Dear Esteemed Readers,

We are pleased to share our latest newsletter, covering the direct tax and transfer pricing updates for the month of September 2017.

In this Edition, in our Back to Basics section, we deal with the remaining provisions under the head 'income from house property'. In this part, we have analyzed the methodology of computing the house property income, particularly the determination of 'annual value' of property. We have also delved into the issues of arrears of rent, unrealized rent and taxability in case of co-ownership of property.

In this age of cloud computing and thrust on e-commerce, businesses are moving at the speed of light, with more reliance on technology. The businesses make various kinds of payments for use of such technology, one such being payment towards subscription charges for accessing the online databases. A question has been always raised by the tax authorities as to whether the subscription charges are in the nature of 'royalty' and whether tax is required to be deducted at source on such subscription charges. In our tax controversy series, we have analysed the controversy relating to the taxability of database subscription charges.

The Supreme Court has dismissed the Revenue's Special Leave Petition (SLP), challenging the Delhi High Court decision, wherein it was held that an opportunity of being heard should be afforded before making an addition to the total income of the impugned party, whose assessment was sought to be re-opened, after the expiry of prescribed period of six years.

The issue of composite rent was placed before the Delhi High Court, which followed the tests laid down by the Supreme Court in the case of Sultan Bros, and held that an inseparable rental income from lease of premises along with furniture & fixtures, etc. would be chargeable to tax under the head 'income from other sources' as opposed to 'income from house property'.

"Nothing is certain except death and taxes". These were the words written by Benjamin Franklin in his letter of November 13, 1789 to Jean Baptiste Leroy and they continue to apply even in today's world. We have analysed the ruling of Kolkata HC, which has taxed the income of the deceased in the hands of the heir, as the legal representative of the deceased.

In a landmark decision, the Mumbai ITAT, following the Supreme Court's ruling in Kotak Securities Ltd., held that no taxes are required to be withheld for payment of subscription charges for database access and retrieval services under section 194J of the Act. The ITAT's ruling is a welcome decision, which upholds the view that subscription charges are not in the nature of royalty.

The Ahmedabad ITAT decided on the issue of addition of share premium to taxable income, treating it as unexplained cash credit under section 68 of the Act. This addition was confirmed, since the taxpayer failed to discharge its onus in proving the identity, genuineness and creditworthiness of the investors.

In the space of International taxation, we present our analysis on the decision of the Bangalore ITAT, wherein it has been held that overseas taxes and medicare payment would not constitute salary taxable in India, while offering overseas salary to tax in India.

In the transfer pricing section, we have analyzed the Delhi ITAT decision, which has observed that where an assessee performs a composite contract amounting to a turnkey project, the activity of supply of equipment

and services was continuous, inextricably linked and inseparable. Thus, benchmarking of both the transactions should be done on an aggregate basis and not on a segregated basis.

The due date for filing the corporate income tax return for some of the corporate taxpayers is October 31, 2017 and this month would be quite busy for the tax team, especially, considering the fact that the Diwali festival is starting from this week. We hope that the corporate taxpayers have analysed the impact of the Income Computation and Disclosure Standards (ICDS) on their tax audit report and the tax return, as it could have significant implications on income disclosed by the company.

We also take this opportunity to wish all our readers a warm Happy Diwali and a prosperous New Year. We wish Lord Ganesha showers his blessings on you, your family and your business and brighten up your today and tomorrow.

We hope you find our newsletter 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.

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Back to Basics – Heads of Income: Income from House Property (Part-II)

In the last issue of *Knowledgeware,* we dealt with section 22 of the Act, the charging section for income from house property. We analysed the various ramifications of this section and its scope and content. We discussed *inter alia* as to what constitutes annual value; the concepts of building and appurtenant land; treatment of foreign property; property occupied for business purposes or comprising a business asset; composite leases involving letting out of property with other facilities; and meaning of the term 'ownership'.

In this article, we deal with the remaining provisions under this head of income.

Determination of annual value

Upto the AY 1975-76, the concept of annual value was defined as 'the value at which the property could reasonably expected to be let out from year to year'. This was the value at which the property was actually to be taxed, irrespective of the actual rent that the property fetched in any particular year.

From the AY 1976-77, this concept has undergone a substantial modification: it is now taxed on the basis of the higher of the following two values:

- Actual rent received or receivable during the year; and
- Value at which the property can reasonably be let out from year to year.

If however the property is let and was vacant for any period during the relevant previous year and as a result of such vacancy, the actual rent received or receivable is less than the value at which it can be reasonably be let from year to year, the annual value will be the actual rent received or receivable.

Explanation 1 to section 23(1) of the Act read with the Rule 4 stipulates certain rules relating to computation of actual rent which is due from a tenant, but cannot be realized. Such rent shall not for part of actual rent if:

- the tenancy is bonafide;
- the defaulting tenant has vacated the premises; or steps have been taken to make him do so;
- the defaulting tenant does not occupy any other property belonging to the assessee;
- the assessee has instituted legal proceedings to recover the unrealized rent; or satisfied the AO that it would be futile for him to do so.

First proviso to s. 23(1)

The first proviso to section 23(1) of the Act provides for a deduction for municipal taxes actually paid during the previous year. The tax deductible under this provision should have been levied by and not merely collected by a local authority. That is to say a tax not levied but only collected by a local authority or a corporation, would not be deductible under this provision (*CIT v. Zoroastrian Building Society 27 ITR 218 (Bombay)*).

Sections 23(2) to 23(4)

Under sections 23(2) to (4), the annual value of a property shall be taken as NIL, if the assessee keeps it for self-occupation, but he cannot occupy it because he is employed, or carries on business or profession in another place, and has to reside at such other place in a building which he does not own. The assessee should not have let out such property or derived any benefit from it, if he wishes to avail this relief. It is also applicable only to one such property belonging to the assessee; other such properties owned by him would be brought to tax as they had been let out. This provision is also applicable to part of property, if it fulfills all the aforesaid conditions.

Section 23(5)

Section 23(5) of the Act has been inserted by the Finance Act of 2017, w.e.f. April 1, 2018. This provision stipulates that the value of a property (and land appurtenant thereto) shall be taken as NIL for the relevant previous year, where it is held as stock-in-trade and not let out during the whole or part of such year. This relief is available for a period of one year, as reckoned from the end of the year in which the certificate of completion is obtained.

Deductions from income

The Finance Act of 2001, has with effect from April 1, 2002, totally recast the section 24 of the Act to provide for:

i. a standard deduction of 30% of the annual value as computed under section 23; and,
ii. a further deduction for interest payable on capital borrowed for acquisition, construction, repair, renewal or reconstruction of the building.

The new standard deduction replaces a plethora of deductions stipulated for insurance, repairs, ground rent, land rent and property taxes levied by the state government, collection charges, etc. The new amendments have substantially rationalized the law and made both compliance and administration easier. This is the direction in which the tax reform should move.

The word “payable” after interest, implies that the deduction would be available on accrual basis; actual proof of payment does not have to be filed with the AO (*CIT v. Chowringhee 15 ITR 405 (PC)); Beharilal v. CIT 2 ITC 328 (Cal)).*

Under the first proviso to this section, the deduction available under this provision for self-occupied property is limited to Rs. 30,000, but if the capital for acquisition or construction was borrowed on or after April 1, 1999 and the construction or acquisition was completed within three years of the end of the FY, in which such capital was borrowed, the limit for deduction increases to Rs. 1,50,000. Interest payable for any financial year prior to the financial year of acquisition or construction is to be amortized over the five previous years, beginning with the year of acquisition or construction. In all such cases, the assessee is required to file a certificate from the lender, indicating the amount of interest payable.

Section 25

Interest payable abroad, chargeable to tax under this Act, on which tax is required to be deducted, but is not deducted and in respect of which there is no person who can be treated as an agent, will not be allowed as deduction, while computing the income under this head.

Unrealised rent and arrears of rent

Under section 25A of the Act, unrealised rent, realized from a tenant and not brought to tax in an earlier year, is deemed to be income under this head in the year of realization, regardless of whether the assessee continues to be the owner of the property.

