Before the Tribunal, the assessee relied on the Tribunal decision in the case of DCT vs. RBS Equities India Ltd [133 ITD 77] wherein it was held that the penalty under section 271(1)(c) was not leviable where no dishonesty was found in the conduct of the assessee and the assessee has taken a reasonable decision in matters of selecting appropriate method for benchmarking the transactions.

Decision: The assessee failed to (i) adopt CUP method and (ii) benchmark each of the transaction separately. The assessee was well aware about the availability of CUPs for the international transactions. The due diligence therefore was not in existence while benchmarking the transaction. Further, the assessee could not demonstrate that the transactions were done in good faith. Considering the above factual matrix, the penalty was confirmed.

Citation: Genom Biotech P. Ltd. Vs. ITO [ITA No. 7214/M/2010)[Mumbai Tribunal]

Tribunal

Payment on account of acquisition of first-right of refusal in respect of future business initiatives does not amount to Royalty and hence, not eligible to TDS

Facts: The assessee was engaged in the business of software development in telecom sector. Majority of the shares of the assessee-company are held by its promoter Shri. Mohan Raju, who was also the Managing Director. A Mumbai-based Company ('WHPL') became interested to be associated with the assessee-company as a co-promoter and hence, acquired 51% of the shares of the assessee-company under a proper agreement, reduced in writing. The said agreement also provided for non-compete clause in terms of which the promoter and WHPL had agreed not to carry on similar business in which the assessee-company was engaged or not to compete with the assessee-company directly or indirectly or alone or in association with others or with any other entity. This clause did not provide for any fee for this covenant.

However, clause XIV of the agreement provided for the right of first refusal to the assessee-company and WHPL in respect of future business initiatives of Shri. Mohan Raju in specified business areas. The same clause provided that Shri Mohan Raju should offer 74% of the economic interest to the assessee-company in the new business initiative which he may promote either as a shareholder or as a partner in the field of telecommunication, digital media and convergence other than those specified in clause 2(b) of the agreement. The said clause read as under:

> **"XIV. Right of first refusal to the Company and WHPL in respect of future business initiatives of MR in specified areas:**
>
> (a) Any new business initiative of MR in the fields of telecommunication, digital media and convergence, other than those provided under Article II (b) hereinabove, shall be considered as 'specified business' for the purpose of this Article;
>
> (b) During subsistence of this Agreement, if MR is intending to promote any 'specified business' or intends to associate himself directly or indirectly in the promotion of any 'specified business' either as a shareholder or partner, MR shall first offer 74% economic interest in such 'specified business' to the Company and if the Company for any reason is unable to accept the offer, then the right shall shift to WHPL and if WHPL too declines to accept the offer, MR may proceed with the special business as if this agreement were never entered into.
>
> (c) In consideration for granting the aforesaid right to participate up to a level of 74% economic interest in any future initiative of MR in 'specified business', the Company shall pay to MR a lump sum amount of Rs. 5 crores. The same shall be paid and discharged by the Company in the following manner:

On or before 315t March 2006 — Rs. 1 Crores
On or before 30th Sep 2006 — Rs. 2 Crores
On or before 315' March 2007— Rs. 2 Crores

(d) It is hereby specifically provided that in the event of breach of the above said stipulation by MR the entire consideration paid to him under this clause shall be recovered by the Company along with interest @ 12% p.a, in addition to taking punitive action against MR available to the Company under law.

Where however the Company does not exercise the right and if WHPL accepts the offer, WHPL shall pay to the Company a sum equal to 10% of the total payment by the Company till then to MR, every time such offer is made to WHPL under this clause."

Accordingly, assessee-company paid a consideration of Rs.5 crores on various dates to its MD Shri, Mohan Raju during the financial years 2005-06 and 2006-07, without deducting any TDS.

A survey operation under the provisions of section133A was carried out in the business premises of the assessee-company on 26/2/2010 by the DCIT(TDS), Bangalore. The TDS authorities questioned the assessee-company as to why the TDS was not deducted on the impugned payments. The assessee-company responded that TDS was not applicable on these payments as these payments were made for acquisition of intellectual property rights which were in the nature of goods.

The TDS Authorities held that the payments were in the nature of royalty within the meaning of the definition of 'royalty' in Explanation 2 to sec.9(1)(vi) of the Act and that the assessee-company ought to have withheld TDS on these payments u/s 194J of the Act. Not having done so, they treated the assessee to be in default within the meaning of section 201 of the Act and demanded tax and interest.

The assessee-company filed an appeal before the CIT(A) who upheld the TDS Officer's order by ruling that the assess-company's case was covered by clause (iv) of Explanation 2 to section 9(1)(vi) of the Act as by giving the right of first refusal, Shri Mohan Raju had parted with his commercial and scientific knowledge, experience and skill in the field of networking in favour of the assessee-company which was in the same business.

Aggrieved by this Order, the assessee-company took the matter before the ITAT. The ITAT, after considering the rival submissions, allowed the appeals filed by the assessee-company vide order dated 21/6/2013 by holding that the provisions of section 194J were not applicable to the payments in question as the term 'royalty' was inserted under the provisions of sec.194J only w.e.f. 13/07/2006 and since the amounts in question were already credited on 1/2/2006 in the books of account of the assessee-company, the provisions introduced subsequently w.e.f. 13/7/2006 could not be applied to the credits or payments made prior to that date.

Against this order of the Tribunal, the Revenue contested the matter before the Hon'ble High Court of Karnataka on the ground that the Tribunal had allowed the appeals of the assessee-company on the grounds which were not urged before the Tribunal without giving an opportunity of hearing to the parties to the case. The Hon'ble High Court, being satisfied with the contention of the revenue, restored this matter to the Tribunal for fresh disposal before the Tribunal again. The Hon'ble High Court made it clear that the Tribunal shall consider the appeals on the ground urged by the assessee-company as well as the additional grounds which the Tribunal found relevant to decide the appeals after recording the finding on both the counts.

Pursuant to the order of the Hon'ble High Court, the appeals were heard before the ITAT on 12/01/2016.