The assessee will be entitled to a deduction of 30% of the amount received, regardless of whether the assessee still owns the house property or not. The amendment nullifies certain rulings of the Calcutta HC, according to which such arrears of rent could only be brought to tax in the AYs to which they relate (*Hamilton and Co v. CIT 194 ITR 391 (Calcutta))*. This necessarily involves the reopening of past completed assessments in a cumbersome process. This provision has been simplified and it came into force with effect from April 1, 2017.

Co-ownership

Where two or more persons own a house property, with definite and ascertainable shares, each of them will be taxed separately in respect of their respective share of income. Further, the explanation below the section clarifies that the deduction for self-occupation shall be allowed to each owner individually. This principle however does not apply to a firm. In the case of the latter, the assessment under section 22 will be on the firm and not individually on the partners. This section would clearly apply In the case of a disrupted HUF, where the shares of the erstwhile HUF are clear, ascertainable and definite; but if the property is being managed by a court receiver or any other representative assessee, the provisions of section 161 of the Act would apply (*Mazumdar v. CIT 15 ITR 484*(*Calcutta*). Further, the assessees may be governed by different personal laws- for example, Dayabhaga school of Hindu law, Muslim law or Portuguese Law- but so long as the shares are clearly demarcated and definite, assessments would be framed separately on each co-owner (*CWT v. Bishwanath 103 ITR536 (SC); CIT v. Dhanlakshmi 215 ITR 662 (Madras); CIT v. Modu Timblo 206 ITR 647 (Bombay))*; the same principle is applicable to a Hindu governed by the Mitakshara school, leaving behind a widow with an ascertainable share in a house property (*Bhupatrai v. CIT 109 ITR 97 (Calcutta)*). But if there is any pending litigation on deciding the ascertainable share of the legal heirs, the income from the impugned property can be assessed as an association of persons (*Abdul Rehman v. CIT 12 ITR 302 (Lahore*)).

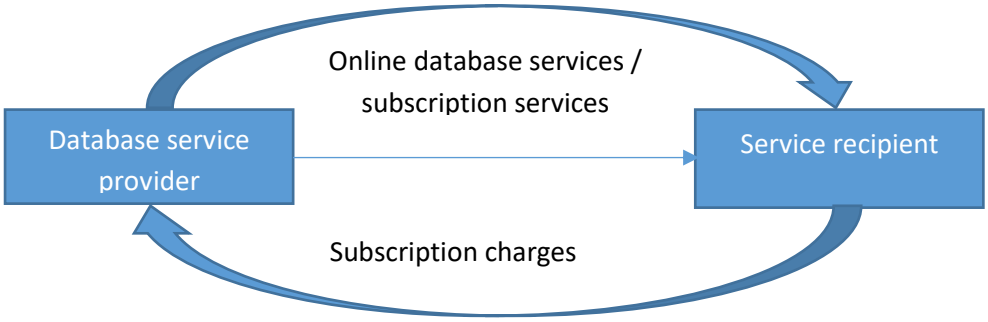
Conclusion

This concludes the second and final article on taxation of income under the house property. In the next issue of *Knowledgeware*, we will take up taxation of “Profit and Gains of business or profession” the third head of income

Tax Controversy – Taxability of Database Services

In the present age of e-commerce and thrust on B2B businesses, it is common for companies, both domestic and international, to be engaged in the business of database services, data collation etc.

A typical business arrangement in respect of database access service is as follows:



From a direct tax standpoint, the crucial issue is whether payment of subscription charges for access to such database could be characterized as royalty / fee for technical services ('FTS') consequently attracting withholding of tax at source.

The issue of database access services qualifying as FTS, has now been more or less settled by the decision of the Supreme Court in the case of Kotak Securities Limited [*Civil appeal no. 3141/2016 arising out of SLP (C) No. 19907 of 2012]* where in, the Apex Court has held that, mere facility provided by the assessee to its customers does not tantamount to provision of services. Human element / effort has to be present and services should be specifically sought by the user / consumer. Though the Supreme Court decision is in context of section 194J of the Income-tax Act, 1961 ('the Act'), the ratio of the decision would apply in the context of section 9(1) (vii) of the Act as well, because s 194J has adopted the definition of FTS in s 9(1)(vii) of the Act.

However, it would appear that the issue whether payment for access to database would be in the nature of royalty still remains debatable.

Different judicial forums appear to have taken conflicting views some of which are noticed hereinafter:

Decisions holding subscription fee for access to database taxable as royalty

- *Decision of Karnataka High Court in the case of Wipro Ltd [ITA No. 2804 of 2005, 2805 of 2005 and 2807 of 2005]*

  In this case the High Court held that, payment made by the assessee to a non-resident in order to obtain a license to use database maintained by it, is to be regarded as royalty.

- *Decisions of Mumbai Tribunal in the case of Gartner Ireland Limited [ITA no. 7101/Mum/2010 dated 24.07.2013 and ITA Nos 2619 to 2622/Mum/2014 & 4534/Mum/2014]*

  In this case, the ITAT held that subscription fees paid to subscribe to a research product sold by assessee (foreign company) amounted to royalty and in doing so the ITAT simply followed the decision in the case of Wipro.

Decisions holding subscription fee for access to database not taxable as royalty

- *Dun & Bradstreet Information Services India Pvt. Ltd v ADIT (Bombay HC)* ***[(2011) 338 ITR 95]***

  In the said case, Dun & Bradstreet Information Services India Pvt. Ltd ('the assessee') had imported business information reports from Dun and Bradstreet, USA, and made remittances against the same and had not deducted tax at source thereof. The tax officer held that the assessee was liable to deduct tax at source and, accordingly, passed an order under section 195 of the Act, read with section 201 of the Act. Against the said order of the tax officer, the assessee had preferred an appeal before the CIT (A). However, the CIT (A) dismissed the appeal filed by the assessee and upheld the order of the tax officer.

  On further appeal by the assessee, the Tribunal set aside the order passed under section 195, read with section 201 by following its decision in the assessee's own case for the assessment year 2002-03 in ITA No. 1773/Mum/2006 and the decision of the AAR on identical facts in the case of Dun and Bradstreet Espana S.A. *In re AAR No. 615 of 2003 [2005] 272 ITR 99 (AAR), D and B Europe AAR No. 657 of 2005, dated 27-10-2005 and D and B UK AAR No. 656 of 2005, dated 27-10-2005*

  Further, the Tribunal said that the AAR had held that sale of the very same business information reports by the subsidiaries of Dun and Bradstreet US in Spain, the Europe and the U.K. to the assesse, did not attract the provisions of section 195.

  On further appeal filed by the Revenue the Bombay High Court held that, since the decision of the AAR related to the very same business information reports imported by the assessee and no fault in the decision of the AAR was pointed out, there was no reason to interfere with the decision of the Tribunal.

- *Factset Research Systems Inc.* ***[In re [2009] 317 ITR 169 (AAR)]***

  The assessee, a non-resident company incorporated in the USA, was involved in maintaining a 'database' which was located outside India and which contained financial and economic information including fundamental data of a large number of companies worldwide. The databases contained published information collated, stored and displayed in an organized manner by the assessee, though the information contained in the database was available in public domain. The assessee entered into a Master Client License Agreement with its customers under which it granted limited, non-exclusive, non-transferable rights to its customers to use its databases, software tools, etc.

  The AAR, on facts, held that, grant of license to the customers was only to authorize licensee to have access to copyrighted database rather than granting it any right in or over the copyright as such. Hence, the subscription fees should not be taxable as royalty.

- *GVK Oil & Gas Ltd v. ADIT [TS-131-ITAT-2016(HYD)]*

  The assessee-company was engaged in the business of oil and gas exploration.

  It had placed a bid for the oil and gas exploration block offered under the Ministry of Petroleum and Natural Gas. To understand the geological and seismic quality of the block in order to optimise the exploration and in order to evaluate various blocks, the assessee entered into agreements with GX Technology Corporation ('GTC'), a USA based Corporation and a leading provider of advanced seismic data and derivatives and GGS Spectrum Limited ('GGS'), a UK

based company. Under these agreements, both the companies agreed to grant non-exclusive license/right to use certain data and derivatives in consideration for an agreed license fee.

The tax officer held that the payment made by the assessee to GGS by way of 'license fee' amounted to consideration for information concerning industrial, commercial or scientific experience and as such constituted 'royalty' both under US as well as UK DTAA. Since the assessee had failed to deduct TDS under section 195 before making the payment, the Assessing Officer held the assessee to be 'an assessee-in-default' under section 201(1) and made the disallowance under section 201(1). The order of the tax officer was upheld by the CIT (A).

On further appeal before the ITAT, placing reliance on the decision in the case of Factset Research (supra), the ITAT held that so long as the licensor had made available the data acquired by them but had not made available any technology for use of such data by the assessee, payments made by the assesse to the foreign companies were not in the nature of royalties.

Recent developments

Recently, the Ahmedabad ITAT in the case of **Cadila Healthcare Limited** *(ITA no 486/ Ahd/ 2016)* and **Welspun Corporation Limited** *(ITA no 48/ Rjt/ 2015)* has held that the payment made by the assessee was simply for copyrighted material and could not be treated as royalty.

- *Cadila Healthcare Limited – facts and decision of the ITAT*

Cadila Healthcare Limited ('the assessee') had made payment to Chemical Abstract Services, USA ('CAS'), a non-resident company, for online access to database system 'SciFinder'. The tax officer was of the opinion that the said payment is made towards exploitation of copyrighted database through license and hence, taxable as royalty.

Aggrieved by the order of the tax officer, the assessee preferred an appeal before the CIT (A). The CIT (A) held that that a payment made for access to database which is publicly available to any person interested in availing of such information, was not in the nature of royalty.

The CIT (A) relied upon the decision in case of Factset Research Systems (supra), Dun & Bradstreet Espana (AAR) (supra) and Dun & Bradstreet Information Services (Bombay High Court) (supra)

On appeal, the Tribunal upheld the findings of the CIT (A) and held that the payment made by the assessee was for copyrighted material and could not be treated as royalty. The Tribunal placed reliance on the following decisions:

- DIT vs Nokia Networks OY [(2013) 358 ITR 259 (Delhi High Court)] and

- DIT vs Dun and Bradstreet Information Services India Pvt ltd [(2011) 318 ITR 95 (Bombay High Court)].

- *Welspun Corporation Limited – facts and decision of the ITAT*

Welspun Corporation Limited ('the assessee') had made payment to Metal Bulletin, UK and The Datamyne Inc., USA, non-resident companies, for online access to specialised database containing copyrighted material. The tax officer was of the opinion that subscription fees were taxable as royalty. In the appeal, the CIT (A) upheld the decision of the tax officer.

On appeal the Tribunal held that the payment was only for copyrighted material and could not be treated as royalty. The Tribunal placed reliance on the following decisions:

- DIT vs Nokia Networks OY [(2013) 358 ITR 259 (Delhi High Court)] and

- DIT vs Dun and Bradstreet Information Services India Pvt ltd [(2011) 318 ITR 95 (Bombay High Court)].

It is also noteworthy that, in this case though the Revenue had relied on the Karnataka High Court decision in the case of Samsung Electronics Ltd. *[TS-5706-HC-2011(KARNATAKA)-O],* however, the Tribunal chose to follow the Bombay High Court decision in favour of the assessee.

It could therefore be said that the issue whether payment towards subscription fees to access the database is in the nature of royalty, is not settled.

It would appear that reliance placed by the Revenue on the decision of the Karnataka High Court, in the case of Samsung Electronics Limited appears to be misplaced as the said decision dealt with use of software as opposed to payments made for allowing access to a database.

The definition of 'royalty' in Explanation 2 to s 9(1)(vi) is vary vast and hence it is possible that each case may turn on its own facts. It speaks of grant of a license, use of any patent etc., use of equipment etc. In a database two things are involved. First is the data itself and second is the medium through which the access is provided. The question to be answered would be whether the 'data' would fall for consideration in any of the clauses of Explanation 2 and whether allowing access to data could be said to amount to imparting of any information or use or right to use equipment etc. Also, whether the consideration paid is for the data or for the medium facilitating access. One view could be that where the data is something which is generally available in public domain, the payment would be more for use of the facility permitting access. On the other hand, where the data is customer specific, the emphasis would be on the contents of the data itself and may amount to imparting of information. The difference between patented and non-patented information is perhaps relevant in this context.

In view of this uncertainty, a considered and reasonable view would have to be taken while discharging the withholding tax obligation and reliance on any case law would have to be clearly demonstrated so as to avoid penal consequences.

HIGH COURT

Opportunity of hearing should be provided before making addition to the total income of the impugned party.

The SC dismissed the Revenue's Special Leave Petition (SLP), challenging the Delhi HC decision upholding that relaxation of time limit prescribed under section 150 read with the Explanation 3 to section 153 would not be available, where no opportunity of being heard was afforded to the other person, whose assessment was sought to be reopened vide notices issued under section 148, after expiry of a period of six years.

Facts in brief:
Rural Electrification Corporation Ltd ('assessee') is a public financial institution. It had advanced loans to the Cooperative Electrical Supply Society Ltd ('Coop Soc'), which created a special corpus fund of INR 10 crores, out of the said advanced loan and earned interest. However, the Coop Soc did not disclose the said interest earned in its tax returns under the understanding that the funds and the corresponding interest income actually belonged to the assessee and not the Coop Soc. This understanding of Coop Soc, though initially challenged by the Revenue was subsequently confirmed by the ITAT, Hyderabad and it held that such income should be taxed in the hands of the assessee and not the Coop Soc.

Based on the decision of ITAT, Hyderabad, the Revenue issued notices under section 148 to the assessee for reopening of its assessments. However, these notices were issued beyond the six years of time frame stipulated under section 149 of the Act.

Also, it was factually observed that no opportunity was provided to the assessee by the ITAT, Hyderabad while deciding on the shifting of the taxability of income from Coop Soc to the assessee.

Contentions of the Assessee:

The assessee challenged the notice issued under section 148 as it was not in accordance with the provisions of section 150 read with the Explanation 3 to section 153 of the Act. The assessee submitted that section 150 could be invoked, if the reassessment was sought to be made 'as a consequence of or to give effect to any findings or direction contained in an order passed by any authority under the said Act by way of appeal, reference or revision or by a Court in any proceedings under any other law'.

The assessee further submitted that the provisions of section 150(1) of the Act, were *pari materia* to second proviso of section 34(3) of the Income Tax Act, 1922, which was subjected to interpretation before the SC in the case of ITO v. Murlidhar Bhagwan Das 52 ITR 335. Subsequently, to supersede the view taken by the SC, the Explanations 2 and 3 were introduced in the year 1964.

Explanation 3 (now Explanation 2, with effect from June 1, 2016) to section 153 allows reopening of an assessment and reassessment of such income in the hands of the other person beyond the time frame stipulated under section 149, where it is per an order passed in appeal, and any income is excluded from the total income of one person and held to be the income of another person. However, this deeming provision can be applied only after giving an opportunity of being heard to such other person.

The assessee argued that the Revenue's notice under section 148 was issued beyond the time frame of six years (per section 149) and was 'invalid' and so was the consequent reassessment of income, as no opportunity of hearing was provided by the ITAT, Hyderabad during the appellate proceedings of the Coop Soc, to present its case why such income is not taxable in the assessee's hands.

The assessee placed reliance on the decision of Gujarat HC in A. B. Parekh v. ITO 203 ITR 186, wherein it was observed that before a notice under section 148 of the Act is issued beyond the time limit prescribed under section 149, the conditions specified in Explanation 3 to section 153 have to be satisfied. These conditions being (i) a finding that income which is excluded from total income of one person must be held to be income of another person; and (ii) before such finding is recorded, such other person should be given an opportunity of being heard.