Key Arguments: The assessee-company contended that the payments were not in the nature of royalty as there was no technical process / patent / invention involved and hence, it was submitted that the provisions of sec.9(1)(vi) could not be applied to the facts of the present case.

As an alternative plea, it was contended that in any case, since the whole agreement was made on 1/2/2006, it should be construed that the amounts were due as on 1/2/2006. Since the term 'royalty' was inserted in the provisions of sec.194J only w.e.f. 13/7/2006, obligation to deduction of tax at source did not arise.

On the other hand, on behalf of the Revenue, it was urged that the impugned payments were in the nature of royalty. The MD, Shri. Mohan Raju had granted the intellectual property rights in respect of software of which he was the owner and transferred certain rights for use of such software in favour of the assessee-company and therefore, the consideration was paid only for the use of intellectual copy rights in software which was nothing but a royalty. Therefore, provisions of section 194J were squarely applicable to the facts of the case.

ITAT's Decision: After hearing both the parties, the ITAT noted that the TDS officer as well as the ld. CIT(A) had re-characterized the transaction ignoring the explicit terms contained in the agreement governing impugned payments.

The ITAT held that TDS provisions were only one mode of recovery of taxes. TDS provisions were not meant to determine the final nature of the transaction or conclusiveness of the transaction. TDS provisions were only tentative. In such circumstances, it was not open for revenue authorities to re-characterize the transaction for the purpose of holding assessee as assessee in default for non-deduction of tax at-source.

After examining the definition of 'royalty' under the Act, the ITAT concluded that the impugned payments could not be characterized as 'royalty' and hence the question of TDS u/s 194J did not arise. From the close reading of the above agreement, the ITAT deduced that none of the clauses of Explanation 2 to section 9(1)(vi) were attracted to the granting of economic interest of first refusal to the assessee-company by Shri Mohan Raju in any new business initiative. The right envisaged in the agreement was only for acquiring the controlling interest in the new initiative of MR.

It may be noted here that the impugned payments were already considered and taxed as non-compete fee by the AO in the hands of the recipient i.e. Shri. Raju but on appeal, the appellate authorities quashed that assessment on technical grounds. Invoking the decision of the Hon'ble Apex Court, in the case of Hindustan Coca Cola Beverages P. Ltd. vs. CIT (293 ITR 226), though no taxes had been paid by the payee on the amount, the ITAT observed that it served no purpose to enforce demand from the tax deductor as the assessment in the hands of the payee was completed.

Our Comments: The transaction in this case seems to have been intelligently structured with due care and regard to the extant provisions of the Act. This judgement is of relevance and importance to those promoters, especially startups in the technology space, who wish to capitalize on their intellectual prowess and efforts to develop fresh businesses. The import of this judgement could be used as an aid while planning and executing shareholding agreements at the time of welcoming an investor partner. Existing businesses could look at this judgement to structure some value stream for their promoters. As it stands today, the non-compete fees are taxable in the hands of the recipient and the provisions are attracted if a taxpayer is carrying on business and agrees to a non-compete obligation for a separate consideration.

Citation: WiFi Networks Pvt. Ltd. vs. DCIT (TDS), Bangalore [ITA Nos.1624 to 1627/Bang/2012] reported in TS-102-ITAT-2016(Bang)

Tribunal held that the maintenance charges received by a condominium from owners as well as tenants were not taxable, based on the concept of mutuality

Facts and Issue: The assessee was a condominium consisted of a complex containing a number of individually owned apartments. The assessee was managed by a group of persons which handled its various day to day activities. The activities of the assessee included providing services to the apartment owners towards repair and maintenance, security, housekeeping, 24 hours power supply on the reimbursement basis. For these services, the assessee charged the apartment owners, a quarterly fee. In addition to the quarterly fee, the assessee received maintenance charges from apartment owners. Some of the apartment owners had given their apartment on rent to outsiders. During AY 2008-09 the AO noticed that the assessee was receiving maintenance charges from apartment owners as well as outsiders who had taken the apartment on rent. The assessee had claimed quarterly fee and the maintenance charges, as not taxable on the principle of mutuality.

The AO observed that the apartment owners had profit motive as they had given the apartment on rent instead of using for their own residential purposes. The AO held that the concept of mutuality was not applicable to the amounts received as maintenance charges. Accordingly, he taxed the receipts of maintenance charges in the hands of the assessee.

On appeal, the CIT(A) deleted the addition to the extent of Rs. 15.06 lakhs (out of Rs. 17.5 lakhs) which was in respect of surplus generated out of contributions from members, but taxed the balance amount of Rs. 2.47 lakhs received from the tenants by considering them as non-members. The short issue before the Tribunal was as to whether the contribution received from apartment owners as well as companies who had taken the apartments on rent would come within the concept of mutuality or not.

Concept of Mutuality

The cardinal principal of the concept of mutuality is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus and that all the participators in the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial.

The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should distribute the surplus amongst themselves. It is enough if they have a right of disposal over the surplus.

Observations of the Tribunal

The tenants occupied the premises and, therefore, for all practical purposes entered into the shoes of the apartment owners. The total number of members in the society were 58 out of which only 7 members had let out their flats. The concept of mutuality required that the contributor and beneficiary should be identified. In the present case, the beneficiary was identified as the apartment owners as long as it will occupy the flat in the condominium. As long as the tenants occupied the apartment in the condominium, they were the beneficiary of the common maintenance charges. Accordingly, all present or future owners, tenants, future tenants or their employees and/ or any other persons that might use the facilities of the apartment in any manner are subject to the regulations set forth in these byelaws.

Decision: The assessee satisfied the principal of mutuality and therefore the surplus generated out of contribution from members as well as tenants i.e. the companies taking apartment on rental would not be taxable in the hands of the assessee.

Citation: Beverlly Park – I, Condominium Vs. ACIT [ITA No. 1775/Del/2013] (Delhi Tribunal)

Compensation paid to tenants for providing alternative accommodation, not in the nature of rent as defined in section 194I of the Act.