The assessee contended that since the second condition was not fulfilled before passing of the order by the ITAT, Hyderabad, the essential ingredient of Explanation 3 to section 153 was missing, and therefore the deeming clause would not get triggered, and accordingly, section 150 would not apply and the bar of limitation under section 149 is not lifted.

Contentions of the Revenue:

The Revenue contended that the opportunity of hearing to the assessee could not be given at the stage of appellate proceedings of the Coop Soc before the ITAT, Hyderabad, since there was no way to ascertain whether the decision to tax the said income would be in favor of the Coop Soc or the assessee. The question of taxation of the said income in the hands of the assessee emerged only from the ITAT, Hyderabad's decision.

Observations and ruling of the Court:

The Delhi HC noted that the question is not to blame the Revenue or the ITAT, Hyderabad for fault in not granting an opportunity of hearing to the assessee. The facts were that the assessee was not being given an opportunity of hearing and the Hyderabad ITAT concluded that the said interest income was to be taxed in the hands of the assessee and not the Coop Soc. The Delhi HC held that this is against the general principle that "no prejudice should be caused to anybody without that person having being heard". Therefore, the Delhi HC set aside the impugned notices issued under section 148 of the Act along with the proceedings and the assessment order. Further, the SC also dismissed the revenue's challenge to the decision of the Delhi HC.

Our comments:

The decision of Delhi HC and impliedly upheld by SC, once again reiterates and upholds the principle that no prejudice can be caused without affording an opportunity of being heard to the party impugned.

Inseparable composite rent taxable as 'income from other sources'

The Delhi HC in the case of Jay Metal Industries Pvt. Ltd. held that composite rental income would be chargeable to tax under the head 'income from other sources', as opposed to 'income from house property'.

Facts & Issue:

Jay Metal Industries Pvt. Ltd. ('assessee' or 'Lessor'), a company, had entered into a lease agreement to rent out its registered office to the lessee. The premises were leased along with the furniture & fixtures, central air-conditioning and power backed diesel generator. The lessee had agreed to pay charges towards maintenance of the premises, including the comprehensive maintenance of generator, air conditioner and furniture & fixtures, directly to the Lessor.

In the return of income filed by the assessee, the rental income from such properties was offered to tax under the head 'income from house property'. The AO taxed the rental income under the head 'income from other sources' and consequentially did not allow the standard deduction @30% of the annual value claimed as deduction by the assesse. The CIT(A) reversed the order of the AO. On appeal by the tax department, the ITAT restored the order of the AO, by setting aside the order of the CIT(A). Aggrieved, the assessee filed an appeal before the HC.

Contentions of the Revenue:

The revenue contended that the lease deed itself mentioned that the rental income was a composite one and hence the rental income was taxable under the head 'income from other sources'.

Contentions of the Assessee:

The assessee contended that the furnishing of premises was just ordinary and comprised a minor part of the whole value of the property. The central air-conditioning with power backup was an integral part of the building. As the property was owned by and belonged to the assessee, rental income could not be treated as a composite income. For this, reliance was placed on the decision of the earlier assessment, wherein the issue was decided in favour of the assessee.

It was also emphasised that the predominant purpose was to lease out the building and the equipment and fixtures were incidental and inseparable therefrom. The assessee had not claimed any depreciation on plant and machinery, fixtures and fittings, etc.

The assesse also made an alternate plea that if the entire rental is not treated as 'income from house property', then only the rental income from furniture, fittings, air-conditioning should be taxed under the head 'income from other sources' and depreciation should be allowed against such rental income on furniture, etc.

Observations & Ruling of the Delhi HC:

The HC observed that the preamble clause of the lease deed was clear that along with the four floors, furniture, fixtures, air conditioning, power backup through diesel generator, were given on a composite rent. Thus, the income earned by the assessee by letting out of its property was taxable as 'income from other sources'. While deciding the case, the HC distinguished the divisional bench ruling of the Kerala HC in Dr. P.A. Varghese v. CIT (1971) 80 ITR 180, wherein the agreement did not provide for letting out of any machinery, plant or furniture, but only letting out of building.

Further, the HC applied the tests laid down in the decision of SC in Sultan Bros (P) Limited v. CIT (1964) 51 ITR 353 and held that the income from the letting out in the hands of the assessee was a "new kind of income", which could not be considered to be income from house property, since the income was not from the ownership of the building alone "but an income which though arising from a building would not have arisen if the plant, machinery and furniture has not also been let along with it."

The HC did not entertain the alternate plea of the assessee to consider rental income attributable to renting of building under 'income form house property', as the same was never urged before the HC (but before the ITAT). As far as depreciation is concerned, the HC observed that assessee could not be deprived of depreciation benefit under section 57(iii) of the Act.

Citation:

Jay Metal Industries Pvt. Ltd. v. CIT (TS-380-HC-2017(Delhi))

Our Comments:

This decision would be relevant in determining the characterization of a particular income, as it determines the methodology of computation of taxable income. Further, the characterization depends on the facts of each case. The tax implications of property income may get significantly influenced by its characterization as business income or income from house property or income from other sources. Taxpayers earning property income need critical attention to various SC rulings. This decision also once again brings into focus the importance of drafting of lease agreements.

Definition of 'legal representative' includes legal heir and legal representatives, with or without the title of 'executors'

The Calcutta HC in Arvind Kayan v. UOI & Other, held that the definition of legal representative shall include legal heir and persons representing the estate, even without the title, either as executors or administrators in possession of the estate of the deceased.

Facts & Issue:

The assessee, Mr. Arvind Kayan was the son of defaulter, Mr. Sushil Kayan. The Tax Recovery Officer ('TRO') initiated penalty proceedings under section 159 of the Act on the assesse and the defaulter (being deceased). The TRO treated the assessee as 'legal representative' of the deceased father. On appeal, the Appellate authority too upheld the TRO's contention. Aggrieved, the assessee preferred an appeal with the Calcutta HC.

Contentions of the Revenue:

The Revenue contended that every person found to meddle with the estate of the deceased, could be considered as the 'legal representative' of the deceased. The TRO noted the fact that there were share transactions entered into between the father & the assessee and they had also worked as the directors of companies. The TRO contended that the shares belonging to the deceased were succeeded by the assessee as the legal heir and thus the assessee was meddled with the estate of the deceased.

Contentions of the Assessee:

The assessee contended that, although he was the son of the defaulter, he had severed his relationship with the deceased in the year 1999. The assessee also submitted that he had purchased the shares belonging to his deceased father during the lifetime of the latter, for a valuable consideration and had disclosed the same in the income tax return of the relevant AY.

Observations & Ruling of the Calcutta HC:

The HC noted that as per section 2(29) of the Act, the term 'legal representative' has the meaning assigned to it in section 2(11) of the Civil Procedure Court, 1908 ('CPC'). Further, section 2(11) of the CPC provides that "a legal representative means a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate of the deceased". Thus, the HC upheld that the definition of 'legal representative' is not confined to the legal heirs only, but also includes persons who represent the estate, even without the title, either as executors or

administrators in possession of the estate of the deceased. In view of this, the HC held that the assessee as the heir was the legal representative of the deceased.

Citation:

Arvind Kayan v. UOI & Others (TS-373-HC-2017(Cal))

Our comments:

Section 159 of the Act provides that the legal representative of the deceased shall, for the purposes of the Act, be deemed to be an assessee and shall be liable to pay any sum, which the deceased would have been liable to pay, as if he had not died. Further, as noted above, a legal representative means a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate of the deceased, whether or not as an executor.

Under the Act, the tax authorities also have the power to recover the tax liability of the deceased from the legal representative. Having said this, as per section 159(6) of the Act, the liability of the representative shall be limited to the extent to which the estate is capable of meeting the liability.

There could be few challenges in filing the returns of the deceased, since it might be difficult to obtain the details of the income earned by the deceased person and the taxes paid (including TDS). Where the person has died intestate with multiple survivors, one would need to analyse as to which surviving person could be treated as legal representative. Further, a dispute might arise if there is no unanimity on the division of the estate among the legal heirs and this can pose a problem in doing the tax compliance on time, for and on behalf of the deceased.

Impact of de novo proceedings on society registration

The Allahabad HC in CIT v. Gyan Deep Shiksha Bharti held that the date of filing of the original application for registration under section 12AA of the Act was irrelevant, when the said application was rejected and the proceedings had commenced de novo with the filing of another application for the registration.

Facts & Issue:

Gyan Deep Shiksha Bharti ("assessee") was a registered society under the Societies Registration Act, 1860, established for the purpose of providing education to children. The assessee filed an application in November 2000 before the CIT, seeking registration under section 12AA of the Act, which was rejected vide the order dated March 21, 2002. Against this order, the assessee filed a representation before the CIT and also filed an appeal before the ITAT.

In relation to the representation before the CIT, the assessee requested to reconsider the order dated March 21, 2002 passed by the CIT. This application was allowed vide order dated January 11, 2005 and registration was granted w.e.f. September 30, 2004. This was done without reviewing or setting aside the order dated March 21, 2002, through which an application for registration was rejected. Unsatisfied, the assessee filed a rectification application to grant registration w.e.f. June 18, 1999 as requested in the original application or alternatively w.e.f. April 1, 2000, which is the commencement of the FY in which the application was initially made. However, the rectification application was rejected and the assessee preferred an additional appeal before the ITAT.

Both the aforesaid appeals before the ITAT were merged and decided, vide a common order. The ITAT set aside the order rejecting the rectification application and directed the CIT to pass a speaking order in the light of the provisions of section 12AA of the Act. However, the ITAT did not deal with the order of the CIT, which refused registration of the society.

Pursuant to the ITAT order, the CIT passed an order holding that the application filed on September 30, 2004 would be considered as an application for grant of registration of the society and therefore the registration would be effective from April 1, 2004. However, the CIT did not set aside or recall its earlier order dated March 21, 2002.

The assessee again filed an appeal before the ITAT and it was held that as original application in prescribed format was filed on November 15, 2000, the registration would be operative w.e.f April 1, 2000. Aggrieved, the department filed an appeal before the HC. The question before the HC was as follows:

"Whether the date of application for registration u/s 12AA would be the date on which the application was originally made i.e. 20 November 2000 or the date on which subsequent application/representation dated 30 September 2004 was filed?"

Contentions of the Revenue:

The revenue contended that once the application for registration of the society was rejected, the subsequent application was a fresh application. Therefore, the registration of society would be operative from the commencement of the FY 2004, i.e. April 1, 2004.

Contentions of the Assessee:

The assessee contended that the registration was filed originally in the prescribed format in the FY 2000 and accordingly, the registration would be operative from the commencement of the same FY, i.e. from April 1, 2000.

Observations & Ruling of the Allahabad HC:

The HC observed that the Act does not specifically provide the date from which the registration, if any, granted to any institution or society would be operative. In such circumstances, ordinarily, when registration is granted, it will be operative from the date of the order and the benefit of sections 11 and 12 of the Act, on the basis of registration, would accrue from the date of commencement of the FY in which the said order is passed or the application is moved, provided nothing contrary to it, is prescribed in the order directing for registration of the society/institution.

The HC held that the date of filing the original application for registration has no relevance, when the said application was rejected. The subsequent application/representation should be treated as a fresh application and accordingly the registration of society under section 12AA of the Act would be operative from April 1, 2004.

Citation:

CIT v. Gyan Deep Shiksha Bharti (TS-396-HC-2017(Allahabad))

Our Comments:

It would appear that the reasons for rejection of the original application are important. If the rejection was on some technical grounds, the assessee would have been better off by seeking rectification thereof. The assessee seems to have made a combined approach – application plus representation to the CIT. If it was a case of mere representation against the order rejecting the application, perhaps the said original application would have been alive. The assessee having made an application would undoubtedly be viewed as a new application and not a continuation of the original application. This outcome therefore appears to be in view of the strategy adopted by the assessee.

TRIBUNAL

Share Premium amount received on issuance of equity shares is taxable

The Ahmedabad ITAT in Umiya Pipes Pvt. Ltd. v. ACIT has confirmed the addition on account of share premium, as the assessee failed to discharge its onus in proving the identity, genuineness and creditworthiness of the investors.

Facts & Issue:

The assessee was engaged in the activity of manufacturing PVC pipes. For the AY 2002-03, it had filed a return of income, declaring a loss. During the year under consideration, the assessee had issued equity shares of face value of Rs. 10 each, at a premium of Rs. 90 per share.

In the course of the assessment proceedings, the AO asked for reasons of loss reported in its return of income and further proceeded to undertake a detailed investigation of the share premium received by the assessee. The assessee's premises were sealed by the bank due to non-payment of dues, due to which it could not furnish the books of accounts as requested by the AO. The AO completed the assessment by undertaking a best judgment assessment under section 144 of the Act. In view of the failure to produce books of accounts, the AO adopted the net profit rate of 4.94% and also taxed the amount of share premium under section 68 of the Act.

During the CIT(A) hearing, the assessee produced additional evidence of the persons from whom share premium was received, along with the dates, PAN information and photocopies of confirmation letters in some cases. However, the CIT(A) rejected the additional evidence produced by the assessee, since the financial statements did not match with the details provided by the assessee.

On further appeal to the ITAT, the assessee pleaded that since the premises were de-sealed by the bank, it should be permitted to furnish the books of accounts. The ITAT took cognizance of the matter and restored the file back to the AO. In the course of subsequent proceedings, the assessee pleaded that the Ahmedabad Civil Court had sealed its premises and hence it could not furnish the books of accounts. The AO retained the additions made in the earlier order, which were confirmed by the CIT(A) and the assessee preferred an appeal before the ITAT.

Contentions of the Revenue:

The Revenue argued that some of the parties did not have PAN Cards, and some had applied for a PAN in 2005, well after the AY in question. It further argued that the assessee did not submit the original confirmations from the parties and relied on the photocopies.

Contentions of the Assessee:

The assessee pleaded that it had filed all the necessary details proving the identity, capacity, genuineness and creditworthiness of the parties. Further, all the payments were received through the banking channels, and all the relevant PAN information had been brought on record by the assessee.

Observations & Ruling of the Ahmedabad ITAT:

The ITAT held that there was no explanation in support of the non-co-operation adopted by the assessee in the second round of appeals. The ITAT further noted that-

- all the thirteen parties were based in Ahmedabad. In spite of this, the assessee could not produce even one of the thirteen parties before the revenue authorities. Further, all the photocopy confirmations submitted are dated well before the remand direction given by the ITAT;
- the assessee's act and conduct in not being able to file a single original confirmation and its further act of submitting photocopies of the same date, indicated a serious issue of such photocopies being non-genuine.

The ITAT distinguished various case laws relied by the assessee. Further, the assessee was not able to prima facie demonstrate the intrinsic value of shares to be at par with the impugned share premium amount. It has not been able to show the crucial nexus between the premium in question vis-à-vis its inbuilt potential, since there can be no strait-jacket formula to determine the share premium, which depends on the current and future potential of the enterprise.

The assessee's act and conduct after having received such high share premium purportedly towards share capital and in showing continuing inability to furnish the requisite information citing subsequent financial difficulties, leading to its premises being seized, therefore did not inspire confidence. Accordingly, the ITAT held that the assessee had miserably failed in proving the genuineness of the transaction.

The ITAT further stated that, there was no material on record to prove the genuineness of the share premium received in the earlier years.

Citation:

Umiya Pipes Pvt. Ltd. v. ACIT (ITA No. 1697/Ahd/2014)

Our Comments:

In a recent decision of the Mumbai ITAT in CIT v. Gagandeep Infrastructure Private Limited (ITA No. 1613/Mum/2014), the assessee had provided various details, like names, addresses, PAN information and original confirmation letters. It had established genuineness of the transaction by filing copies of the share application form, form filed with the Registrar of Companies and also the bank details of the applicants. Based on this, the Mumbai ITAT deleted the addition made under section 68 of the Act on account of unexplained cash credit.