Facts and Issue: The assessee, Sahana Dwellers Pvt. Ltd. was a real estate developer. It also carried out projects for the Slum Rehabilitation Authority ('SRA') wherein it provided free of cost flats to hut dwellers. For one such SRA project, the land/ property belonged to the Brihan Mumbai Mahanagar Palika and approximately 100 inhabitants of the said building were the tenants of the Municipal Corporation. As per the terms of SRA, while the assessee constructed the building it was required to provide alternative accommodation to the tenants as they had to vacate the building for the purpose of construction. However, as the assessee was not able to provide alternative accommodation to the tenants, it agreed to pay compensation to the tenants for enabling them to meet the expenditure to be incurred by them towards rent payable. This compensation was revised from time to time.

During the assessment proceedings of AY 2010-11, the AO noted that the assessee had not deducted TDS on an amount of Rs.51.84 lakhs paid to tenants as compensation. The AO contended that the compensation paid by the assessee to the tenants was actually rent and hence provisions of Sec 194I were applicable. The AO disallowed the entire sum paid under section 40(a)(ia) for non-deduction of TDS. The CIT (A) upheld AO's order. Before the Tribunal assessee relied on Mumbai ITAT decision in **Jitendra Kumar Madan vs. ITO [(2012)32 CCH 59]** wherein compensation paid for alternative accommodation was treated as income from other sources in the hands of the recipients indicating thereby that the nature of such income was not rent. The department contended that for payment to qualify as rent it wasn't necessary that deductor should be the owner of property.

Decision: The Tribunal noted the agreement entered into between the assessee and the society formed by the tenants. It was observed that the concerned persons to whom the assessee had made the payments were neither tenants of the assessee nor the assessee had in reality paid rent on behalf of them. Thus the payment made by the assessee did not come within the purview of rent as defined under clause (i) of Section 194I as the assessee wasn't making such payment for use of any land, building, etc. The Tribunal thus held that the payment made by the assessee is in the nature of compensation. Accordingly, there is no requirement for deduction of tax under the said provisions and the disallowance made under section 40(a)(ia) of the Act could not be sustained.

Citation: Sahana Dwellers Pvt. Ltd. vs. ITO (ITA No. 5963/Mum/2013)[Mumbai Tribunal]

Ahmedabad Tribunal expresses dissent from view taken by Hyderabad Tribunal, wherein it was held that income from carbon credits are capital receipt, not subject to income tax. Rules that transfer of carbon credit was a taxable receipt.

Facts and Issues: The assessee was engaged in the business of manufacturing & commissioning of transmission line towers & steel structures and supply of transmission & distribution line material. During the assessment proceedings, the AO noticed that the assessee had income from sale of carbon credits i.e. Certified Emission Reductions (CER) of Rs. 5,78,28,058. These carbon credits were earned from its bio-mass power plants situated at Tonk (Rs. 4,73,00,773) and Padampur (Rs. 1,05,27,285). The said sale of carbon credit was not offered to tax on the ground that the same was capital receipt and therefore, not chargeable to tax.

The AO treated the income from sale of carbon credit, as revenue in nature and made the following observations:

- It was wrong for the assessee to compare the carbon credits with the government subsidies, in as much as the receipts were not from the government or any regulatory body. What the assessee had received was the sale consideration of the carbon credits from another business entity who were in need of these credits and not from an independent body to promote the public good. All the precedents cited by the assessee with respect to subsidies etc. were the cases in which monies were received from the public bodies;
- While there was no specific provision for taxation of carbon credits, but connotations of 'income', under section 2(24) of the Act was wide enough to cover the same;
- The word 'income' would take in its fold any monetary returns coming in unless specifically exempt.

The assesse contended that CERs are non- taxable capital receipts as it is an effort to protect global environment in the global benefit. It is in the nature of grant and subsidy. The assessee also contended that the sale receipts were received in FY 2009-10 and 2010-11.

The decision of the CIT(A)

The CIT(A) held that transfer of carbon credit was a capital receipt, not taxable relying on the decision of the Hyderabad Tribunal in the case of My Home Power Ltd. v DCIT [ITA No. 1114/Hyd/2009]. The CIT(A) took note of the following observation of the above decision:

> *"…Carbon credit is not an offshoot of business but an offshoot of environmental concerns. No asset is generated in the course of business but it is generated due to environmental concerns. Credit for reducing carbon emission or greenhouse effect can be transferred to another party in need of reduction of carbon emission. It does not*

increase profit in any manner and does not need any expenses. It is a nature of entitlement to reduce carbon emission, however, there is no cost of acquisition or cost of production to get this entitlement. Carbon credit is not in the nature of profit or in the nature of income."

Observations of the Tribunal dissenting on the view of the Hyderabad Tribunal

The Ahmedabad Tribunal gave the following factual finding to disagree with the view taken by the Hyderabad Tribunal:

Generation of CERs part and parcel of business activity

- The grant of CERs are inextricably linked to the actual functioning of the unit, inasmuch as it was reduction of emission of harmful gases, as a result of the change in the manner in which unit functioned e.g. lesser or no use of fossil fuel, which entitles the assessee to the CER. The CER was therefore generated or created due to carrying on business, and had not accrued due to 'world concern. The CER was generated due to carrying on business in a manner friendly to the cause of reduction of harmful gases and thus, protect the environment.
- As regards the finding that "Carbon credits are made available to the assessee on account of saving of energy consumption and not because of its business", the CERs are made available to the assessee because of its carrying on the business in an environment friendly manner. If there was no carrying on of the business, there would be no carbon credits. The CERs, are an offshoot of business being carried in environmentally responsible manner. **The activity of business and activity of earning carbon credits cannot, therefore, be divorced from each other.**
- The core activity was business and being environmentally responsible was the manner in which this core activity was carried out. It was thus incorrect to say that carbon credits were made available to the assessee, not because of its business.
- The activity of obtaining CERs was a systematic activity which requires careful planning and a series of actions before the CERs are obtained. The functioning of the business and the reductions in emissions are to be monitored by the appropriate authorities. The carbon credits are not a windfall which appear out of the blue. A series of conscious decisions are thus required to be taken by the assessee in order to get the CERs and the considerations of CERs

essentially therefore have a role to play on the manner in which business was carried out. The generation of CERs was thus on account of business activity.