In the present case, the assessee failed to provide the original confirmation letters of the parties and even did not produce the parties before the tax authorities. The ITAT has been scathing in its attack on the complacency shown by the assessee in discharging its onus in proving the identity, genuineness and creditworthiness of the paying investors, thereby making an addition under section 68 of the Act on account of unexplained cash credit.

No tax needs to be withheld under section 194J on subscription charges

The Mumbai ITAT in Kitara Capital Private Ltd. v. ITO held that no taxes are required to be withheld under section 194J of the Act on payment towards subscription charges for online database access and retrieval services.

Facts and Issue:

The assessee is a domestic company engaged in the business of advisory services related to carrying out research for private equity investments. During the course of the assessment proceedings, the AO noticed that the assessee had made payment of subscription fees to Bloomberg Data Services India Private Ltd, which was according to the AO in the nature of a payment towards professional services; hence, it was liable for TDS under section 194J of the Act.

The assessee submitted that the payment made to Bloomberg Data Services India Private Ltd was not in the nature of any managerial or technical services. Such data was accessible by any subscriber on payment of a requisite fee and therefore does not attract the TDS provisions under the domestic provisions of the Act.

The assessee challenged the decision of the AO before the CIT(A), who upheld the decision of the AO. Aggrieved by the decision, the assessee preferred an appeal before the ITAT.

Contentions of the Revenue:

The revenue contended that tax should have been withheld under section 194J of the Act on subscription charges, since the payments were in the nature of royalty. For this, the revenue relied on the decision of Karnataka High Court in the case of CIT v. Samsung Electronics Co. Ltd. (2011) 16 taxmann.com 141 .

Contentions of the Assessee:

The assessee submitted that in the normal course of business, it was required to access the data of Bloomberg Data Services, which was similar to availing subscription services of financial e-magazines through online portals. The payment was in the nature of terminal charges for online information and data base access and retrieval services. Such services were available in the public domain and hence would not require any taxes to be withheld under section 194J of the Act.

To support its contention, the assessee relied on the decision given by the Mumbai ITAT in the case of India Capital Markets P. Ltd. v. DCIT in ITA.No.2948/Mum/2010 and 4851/Mum/2010 (AY 2006-2007) dated December 12, 2012, an entity having similar business functions to the assessee, which had made similar payments to Bloomberg Data Services.

Further to substantiate its claim on non-deduction of TDS, the assessee, relying on the proviso to section 201(1) read with second proviso to section 40(a)(ia) of the Act, submitted that, Bloomberg Data Services, had certified that the payments received by them have been offered to tax at the time

of filing the tax return. Therefore, since the recipient had treated it as income and paid taxes thereon in its tax return, no further disallowance is warranted.

Observations & Ruling of the Mumbai ITAT:
The ITAT agreed with the contention of the assessee, that such payments are not covered within the definition of royalty, as they are not for use of any equipment or copy rights or any license/right to use certain data in consideration for an agreed license fee.

It accepted the contention of the assessee that such subscription fees were paid to Bloomberg Data Services for accessing the database and was in the nature of subscription of e-magazine journal.

The Mumbai ITAT further held that the revenue had failed to challenge or bring any contrary perspective of why the assessee should be treated as assesse-in-default in view of the second proviso to section 40(a)(ia) of the Act read with proviso to section 201(1) of the Act, which states that an assessee shall not be treated as assesse-in-default, if the recipient has offered the income to tax and paid taxes thereon. Thus such expenses did not warrant any disallowance.

The ITAT concluded that owing to the nature of payment being subscription charges of e-magazine journal and in absence of any contrary material available to treat the assesse-in-default, such payments do not attract TDS provisions under section 194J of the Act.

Citation:

Kitara Capital Private Limited v. ITO (TS-368-ITAT-2017(Mumbai)

Our comments:

The ITAT's ruling on database access and subscription charges is a welcome decision, which upholds the view that subscription charges are not in the nature of royalty.

The issue of database access services qualifying as fees for technical services or royalty, has now been more or less settled by the decision of the SC in the case of Kotak Securities Limited (Civil Appeal No. 3141 of 2016 dated March 29, 2016] wherein, the Apex Court has observed that such services failed the test of a specialised, exclusive and individual requirement of the user. In the absence of the same, though rendered, the services would merely be in the nature of facility offered and hence tax is not required to be deducted under section 194J of the Act.

On the proviso to section 201(1) read with second proviso to section 40(a)(ia) of the Act; it is now well settled that-

- If the amount paid by the payer has been included by the payee in his return of income for the relevant AY,
- the payee has filed the return of income under section 139 of the Act and has paid the tax due on such income declared in its annual return of income, no disallowance under section 40(a)(ia) of the Act can be made by the AO in view of the second proviso to section 40(a)(ia) read with first proviso to section 201(1) of the Act.

This legal position has been accepted in following decisions:

- Visu International Ltd. v. DCIT (ITA No. 488/Hyd./2013),
- G. Shankar v. ACIT (ITA No. 1832/2013/Bangalore),

ITO v. Dr. Jaideep Sharma (20140) 52 taxmann.com 420 (Delhi)

Assessee would not be considered as assesse-in-default, where expenses liable for TDS are suo-motu disallowed and offered to tax under section 40(a)(ia)

The Mumbai ITAT in Destimoney Enterprises Ltd. v. ITO-TDS (OSD) held that the assessee will not be considered an assessee-in-default, where expenses liable for TDS are suo-motu disallowed and offered to tax under section 40(a)(ia) of the Act.

Facts in brief:

A survey was conducted by the Income tax department under section 133A of the Act, on the premises of Destimoney Enterprises Ltd. ('assessee'), wherein certain discrepancies were identified in respect of compliance under the TDS provision. The AO identified that the TDS was not made from the amount of 'provision for rent' of Rs. 2,83,91,800, which was debited to the profit and loss account. The Tax Audit Report in Form 3CD reported that the assessee had declared the said amount as inadmissible expenses under section 40(a)(ia) of the Act. The said rental amounts were not accrued/ paid, but a provision was made made due to the ongoing litigation with the landlord. Further, the assessee had 'suo moto' disallowed the amount in the tax return filed. However, the AO disagreed and held that the assessee was liable to deduct TDS under section 194-I and therefore considered the assessee to be in default under sections 201 and 201(1A) of the Act.

During the course of the assessment, the AO also identified that assessee had paid lease line and internet charges to a company without complying with the TDS provisions. The assessee submitted that the payments were for use of internet connection and not for 'use of any plant or equipment' and therefore TDS provisions were not attracted. The AO disregarded the assessee's contentions and treated it as an 'assessee-in-default' and raised a demand for tax and the interest. The CIT(A) concurred with the AO's view. Being aggrieved, the assessee preferred an appeal to the ITAT.

Contentions of the Assessee:
The assessee contended that since no amount was claimed as deduction, it cannot be considered as an 'assessee-in-default' under the TDS provisions. In relation to TDS on lease line charges and internet charges, the assessee placed reliance on the decision of Madras HC in Skycell Communication Ltd v. DCIT 251 ITR 53, Bangalore ITAT in Wipro Ltd v. ITO 80 TTJ 91 and an unreported decision of the Delhi HC in CIT v. Bharti Cellur Lte & others.

Observations and rulings of the Mumbai ITAT:
The Mumbai ITAT noted that the assessee had made suo-moto disallowance for provision of rent under section 40(a)(ia) of the Act and had not claimed any deduction for such expenses from its total income. Therefore, it was of the opinion that where there was no claim of expenditure by the assessee and it had made suo-moto disallowances under section 40(a)(ia) of the Act, TDS provisions are not applicable.

Based on the facts present, the ITAT observed that the assessee had only availed internet services and paid internet/ lease charges (i.e. for use of internet connection and not for use of any asset, plant and machinery, which involved any payment of rent), which did not fall within the provisions of section 194-I, 194-C and 194-J of the Act. Further, the decisions relied upon by the assessee are squarely on the point and therefore, the TDS provisions were not applicable for these payments.

Citation:
Destimoney Enterprises Limited v. ITO-TDS (OSD), Mumbai (ITA 4124 and 4125/M/2015)

Our Comments:
The ruling of Mumbai ITAT is in line with the principle laid down in the recent decision of the SC in the case of Palam Gas Service v. CIT 81 taxmann.com 43. The SC has upheld the ratio laid down by the Punjab and Haryana as follows-

"The Punjab & Haryana High Court in P.M.S. Diesels v. CIT [2015] 374 ITR 562 has exhaustively interpreted Section 40(a) (i)/ (ia) keeping in mind different aspects. We would again quote the following paragraphs from the said judgment, with our complete approval thereto:

"26. Further, the mere incurring of a liability does not require an assessee to deduct the tax at source even if such payments, if made, would require an assessee to deduct the tax at source. The liability to deduct tax at source under Chapter XVII-B arises only upon payments being made or where so specified under the sections in Chapter XVII, the amount is credited to the account of the payee. In other words, the liability to deduct tax at source arises not on account of the assessee being liable to the payee but only upon the liability being discharged in the case of an assessee following the cash system and upon credit being given by an assessee following the mercantile system. This is clear from every section in Chapter XVII."

It would be pertinent to refer to the provisions of Section 194-I, which lay down that a person responsible for paying any income by way of rent shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier, deduct income tax thereon.

The thrust of the provisions is clearly on the income getting accrued by way of right to receive in the hands of the deductee and in essence refers to crystallisation of the liability in the hands of the deductor which results in credit of the amount to the account of the deductee.

The underlying objective of provisions of section 201 of the Act is to empower the collection of tax not deducted by the payer and compensate the Government for the failure of an assessee to deduct or pay the TDS amount to the credit of the Government.

INTERNATIONAL TAX

Taxes withheld overseas would not constitute taxable salary in India

The Bangalore Tribunal in Shri Sunil Shinde's case, held that overseas taxes and medicare would not constitute taxable salary in India while offering overseas salary in India.

Facts & Issue:

Shri Sunil Shinde ("**assessee**") was an employee of Fidelity Business Services India Private Limited and was transferred to Fidelity Investments Systems Inc, USA from 7 October 2010 to 21 June 2012.

The assessee was an ordinary resident (ROR) in India during the FY 2010-11. However, in the USA, he was non- resident during the year 2010 but a resident in 2011.

The assessee derived income from salary during the FY 2010-11. Being resident of India in FY 2010-11, the assessee had offered the actual salary income received in US as taxable in his India tax return and claimed FTC in respect of the Federal taxes withheld from his overseas salary.

The AO added back the Federal tax claimed as FTC to the income of the assessee.

The CIT(A) upheld the order passed by the AO and made the following adjustments to the total income of the assessee, considering the same as benefits in the hands of the assessee:

a. Enhanced the amount of Federal tax addition to income;
b. Added back State taxes withheld in US to income;
c. Added Medicare paid in US to income.

Aggrieved, the assessee filed an appeal before the ITAT.

Contentions of the Revenue:

The revenue contended that cases relied upon by the assessee were not applicable to the facts of the case of the assessee.

Contentions of the Assessee:

The assessee's contentions were as follows:

- The federal tax and state tax do not constitute taxable income. Reliance was placed on various judicial precedents with following reasons:
    - Tax deducted at source (TDS) is a diversion of income by overriding title. The right to receive taxes deducted at source lies with Government and therefore, only the net income received by the assessee should be taxable in India.
    - Section 198 was specifically enacted in order to bring the TDS within the purview of tax and the provisions states that taxes deducted at source in accordance with the provisions of the Act is deemed to be income which is received. Accordingly, TDS is deemed income as the same is not actually received by the assessee. It does not refer to TDS outside India.
    - Section 5(1)(c) covers income which accrues or arises outside India. It does not provide for taxation of amounts deemed to accrue/arise/be received outside India.

Thus, deeming fiction does not form basis of taxation in respect of income earned/received outside India.

- Given the above, assessee contended that Federal Taxes and State taxes should be considered as income deemed to accrue/arise/received outside India and are therefore not taxable in the hands of the assessee.

- Medicare payment - The assessee contended that Medicare payment is in the nature of social security and hence, a non-taxable perquisite in the hands of the assessee. Reliance was placed on various judicial precedents which held that in case the benefit is purely contingent in nature or the employee does not get any vested right at the time of contribution, same cannot be considered as taxable perquisite.

Foreign Tax Credit – It was contended that if State Tax paid in US is considered as income in India, then corresponding credit for such taxes paid should be allowed.

Observations & Ruling of the Bangalore Tribunal:

- In accordance with section 5(1)(c) of the Act, the Federal tax and State tax withheld in US which accrues or arises outside India would not constitute income in the hands of the assessee as the same is actually not received.
- Relying on judgements referred to by the assessee and having regard to section 5(1)(c), the ITAT accepted that only actual income that is received by the assessee outside India is taxable. In other words, only the net income after TDS can be taxed in India.
- In the absence of a vested right, Medicare amount was considered as non- taxable.

The claim of FTC was remanded back to the AO to determine the quantum of FTC in accordance with Article 25 of Indo US DTAA. The claim was to be restricted to the tax payable on total income before giving effect to FTC.

Citation:
Sunil Shinde vs. ACIT [TS-377-ITAT-2017(Bang)]

Our Comments:

The taxable income of resident employees who receive salary income both within and outside India could expect relief to the extent of foreign taxes paid by employer consequent to above decision. Employees are advised to consider FTC diligently on the double taxed income. The decision has also reinstated that perquisite provided by employer, the benefit of which has not vested at the time of contribution, should be considered as exempt.
Whether the adoption of principles emerging from above decision in other jurisdiction is worthwhile, requires evaluation. It is advised to examine such positions on case-to-case basis as claiming tax benefits on overseas income, especially at low levels are often litigious.
While there seems to be support for the view taken by the Tribunal it does not seem to gel with the proposition that income accrues first and then the tax thereon is subjected to charge and quantification and collection/assessment. If this line of reasoning is correct gross income could be said to accrue outside India and hence subject to tax in India u/s 5(1)(c). However, in the absence of any contrary view, the view taken by the Tribunal and the High Court decision relied upon by the Tribunal would prevail.

TRANSFER PRICING

Segregated Benchmarking not suited in case of turnkey projects though the price for supply of equipments and rendering of services is computed separately.

The Delhi ITAT in RTA Alesa AG v. DCIT, held, on facts, that a composite contract performed by the taxpayer, amounted to a turnkey project and therefore, the activity of supplying of equipment along with services was continuous and inextricably linked and inseparable from each other. Hence, the benchmarking of both the transactions should be done on an aggregate basis and not on segregated basis.

Facts & Issue:

RTA Alesa AG, Switzerland ('taxpayer' or 'assessee') was a subsidiary of Rio Tinto Plc. engaged in the business of providing material handling technologies and services, including turnkey projects, harbour facilities, conveying systems, storage equipment, vehicle loading and unloading, training and technical assistance. The assessee was awarded an EPC contract by Bharat Aluminum Company Limited ('BALCO') in India for 55TPH bath processing plant for carbon plant of BALCO smelter expansion project at Corba, Chattisgarh. Accordingly, the assesse had set up a project office in India for executing the EPC project with BALCO on a general permission from the RBI. This Project office constituted a PE in India. The Project with BALCO had four parts:

- Onshore services;
- Onshore supply;
- Offshore services; and
- Offshore supply.

BALCO and the project office had entered into a separate onshore agreement with separate consideration for the onshore part of the contract, viz. supply of equipment, commissioning spares and rendering erection, inland transportation, onsite installation and commissioning services.

The assessee had benchmarked the above two transactions, i.e. supply of equipments and rendering of services separately by applying the TNMM method, based on segmental Profit & Loss Account workings for supply of equipments and rendering of services respectively.