The Ahmedabad Tribunal disagreed with the view of the Hyderabad Tribunal that "Carbon credit was not an offshoot of business but an offshoot of environmental concerns."

Taxability under section 28(iv)

- This gain was not in terms of money, but it was a gain nevertheless. It was clearly a benefit in the sense it entitles the assessee to transfer a right to produce more emission- which was a valuable entitlement, and it arises from carrying on of business. Section 28(iv) provides for taxability of "the value of any benefit or perquisite, whether convertible into money or not, arising from business or exercise of profession" as a business income.

The Ahmedabad Tribunal disagreed with the view of the Hyderabad Tribunal that "It was not liable for tax in terms of sections 2(24), 28, 45 and 56 of the Act.

Income earned on sale of these credits was capital receipt

The Ahmedabad Tribunal placed reliance on the decision of the Supreme Court in the case of CIT v. Maheshwari Devi Jute Mills Ltd. (57 ITR 36), wherein was held that transfer of surplus loom hours to other mill out of those allotted to the assessee under an agreement for control of production was capital receipt and not income.

The Ahmedabad Tribunal disagreed with the view of the Hyderabad Tribunal that "carbon credit was entitlement or accretion of capital and hence income earned on sale of these credits was capital receipt.

Taxability of subsidies received

- As regards the judicial precedents in respect of taxability of subsidies received by the assessee, various judicial decisions are not relevant in the present context. The assessee had not received any monies, as a subsidy, from any government or public or multilateral forum. What the assessee had received was an advantage incidental to carrying on business in an environmentally responsible manner. It was an offshoot of business.

Binding judicial precedents

- The question of binding judicial precedents arises only in the context of what was actually decided and on the legal questions. The factual aspects which have not been considered or decided in the judicial precedents cannot be treated as covered by these precedents. Since these crucial facts were not brought to the notice of the Hyderabad Tribunal, the bench could not deal with the peculiarities of different types of carbon credits, identify the kind of carbon credit that was examined with respect to the taxability issues and was thus lead to proceed on certain assumptions which seem to be incorrect.

Decision: Income from sale of carbon credit was a taxable receipt. However, the taxability of the income from CERs will be taxable only when the right to receive consideration for transfer of these CERs is quantified and crystallised. As the sale is not in the effected in the relevant previous year, the CER value cannot be taxed in that assessment year.

Citation: DCIT vs. Kalpataru Power Transmission Limited [ITA No. 538/Ahd/2013]

ITAT allows foreign tax credit for deemed dividend tax which would have been payable in Oman against income tax payable in India. Further, quashes CIT's revisionary order under section 263 as AO had carried requisite enquiry at the time of passing assessment order

Facts and Issue: The assessee, a cooperative society, was primarily engaged in manufacture of fertilizers like urea and ammonia. The assessee entered into a Joint Venture (JV) with an Oman Oil Company to form Oman Fertilizer Company SAOC (OMIFCO) which was registered under Omani Laws. The assessee held 25% share in OMIFCO. The fertilizers manufactured by OMIFCO were purchased by the Government of India under a long term agreement. The assessee had a branch office in Oman to oversee its investment in OMIFCO. The said branch office in Oman constituted PE in Oman in terms of India-Oman Tax Treaty.

The tax return, for AY 2010-11 was filed by the assessee. The assessee had received dividend of Rs. 134.41 crores from OMIFCO which was offered to income tax in India. Against the income tax payable in India on such dividend, the assessee, claimed foreign tax credit (FTC) of Rs. 41.53 crores. The assessee's case was selected for scrutiny under section 143(2) and 142(1) of the Act. During the course of the assessment proceedings, the AO called for various details including details of assessee's claim for FTC. All necessary details were furnished by the assessee and the same were examined by the AO. Thereafter, the assessment order was passed by the AO under section 143(3) of the Act, wherein FTC of Rs. 41.53 crores was allowed. The said dividend was exempt in Oman by virtue of Artcile 8(bis) of Omanian Tax Laws.

The CIT, subsequently formed the view that as the assessee had not paid any tax in Oman owing to exemption, no FTC was available to it. The CIT observed that Article 25(4) required that in order to claim credit, income tax should **have been payable** in Oman, but for the tax incentives granted in Oman to promote economic development. The CIT opined that exemption granted by Oman cannot be treated as a tax incentive, as same existed across the board and was simply a feature of Oman's Tax Law which did not tax dividend income. The CIT thus passed order under section 263 of the Act, setting aside the AO's order. The CIT further directed the AO to compute addition on the ground that undistributed and un-received dividend income was also chargeable to tax.

Revisionary power under section 263

Observations of the ITAT

- The notice issued by CIT under section 263 only referred to the issue pertaining to allowing tax credit on dividend income earned in Oman. During the original assessment proceedings, detailed inquiry letter was issued by AO. The assessee had filed detailed replies which were duly considered by the AO.

- Similar tax credit was allowed to the assessee in previous AYs and thus, the AO only followed the view adopted in preceding several AYs.

- While show cause notice issued by the CIT only mentioned one issue, the final order under section 263 mentioned other issues which resulted in complete denial of opportunity to the assessee. The ITAT relied on the decision of the Delhi HC in case of Ashish Rajpal (320 ITR 674), wherein proceedings under section 263 were quashed owing to the breach of principles of natural justice.

Decision: The issue for which section 263 show cause notice was issued was not only thoroughly examined during scrutiny assessment, but was also examined in previous AYs starting from AY 2006-07. Accordingly, view adopted by AO was in consonance with the consistent view adopted by the Income Tax authorities in earlier years. The AO had not blindly followed the view adopted in preceding AY but also independently examined the issue by raising detailed inquiries. Thus, where the view adopted by AO was one of the possible views, the CIT could not substitute his view for the view of the AO by invoking jurisdiction under section 263. The CIT's invocation of revisionary powers under section 263 were not tenable.

Allowability of FTC on merits

Observations of the ITAT

- It was crucial to ascertain as to whether dividend income was exempted with the purpose of promoting economic development. For ascertaining the intention behind insertion of Article 8(bis), Oman Ministry of Finance had issued a letter wherein it was clarified that said provision was inserted to promote economic development by attracting investments. Accordingly, Article 8(bis) exemption should be construed as an incentive granted under

Oman's tax laws so as to qualify for benefit under Article 25(4). The interpretation of Omani Tax Laws can be clarified only by the highest tax authorities of Oman and such interpretation given by them must be adopted in India.

- Even under the Omani Tax Laws, the PE offers to tax only on the dividend income actually received and not the total share of the PE in the profits of OMIFCO. On the other hand, books of account of the assessee in India were required to be prepared in consonance with the Indian Accounting Standards. Thus, undistributed share of profit reflected in the books of the PE could not partake the character of income under the provisions of the Act. Accounting entries are not determinative of taxability under the Act and only the real income could be brought to the charge of tax.

Decision: Deemed dividend tax which would have been payable in Oman was allowed as FTC against income tax payable in India. Further, undistributed and un-received dividend income from OMIFCO could not be brought to income tax in the hands of the assessee.

Citation: Krishak Bharati Cooperative Ltd. vs. ACIT [(TS-117-ITAT-2016(Del.)]

Mumbai ITAT grants complete stay of demand to assessee, a Singaporean company till disposal of appeal by ITAT relying on CBDT Instruction dated 21 August 1969

Facts and Issues: The assessee was a Singapore based company engaged in the business of providing management support services to group entities in Asia Pacific Region. During AY 2011-12, the assessee rendered management support services to its 100% Indian subsidiary and received a management fee of Rs. 22.56 crores. The nature of services provided by the assessee were management, general support and administrative services.

In the tax return, the assessee claimed the said receipt as non-taxable in India, as per Article 12(4) of the India-Singapore Tax Treaty claiming that the said services do not make available any technical knowledge, experience, skill know-how or processes etc. to the Indian subsidiary.

During the year under consideration, the assessee's employees had visited India for a period of 98 days, for two specific and independent reasons:

1) 9 days – in connection with providing services under the agreement in pursuance of which the assessee had earned Rs. 22.56 crores as management fees;

2) 89 days – in connection with the contract entered into by the Indian subsidiary with BSNL for the purpose of setting up Internet Data Centers ('IDC') in India. The employees of the assessee being more qualified were sent to assist the Indian subsidiary in setting up the IDC business. The assessee did not charge any fees for the said services and only recovered the employees' travelling cost from the Indian subsidiary without any mark-up, on a cost to cost basis.

The AO, while completing assessment under sections 143(3) r.w.s 144C(1) of the Act held that the assessee had a PE in India. The AO attributed entire management fees to the alleged PE. The AO, further allowed only 10% as expenses and held balance 90% as business income of the alleged PE.

The AO accordingly raised a demand of Rs. 9.82 crore. The assessee’s appeal on merit was pending with the Mumbai ITAT which was fixed for hearing on 29 November 2017.

The assessee also filed a stay application before the ITAT submitting that the demand was liable to be stayed in the interest of justice. The assessee submitted that the AO had assessed the income of Rs.20 crore (appox.) which was about 10 times the returned income. The assessee placed reliance on CBDT Instruction No.96 dated 21 August 1969 which provided that where the income determined on assessment was substantially higher than the returned income, say twice the latter amount or more, collection of the tax in dispute should be kept in abeyance till the decision on the appeal, provided there were no lapses on the part of the assessee.

Observations of the ITAT

The AO had allowed deduction for expenses for only 10% and taxed 90% of the management fees as business income. With respect to management services, the TPO in the assessee's own case had accepted the mark up of 10% on cost to be on arm’s length basis.

Decision: Relying on CBDT Instruction No. 96 dated 21 August 1969, the ITAT, without going into merits of the case, granted stay of demand till the disposal of the appeal.

Citation: Dimension Data Asia Pacific Pte. Ltd [TS-133 -ITAT-2016(Mum)]

Assessee not liable to deduct TDS in respect of year end expense provisions reversed subsequently since no income accrued to the assessee

Facts: The assessee was engaged in the business of manufacture and sale of injection equipments, auto electric items, portable electric power tools etc. During the year assessee had made provisions for expenses amounting to Rs. 1.79 crores in accordance with Accounting Standard-29 (AS-29) issued by Institute of Chartered Accountants of India. The said provision to the extent of Rs. 1.79 crores was subsequently reversed in the beginning of the next financial year as no invoice was received by the assessee. The assessee while filing income tax return for AY 2012-13 made suo-moto disallowance u/s 40(a)(i) and 40(a)(ia) in respect of provisions on which no TDS was made.

During the course of proceedings under section 201 the assessee contended that since the provision was reversed in the beginning of next year no TDS was required to be deducted.

However TDS officer held that the system of accounting followed by assessee was faulty and does not enable any verification. The TDS officer also held that since the assessee was following the mercantile system of accounting TDS should have been deducted on the provision made. Thus the TDS officer held the assessee as assessee in default u/s 201 and raised a demand of Rs 17.93 Lakh toward tax and Rs 4.24 Lakh towards interest.

Decision: Before the Tribunal, the assessee submitted that – (i) no income had accrued to the payees and a mere provision was made in the books of accounts at the end of the year; (ii) payees as well as the exact amount payable to them was not identifiable; (iii) existence/accrual of income in the hands of payee was a pre-condition to fasten the liability of TDS in the hands of the payer; (iv) Sec 195 stipulates that the payer has to deduct TDS at the earlier point of time either at the time of crediting the sum to the payee account or at the time of payment and thus both the events i.e. crediting the amount to payee's account and payment to the assessee must necessarily occur. The assessee thus contended that in absence of payment the question of deducting TDS at the time of crediting did not arise.

Revenue argued that as per plain reading of Sec 195, the liability to deduct tax at source had arisen the moment the amount was credited in the books of accounts, irrespective of whether the amount was paid or not. Revenue also submitted that the provisions of taxing statutes should be construed strictly.

Tribunal held that "the liability to deduct tax at source arises only when there is accrual of income in the hands of the payee." The Tribunal noted that the SC in the case of GE India Technology Centre P. Ltd. [327 ITR 456] had held that if payment was not assessable to tax then there was no question of TDS being deducted. The Tribunal further held that no income had accrued in the hands of the payee considering the fact that the provisions made at year-end were reversed in the beginning of the next accounting year.

ITAT also relied on SC ruling in CIT vs. Shoorji Vallabhdas & Co. [46 ITR 144] wherein it was held that “Mere entries in the books of accounts does not establish the accrual of income in the hands of the payee”

Accordingly, ITAT held that there was no liability in the hands of the assessee company to deduct TDS, merely on the provisions made at the year end and therefore the assessee company cannot be treated as ‘assessee in default’ for not deducting TDS on a mere provision.

Our comments: Bangalore ITAT in case of IBM India Private Ltd [TS-305-ITAT-2015(Bang)] had held that assessee was liable to deduct TDS on quarterly expense provisions entries through credit in suspense account as per its global group accounting policy. Bangalore ITAT had thus held that “statutory provisions dealing with collection and recovery of tax under Chapter XVII of the Act envisage TDS collection de hors charge u/s. 4(1) of the Act". However, Mumbai ITAT in the case of Pfizer Ltd. [TS-812-ITAT-2012(Mum)] had held that Revenue cannot invoke provisions of Sec 201(1) once assessee made suo-moto disallowance u/s 40(a)(i)/(ia).

Citation: Bosch Limited, ITA 1583/Bng/2014, Bangalore Tribunal

Option to assessee to avail the benefit of provisions of Act over the provisions of DTAA

Facts: The assessee, Lloyds Register, UK, had a branch Office in India. However during its worldwide corporate restructuring, it applied for the closure of its branch in India and RBI granted the final approval on 2nd December 2005. For AY 2005-06, the assessee filed a return and claimed a business loss of Rs 38.57 lakhs. This loss was incurred on account of expenses towards bad debts, the corresponding income having been offered for tax in an earlier year and by way of leave encashment expenses allowed on payment basis u/s 43B of the Act. As these expenses were incidental to the conduct of the assessee's business, it further claimed set off of this loss against the income under the head capital gain.

During the course of assessment, AO noted that the assessee had admitted that it had discontinued business w.e.f 1st April 2004 and it had no PE in India. The AO further noted that the business profit could not be taxed in India in view of Article 7 of India- UK DTAA and therefore set off of loss could not be allowed. The AO held that once the assessee had taken the benefit of DTAA, the loss arising under the head of business income would not be set off against any other head of income. AO further held that as no business activity was carried out by assessee, the business loss would could not be set off against a capital gain.

Decision: The assessee submitted that the losses were arising out of its earlier activities and they were relatable to the business of the assessee. The provisions of the Act (section 71(2) allows set off of business losses against income under the head capital gain) were in favour of the assessee. The assessee, relying on the decision of Special Bench in case of Sumitomo Mitsui Banking Corporation [TS-768-ITAT- 2012(Mum)], contended that business losses were permitted to be set off against capital gains, as the assessee had the alternative to opt for the provisions of the Act over the provisions of the tax treaty.

ITAT noted that the provisions of sec 90 give an option to the assessee to opt for the provisions of the DTAA or the Act whichever is beneficial to it. The assessee had claimed that set off of losses should be dealt with as per the provisions of sec 71(2) and had claimed such set off of losses accordingly.. The ITAT, relying on the decision of special bench in case of Sumitomo Mitsui Banking Corporation, held that the assessee could avail the benefit of provisions of Act over the provisions of DTAA in claim such setting off of losses in accordance with statutory provisions.

Citation: Lloyds Register U.K., ITA 3857/Mum/2011, Mumbai Tribunal

CBDT Notification/ Circular

Partial modification of Instruction No. 1914 dated 21 March 1996 to provide for guidelines for stay of demand

The CBDT had earlier issued Instruction No. 1914 dated 21 March 1996 that contained guidelines regarding procedure to be followed by the AO for recovery of outstanding demand, including procedure for grant of stay of demand where the appeal filed by the assessee is pending with the CIT(A).

The said Instructions prescribed that the tax demand would be stayed only if there are valid reasons for granting stay. Mere filing of an appeal against the assessment order before the CIT(A) will not be a sufficient reason to stay the recovery of tax demand. The said Instructions prescribed that while granting stay, the AO may require the assessee to offer a suitable security (bank guarantees, etc.) and/or require the assessee to pay a reasonable amount in lump sum or in installments.

The CBDT has issued revised guidelines in partial modification of Instruction No. 1914. The said guidelines aim to streamline the process of grant of stay and standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed before CIT(A). Key features of the guidelines are as under:

A. In case where the outstanding demand is disputed before the CIT(A), the AO shall grant stay of demand till disposal of the appeal before the CIT(A) on payment of 15% of the disputed demand, unless the case falls in the category discussed is para(B) hereunder.
B. In a situation where:
   i. The AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount higher than 15% is warranted
   ii. The AO is of the view that the nature of addition resulting in the disputed demand is such that payment of a lump sum amount lower than 15% is warranted

   the AO shall refer the matter to the administrative Pr. CIT/CIT, who after considering all relevant facts shall decide the quantum/proportion of demand to be paid by the assessee as lump sum payment for granting a stay of the balance demand.

C. In a case where stay of demand is granted by the AO on payment of 15% of the disputed demand and the assessee is still aggrieved, he may approach the jurisdictional Pr. CIT / CIT for a review of the decision of the AO.

The AO as well as the Pr. CIT / CIT has been granted 2 weeks time to dispose of the stay petition. The AO before granting stay may impose additional conditions such as:

i. Require an undertaking from the assessee that he will cooperate in the early disposal of appeal failing which the stay order will be cancelled
ii. Reserve the right to review the order passed after expiry of reasonable period (say 6 months) or if the assessee has not cooperated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situation
iii. Reserve the right to adjust refunds arising, if any, against the demand, to the extent of the amount required for granting stay and subject to the provisions of section 245 of the Act

Source: CBDT Office Memorandum F. No. 404/72/93-ITCC dated 29 February 2016

Holding period of bonds, debenture, debenture stock or deposit certificates converted into shares of a company would include pre-conversion period

Section 2(42A) of the Act defines the term "short term capital asset". Period of holding of the particular assets decides whether the asset would be short term capital asset or long term capital asset. There are different rates of income tax for assets classified as long term or short term assets. Clause (i) of the Explanation 1 to section 2(42A) provides mechanism for determining the period for which any capital asset is held by the assessee in certain specified situation viz. shares held in a company in liquidation, in case of amalgamation, demerger etc.

Section 47(x) of the Act provides that conversion of bonds, debenture, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company shall not be considered as 'transfer'.

The CBDT has inserted new Rule 8AA to the IT Rules. Rule 8AA now specifically provides that holding period of shares or debenture would include pre-conversion period. Accordingly, holding period of bonds, debenture, debenture stock or deposit certificates into shares or debentures (the conversion of which is not regarded as transfer as per section 47(x) of the Act) would include the period of acquisition of such bonds, debenture, debenture stock or deposit certificates, till the date they are converted into shares or debentures. The new rule shall come into force from 1st April 2016.

Source: Notification No. 18/2016 [F. No. 142/1/2016-TPL] dated 17 March 2016

CBDT clarifies on TDS applicability on payments by TV channels to production houses / advertising companies

The CBDT had received various representations on the issue of applicability of TDS provisions on payments made by broadcasters/telecasters to production houses for production of content or programme for broadcasting/telecasting as to whether the same would fall under section 194C or

194J of the Act. The disputes were on the issues as to whether payments made by the broadcaster/telecaster to production houses for production of content/programme are payments under a 'work contract' or a contract for 'professional or technical services' and, therefore, liable for TDS under section 194C or 194J of the Act.

The CBDT envisages 2 distinct payments to be made by broadcasters/telecasters and clarified applicability of TDS provisions as under:

1. A payment for production of content/programme
2. A payment for acquisition of broadcasting/telecasting rights

A payment for production of content/programme

Where the content is produced as per the specifications provided by the broadcaster/telecaster and the copyright of the content/programme also gets transferred to the broadcaster/telecaster, the CBDT clarified that such contract is covered by the definition of the term 'work' in section 194C of the Act and therefore, subject to TDS under that section.

A payment for acquisition of broadcasting/telecasting rights

Where the broadcaster/telecaster acquires only the broadcasting/telecasting rights of the content already produced by the production house, there is no contract for 'carrying out any work', as required in section 194C(1). Therefore, such payments are not liable for TDS under section 194C. The CBDT however has kept the issue open in respect of application of other sections triggering TDS obligation.

Source: CBDT circulars nos. 4/2016 dated February 29, 2016

CBDT instructs no re-characterization of capital gains on sale of listed shares, where shares are held for more than 12 months

The taxation of shares and securities, whether as 'capital gain' or 'business income' is an area of dispute between the taxpayer and the Income tax authorities, where large number/volume of transactions are entered by the investors.

The CBDT had earlier through Instruction No. 1827 dated 31 August 1989 and Circular No. 4 of 2007 dated 15 June 2007, summarized the said principles for guidance of the Income tax authorities. Disputes however continue to exist on the application of these principles to the facts of an individual case since the taxpayer finds it difficult to prove the intention in acquiring such shares/securities.

The CBDT recognized the fact that no universal principal in absolute terms can be laid down to decide the character of income from sale of shares and securities. The CBDT also noted that major part of shares/securities transactions take place in listed shares/securities. With a view to reduce litigation and uncertainty in the matter, in partial modification of the aforesaid CBDT Circulars, the CBDT has issued the following guidelines to be followed by the Income tax authorities to decide whether the surplus generated from sale of listed shares or other securities would be treated as Capital Gain or Business Income:

a. Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,
b. In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the AO. However, this stand, once taken by the assessee in a particular AY, shall remain applicable in subsequent AYs also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;
c. In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.
d. The CBDT has however clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long Term Capital Gain / Short Term Capital Loss or any other sham transactions.
e. The above CBDT Circular has been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities.

Source: CBDT circulars no. 6/2016 dated February 29, 2016

CBDT clarifies on TDS on payments by television channels and publishing houses to advertisement companies for procuring or canvassing for advertisements

The CBDT had received various representation on the issue of applicability of TDS provisions on payments made by television channels or media houses publishing newspapers or magazines to advertising agencies for procuring and canvassing for advertisements. The CBDT envisaged 2 types of payments involved in the advertising business:

i. Payment by client to the advertising agency, and
ii. Payment by advertising agency to the television channel/newspaper company

Payment by client to the advertising agency

The applicability of TDS on these payments has already been dealt with in Circular No. 715 dated 8 August 1995, where it has been clarified that while TDS under section 194C (as work contract) will be applicable on the first type of payment, there will be no TDS under section 194C on the second type of payment by advertising agency to the media company.

Payment by advertising agency to the television channel/newspaper company

The CBDT further discussed as to whether the fees/charges taken or retained by advertising companies from media companies for canvassing/ booking advertisements (typically 15% of the billing) is ‘commission’ or ‘discount’. The assessee argues that since the relationship between the media company and the advertising company is on a principal-to-principal basis, such payments are in the nature of trade discount and not commission and therefore, outside the purview of TDS under section 194H of the Act. The Income tax authorities, on the other hand, takes the stand in some cases that since the advertising agencies act on behalf of the media companies for procuring advertisements, the margin retained by the former amounts to constructive payment of commission and, accordingly, TDS under section 194H is attracted.

The CBDT has now clarified that no TDS is attracted on payments made by television channels/newspaper companies to the advertising agency for booking or procuring of or canvassing for advertisements. It is further clarified that ‘commission’ referred to in the CBDT Circular No. 715 dated 8 August 1995 does not refer to payments by media companies to advertising companies for booking of advertisements but to payments for engagement of models, artists, photographers, sportsperson, etc. and therefore, is not relevant to the issue of TDS referred to in this Circular.

Source: CBDT circulars no. 5/2016 dated February 29, 2016

CBDT tightens TPO reference guidelines for assessments

Earlier the CBDT had issued new Instruction No. 3/2016 containing guidelines for TP assessment. The said Instruction replaces Instruction no. 15/2015. New instructions are applicable with immediate effect for both international transactions as well as specified domestic transactions. The guidelines on various issues are as follows:

Reference to Transfer Pricing Officer

For proper administration of the Act, the CBDT has decided that the AO shall henceforth make a reference to the TPO only under the circumstances laid out in this Instruction.

All cases selected for scrutiny, either under the Computer Assisted Scrutiny Selection [CASS] system or under the compulsory manual selection system on the basis of transfer pricing risk parameters have to be referred to the TPO by the AO, after obtaining the approval of the jurisdictional Pr. CIT or CIT. The fact that a case has been selected for scrutiny on a TP risk parameter becomes clear from a perusal of the reasons for which a particular case has been selected and the same are invariably available with the jurisdictional AO. Thus, if the reason or one of the reasons for selection of a case for scrutiny is of TP risk parameter, then the case has to be mandatorily referred to the TPO by the AO, after obtaining the approval of the jurisdictional Pr. CIT or CIT.

Cases selected for scrutiny on non-transfer pricing risk parameters but also having international transactions or specified domestic transactions shall be referred to the TPO only in the following circumstances:

a) where the AO comes to know that the taxpayer has entered into international transactions or specified domestic transactions or both but the taxpayer has either not filed the Accountant's report under Section 92E at all or has not disclosed the said transactions in the Accountant's report filed
b) where there has been a transfer pricing adjustment of Rs. 10 Crore or more in an earlier AY and such adjustment has been upheld by the judicial authorities or is pending in appeal and
c) where search and seizure or survey operations have been carried out under the provisions of the Act and findings regarding transfer pricing issues in respect of international transactions or specified domestic transactions or both have been recorded by the Investigation Wing or the AO.

For all cases to be referred by the AO to the TPO, the AO must, as a jurisdictional requirement, record his satisfaction that there is an income or a potential of an income arising and/or being affected on determination of the ALP of an international transaction or specified domestic transaction before seeking approval of the Pr. CIT or CIT to refer the matter to the TPO for determination of the ALP:

- where the taxpayer has not filed the Accountant's report under Section 92E of the Act but the international transactions or specified domestic transactions undertaken by it come to the notice of the AO
- where the taxpayer has not declared one or more international transaction or specified domestic transaction in the Accountant's report filed under Section 92E of the Act and the said transaction or transactions come to the notice of the AO and
- where the taxpayer has declared the international transactions or specified domestic transactions in the Accountant's report filed under Section 92E of the Act but has made certain qualifying remarks to the effect that the said transactions are not international transactions or specified domestic transactions or they do not impact the income of the taxpayer.

In the above three situations, the AO must provide an opportunity of being heard to the taxpayer before recording his satisfaction or otherwise. In case no objection is raised by the taxpayer to the applicability of Chapter X [Sections 92 to 92F] of the Act to these three situations, then AO should refer the international transaction or specified domestic transaction to the TPO for determining the ALP after obtaining the approval of the Pr. CIT or CIT. However, where the applicability of Chapter X [Sections 92 to 92F] to these three situations is objected to by the taxpayer, the AO must consider the taxpayer’s objections and pass a speaking order so as to comply with the principles of natural justice. If the AO decides in the said order that the transaction in question needs to be referred to the TPO, he should make a reference after obtaining the approval of the Pr. CIT or CIT.

In addition, a case involving a transfer pricing adjustment in an earlier assessment year that has been fully or partially set-aside by the ITAT, High Court or Supreme Court on the issue of the said adjustment shall invariably be referred to the TPO for determination of the ALP.

For administering the transfer pricing regime in an efficient manner, it is clarified that though AO has the power under Section 92C to determine the ALP of international transactions or specified domestic transactions, determination of ALP should not be carried out at all by the AO in a case where reference is not made to the TPO. However, in such cases, the AO must record in the body of the assessment order that due to the Board’s Instruction on this matter, the transfer pricing issue has not been examined at all.

Role of Transfer Pricing Officer (TPO)

The role of the TPO begins after a reference is received from the AO. In terms of Section 92CA, this role is limited to the determination of the ALP in relation to international transactions or specified domestic transactions referred to him by the AO. However, if any other international transaction comes to the notice of the TPO during the course of the proceedings before him, then he is empowered to determine the ALP of such other international transactions. The transfer price has to be determined by the TPO in terms of Section 92C. The price has to be determined by using any one of the methods stipulated in sub-section (1) of Section 92C and by applying the most appropriate method. There may be occasions where application of the most appropriate method provides results which are different but equally reliable. In all such cases, further scrutiny may be necessary to evaluate the appropriateness of the method, the correctness of the data, weight given to various factors and so on. The selection of the most appropriate method will depend upon the facts of the case and the factors mentioned in Rule 100. The TPO, after taking into account all relevant facts and data available to him, shall determine the ALP and pass a speaking order.

The TPO’s order should contain details of the data used, reasons for arriving at a certain price and the applicability of methods. It may be emphasised that the application of method including the application of the most appropriate method, the data used, factors governing the applicability of respective methods, computation of price under a given method will all be subjected to judicial scrutiny. It is, therefore, necessary that the order of the TPO contains adequate reasons on all these counts. Copies of the documents or the relevant data used in arriving at the arm’s length price should be made available to the AO for his records and the use at subsequent stages of appellate or penal proceedings.

The TPO, being an Additional/Joint CIT, shall obtain the approval of the jurisdictional CIT (Transfer Pricing) before passing the order. The jurisdictional CIT (TP) should assign a limited number of important and complex cases, not exceeding 50, to the Additional/Joint CsIT (TPOs) working in the same jurisdiction.

In addition to the above, the TPO is required to carry out the Compliance Audit of the Advance Pricing Agreements (APAs) entered into by the CBDT and the taxpayers as well as play an important role in respect of Safe Harbour provisions.

Role of the AO after Determination of ALP by the TPO

The AO has to compute the total income of the assessee in conformity with the ALP determined by the TPO.

Sources: CBDT Instruction No. 3/2016 dated 10 March 2016