The assessee benchmarked the transaction of rendering of service and service charges paid using the TNMM as the most appropriate method with Operating Profit/Operating Cost (OP/OC) as the Profit Level Indicator(PLI). The margin of the tested party, i.e. the assessee, was computed at 18.51%. The assessee had chosen four comparables and worked out the average OP/OC margin at 18.80%, using multiple year data. However, during the assessment proceedings before the TPO, the assessee submitted a list of new comparables and updated the margin of the comparables, having mean of 17.58%.

With respect to supply of equipments, the assessee benchmarked the international transaction relating to supply of equipments using the TNMM as the most appropriate method with OP/OC as PLI.

The tested party margin, i.e. the assessee was computed at 1.47% for this segment. The assessee had chosen four comparables having average OP/OC margin of 5.99%, using multiple year data. During the assessment proceeding before the TPO, the assessee submitted an updated margin of the comparables, having mean of 2.95%.

The TPO rejected the assessee's approach of benchmarking of equipment supply transaction and services transaction separately. Instead, he aggregated the supply and services portions, conducted a fresh study, arrived at an average PLI of 24.04% of comparables and made an addition of Rs. 3.15 crores on this basis. The DRP confirmed the approach of the TPO. The assessee preferred an appeal before the Delhi ITAT.

Contentions of the Assessee:

The assessee contended that, the two activities of rendering services and supply of equipments could not be aggregated, where possibility to determine the profit for each transaction separately existed, and therefore, the economic analysis had to be carried out separately, except in the cases where the transaction were so closely linked or continuous that they could not be evaluated on a separate basis, only in those cases the transactions could be evaluated together. Further, they had maintained separate records for provision of onshore services and supply of equipment and therefore, analysis should be done transaction to transaction basis.

The assessee had entered into contract with BALCO for supply of equipments, spares etc. and service, erection and commissioning of plant. Further, these supply and services contracts were independently negotiated. Additionally, separate invoices were raised in respect of supply of equipments and services rendered. Therefore, analysis should be done on a transaction to transaction basis, in a segregated fashion.

Contentions of the Revenue:

The TPO had rejected the benchmarking done by the assessee on the ground that, the assessee was awarded a composite contract of commissioning of the plant, which included onshore and offshore supply of equipments, spare parts as well as onshore and offshore services of erection and commissioning, etc. It was a turnkey project and for executing the onshore supply and services, the assessee had set-up a project office in India. The supply of equipments was integral part of the whole contract of commissioning of the plant and it was awarded as a whole to the assessee. The TPO further contended that, merely identifying the prices of the part of the contracts for supply of equipments and services could not change the composite nature of the turnkey project.

Observations & Ruling of the Delhi ITAT:

The ITAT observed that, the issue of arm's length price of international transaction on "transaction by transaction" basis or as a "bundle transaction" had been discussed by the Delhi HC in Sony Ericsson Mobile Communication India Private Limited v. CIT (2015) 55 taxmann.com 240. In that case, the HC observed that the expression "class of transaction", "functions performed by the party" under section 92C(1) of the Act, illustrated the word "transaction", included bundle or a group of connected transactions. Clubbing of closely linked transactions, which included continuous transaction, may be

permissible under the Act and the taxpayer could aggregate the controlled transactions, if the transaction met the common portfolio or packet parameter.

The ITAT observed that, the entire contract awarded to the assessee, was a continuous activity and was composite in nature, as the assessee was required to deliver complete facility to BALCO and therefore, activity of supplying of equipments, spare parts and commissioning of plant was a complex web of activities which were continuous inextricably linked and inseparable from each other. This fact also got strengthened from the observation that the assessee has recognized revenue from the supply of the equipments as well as from the services in the ratio of the percentage of contract work executed, i.e. 85.35991%. The assessee had applied same ratio both over the supply contract value and service contract value for computing the revenue recognized from both these components during the year.

The ITAT further observed that, merely splitting of the price into components of the contract, could not make the transaction separable from each other. To execute the turnkey project, it was required to provide material and services, side by side for erection and commissioning and installation of the plant.

In view of the above, the ITAT agreed with the contentions of the TPO and DRP, in benchmarking both the transactions on the aggregate basis.

Citation:
RTA Alesa AG v. DCIT (TS-675-ITAT-2017(Delhi)-TP)

Our Comments:
The concept of aggregation of transactions for the purposes of TP benchmarking has been accorded a legal sanction under the scheme of the Act itself. Section 92C(1) of the Act refers to 'nature of transaction or class of transaction'. Further, the term 'transaction' has been defined in Rule 10A(d) of the Rules to include a number of 'closely linked transactions'.

The guiding principle is that, if a number of transactions were closely-linked or continuous in nature and arising from continuous transactions of supply and services, the transactions could be permitted as closely linked transactions for the purpose of transfer pricing.

Aggregation of transactions or 'Combined Transaction Approach' was a well-accepted practice for benchmarking and determination of ALP of international transactions / specified domestic transactions and has been widely upheld in many judgements, notably the Pune ITAT decision in Cummins India Ltd. v. ACIT (2015) 53 taxmann.com 53 and the Punjab & Haryana HC decision in Knorr-Bremse India P. Ltd. v. ACIT (2016) 380 ITR 307. One must also weigh in balance, the decision of the Mumbai ITAT in SAS Institute (India) (P.) Ltd. v. ACIT (2016) 67 taxmann.com 271, where the ITAT upheld that taxpayer's segregated approach to TP benchmarking over the TPO's proposal to aggregate the transactions, thereby hinting that the TPO could not insist on aggregation of transactions, where assessee himself had benchmarked the transactions separately in accordance with rules in force. It must be said that the latter decision reflects a narrower interpretation of the entire issue and was essentially, driven by facts.

The OECD transfer pricing guidelines, at Paragraphs 3.9 and 3.11, have highlighted that in certain situations, it was difficult to evaluate transactions separately and needed to be evaluated by bundling

them. The said OECD guidelines have alluded to business considerations and have referred to a ‘portfolio approach’ as a business strategy, consisting of tax payers bundling certain transactions for the purpose of earning an appropriate return across portfolio, rather than single product. For instance, some products could be marketed by the taxpayer with a low profit or even at a loss because they created a demand for other products or related services of the same taxpayer that are then sold or provided at higher profits. Some of the examples given in the OECD guidelines for transfer pricing, include the equipment and captive after-market consumables, such as vending coffee machines and coffee capsules, or printers and cartridges.

The Guidance Note on transfer pricing issued by the ICAI has also dealt with the subject of aggregation and it provides that two or more transactions could be said to be 'closely linked', if they emanated from a common source, being an order or contract or an agreement or an arrangement, and the nature, characteristic and terms of such transactions substantially flew from the said common source.

In balance, on a conspectus of the commentaries and also the judicial pronouncements on the impugned subject, it may be deduced that in principle, two or more transactions between the same parties, i.e., the assessee and its associate enterprise could be said to be closely linked, if the transactions were interlinked and terms and conditions as well as prices between the parties were determined based on the totality of the transactions and not on individual and separate transactions.

GLOSSARY

ABBREVIATION	MEANING
AAR	Hon'ble Authority for Advance Rulings
ACIT	Learned Assistant Commissioner of Income Tax
ACT	Income Tax Act, 1961
AO	Learned Assessing Officer
AY	Assessment Year
CBDT	Central Board of Direct Taxes
CIT	Learned Commissioner of Income Tax
CIT(A)	Learned Commissioner of Income Tax (Appeals)
DCIT	Learned Deputy Commissioner of Income Tax
DRP	Dispute Resolution Panel
DTAA	Double Tax Avoidance Agreement
FTS	Fees for Technical Services
FY	Financial Year
HC	Hon'ble High Court
INR	Indian Rupees
IRA	Indian Revenue Authorities
ITAT	Hon'ble Income Tax Appellate Tribunal
IT Rules	Income Tax Rules, 1962
Ltd.	Limited
PE	Permanent Establishment
SC	Hon'ble Supreme Court
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer