

TAX HIGHLIGHTS

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Permanent establishment

Space provided by an organiser to a foreign entity for rendering services relating to an event constitutes a PE in India

The applicant is registered in Belgium, and it is engaged in the business of providing technical equipment and services for events including lighting, sound, video and LED technologies. It entered into a service agreement with the Organising Committee of the Commonwealth Games, Delhi, (OCCG), for a term commencing on 9 July 2010 and expiring on 30 October 2010, to provide services on a turnkey basis.

In terms of the agreement, the applicant rendered the services for two days, namely 3 October 2010, at the opening ceremony, and on 14 October 2010 at the closing ceremony of the Commonwealth Games Delhi, 2010. Its employees and equipment were in India for a period of only 66 days for the preparatory, installation and dismantling of equipment from 2 August 2010 to 24 October 2010.

As a consideration, OCCG agreed to pay fees of USD3.5 million, inclusive of the withholding and service tax, in installments. Four invoices were raised of which payments have been made against three after withholding tax at source and issued withholding tax certificates.

The Authority for Advance Ruling (AAR) held that the space provided by an organiser to a foreign service provider for rendering services relating to an event, i.e., lighting, sound, video, etc., constitutes a Permanent Establishment (PE) in India since the space is available at its disposal with exclusive right of access, controlled by it and used for its business. There was a clear link between the place of business and an identifiable geographical point, from where its business was done. The establishment need not be enduring or permanent in the sense that it should be in its control forever. The applicant had met each of the criteria for establishing a PE, namely, place of business, the power of disposition, the permanence of location, business activity and business connection.

The AAR thus held that the payments received by the applicant for rendering lighting and searchlight services, earned through its PE in India, would be taxable as business profits under Article 7 of the India-Belgium tax treaty and under the provisions of the Income-tax Act, 1961 (the Act).

The AAR also held that the services rendered by the applicant were technical services since such services were complex and could not be availed without the assistance of highly trained technical personnel. However, the AAR held that by virtue of Most Favoured Nation (MFN) clause under the tax treaty, a restricted scope of Fees for Technical Services (FTS) [make available condition] provided under the India-Portugal tax treaty will be imported into the India-Belgium tax treaty. It cannot be said that the applicant had 'made available' the technical knowledge, experience, skill, knowhow or processes, which enable the development and transfer of a technical plan or technical design, and which enable the person acquiring the services to apply the technology contained therein. Therefore, the services provided by the applicant are not taxable as FTS.

Further payment for such services is also not in the nature of royalty since there is no assignment of any right to use the know-how, technical experience, skill, processes and methodology, or even the copyright, patent, trade mark, design or model, or any intellectual input comprised therein.

Production Resource Group (2018] 401 ITR 255 (AAR)

For further details, please refer to our Flash News dated 19 January 2018 available at this [link](#)

Services provided by the seconded employees of a foreign company to its subsidiary in India do not result in a permanent establishment

The taxpayer is a tax resident of South Korea engaged in the business of manufacturing and sales of various categories of television, home appliances, telecommunication terminals, semi-conductors as well as other state of the art IT products for global markets. The taxpayer has two wholly owned subsidiaries in India i.e. Samsung India Electronics Private Limited (SIEL) and Samsung India Software Operations Private Limited (now known as Samsung R&D Institute India Bangalore Private Limited) (Samsung R&D).

During the relevant year, a survey was conducted, wherein it was found that SIEL was manufacturing the items under the technical assistance of the taxpayer for which the taxpayer used to receive FTS. The Assessing Officer (AO) observed that the Indian company's office was being used as place of management for South Asia operations by the parent company and therefore, the Indian company would constitute PE

of the foreign parent company under Article 5(2)(a) of the India-Korea tax treaty and a part of income from sales in South Asian countries such as Bangladesh, Nepal, Bhutan, and Maldives should be attributed to Samsung Electronics, Korea.

The AO held that the Indian company was acting as a dependent agent of the foreign company in terms of Article 5(5) of the India-Korea tax treaty, and the transactions between the two were not at arm's length. The AO held that expatriate employees create a PE of the taxpayer in India by rendering services to SIEL through its employees basis, and added an estimated income of 10 per cent on the remuneration paid to such expatriate employees during the years under consideration to determine the profits attributable to tax in India by applying Rule 10(iii) of the Income-tax Rules, 1962 (the Rules).

The Delhi Tribunal held that the services provided by the seconded employees of a foreign company to its subsidiary in India do not result in PE in India. The Tribunal held that the expatriate employees are only discharging functions of subsidiary towards the holding company for the benefit of the business of the subsidiary. It is to make the Global Business Management (GBM) understand the priorities and preferences of the Indian customers by providing India specific information to GBM which in turn then carry out research and development to develop India-specific products.

In the absence of proof as to any management activity of the taxpayer being conducted in India or it is established that the decisions relating to the products to be manufactured, pricing in the domestic markets, or the decisions relating to the launch of such products in India is taken by the taxpayer, the Delhi Tribunal observed that it is difficult to agree with the lower authorities that the taxpayer has been conducting the business in India through the expatriate employees. Consequently, the Tribunal held that there is no fixed place PE of the taxpayer constituted through the expatriated employees.

The Delhi Tribunal also held that, except stating that 10 per cent of the remuneration of these employees has to be assumed as the income of the taxpayer, there is absolutely no evidence that is placed on record by the AO to show that the taxpayer derived any business income in India by way of business through these expatriate and seconded employees. The Delhi Tribunal held that as there is no business activity that is conducted by the taxpayer through the expatriate employees, the question of estimated income does not arise.

Samsung Electronics Company Ltd v. DCIT [2018-TII-91-ITAT-DEL-INTL]

For further details, please refer to our Flash News dated 3 April 2018 available at this [link](#)

Indian company, having franchise rights from foreign company, does not constitute agency PE of such foreign company in India under the India-U.S. tax treaty

The taxpayer, being a tax resident of the United States of America (USA), filed its return of income for Assessment Year 2012-13 declaring total income of INR16.53 million. The taxpayer entered into Master Franchises Agreement (MFA) with Jubilant Food Works Limited (Jubilant) for the franchise of Domino's Pizza Store. The said MFA provide certain store/consultancy services to Jubilant.

In terms of the agreement, Jubilant paid store opening fees for those services. The franchise fee is received by the taxpayer from Jubilant for ongoing use of Dominos trademark and also for the right to use the new technology, new product development and system improvement. As per MFA, the taxpayer is entitled to charge 3 per cent of the sales of store of Jubilant and further 3 per cent on sale of their sub-franchise store.

The taxpayer claimed that Jubilant has complete independence with regard to its business dealing and transaction and does not act on behalf of the taxpayer or under its instruction. The taxpayer has offered the income received from Jubilant in the nature of royalty taxable at 10 per cent under the tax treaty. The taxpayer has also offered the income from franchise fee and consultancy services provided to Jubilant for opening of store.

The AO held that Jubilant is totally dependent upon the taxpayer. The taxpayer has exclusive franchise right in India. Jubilant is not allowed any other activities other than activities prescribed in the agreement. Further, the quality of material and equipment used has to be approved by the taxpayer. The expenses on advertisement and marketing are also carried out in accordance with the provision of agreement. On the basis of above observation, the AO held that Jubilant does not have economic independence and its modus-operandi is not on principal to principal basis. Therefore, Jubilant is dependent agent for the purpose of determining a PE. The AO treated the receipt from operations in India as a business receipt taxable at 40 per cent.

The Delhi Tribunal observed that the Sub-Franchise Agreement (SFA) is executed between Jubilant and sub-franchise and not between the taxpayer and sub-franchise. The Delhi Tribunal on perusal of these facts from the copy of MFA and SFA observed that the assertion of taxpayer is correct.

The Delhi Tribunal further observed that the SFA is signed on behalf of Jubilant and Travel Food Services Pvt. Ltd. for Mumbai and Delhi location. The profit and loss from the business belongs to Jubilant or sub-franchise. It has been observed that certain clauses and the agreement entitles the taxpayer to examine the accounts, approve suppliers and allowing control over advertisement, however, the Jubilant or sub-franchise are not storing any goods on behalf of the taxpayer. From the sub-franchise, the taxpayer is entitled to only royalty and store opening fees.

On a perusal of Article 5 of the India-U.S. tax treaty it has been observed that none of the conditions prescribed under clause (a) to clause (l) of Article 5(2) are attracted. The AO has relied upon Article 5(4) of the India-U.S. tax treaty. However, the Indian company has no authority to maintain in India its stock or goods or merchandise on behalf of the taxpayer. No activities are carried out by the Indian company on behalf of the taxpayer. Therefore, it does not constitute PE in India.

DCIT v. Domino's Pizza International Franchising Inc. [2018] 171 ITD 321 (Mum)

For further details, please refer to our Flash News dated 25 May 2018 available at this [link](#)

Payments received by a foreign company for global reservation/other services are chargeable to tax in India under the Income-tax Act as well as under the India-Luxembourg tax treaty

The applicant is a company within the FRHI Group incorporated under the laws of and Duchy of Luxembourg. The applicant is the principal operator company of the FRHI Group outside of North America and provides services in connection with hotel management and including all services that are necessary for hotel operation, such as establishing hotel standards & policies, sales and marketing, centralised reservations, purchasing and certain other services as per the operational requirements of the hotel owners to meet the hotel brand requirements.

Bengal Ambuja Housing Development Limited (BAHDL) engaged the applicant to provide certain services in different phases of hotel development and operation so that the hotel property, i.e., Swissotel Kolkata can be developed and operated as per international standards. For the aforesaid purpose, the applicant and BAHDL entered into a centralised services agreement under which the applicant agreed to provide the specified services which are referred to as Global Reservation Services (GRS).

AAR ruling:

On a perusal of the terms of the agreement, it emerges that the different agreements are a part of the wholesome arrangement. The applicant has performed different functions in regard to the operation and management of the hotel in each of these agreements. These agreements contain references to each other at several places and are co-terminus with each other as well.

There is no doubt that the Indian hotel, Swissotel Kolkata is a fixed place. Upon a careful analysis of the terms of the various agreements, it was observed that the hotel is entirely at the disposal of the applicant. At the very stage of inception, i.e., the construction of the hotel, the applicant is called upon to oversee the design and construction of the property to ensure that it is compliant with the brand standards of the applicant. Once the hotel is constructed, its operation and management rest with the applicant.

Some of the core functions of the operation of the hotel such as sales and marketing, reservation, etc. have also been outsourced to the applicant. For providing such services, the hotel has undertaken to cooperate with the applicant to arrange for visas, licenses, authorisations for the applicant, its consultants, and employees, etc. to carry out such services at the hotel premises.

The applicant has, in substance, taken over all the important functions in relation to the operation and management of the Indian hotel. It is referred to as 'Operator' in the Hotel Management agreement, as 'Advisor' in the Centralized Services agreement and Hotel Advisory agreement, 'Licensor' in the Hotel License agreement and 'Consultant' in Technical Services agreement.

The fact is that irrespective of its different nomenclature in different agreements, the applicant is engaged in the complete management of its business operations in India. Therefore, the Indian hotel, Swissotel Kolkata, satisfies all the three tests and does constitute a fixed place PE of the applicant with respect to these incomes. The applicant is carrying on its entire business operations from this fixed place. The

existence of a PE of the applicant in India gets established within the meaning of Article 7 of the India-Luxembourg tax treaty.

The final decision in respect of all of the important functions relating to the operation and management of the hotel is in the hands of the applicant. The arrangements of this kind can only exist in a principal to principal agreement. The Principal-agent relationship is completely non-existent in the facts of the case.

It was thus held that the payments received by the applicant from the Indian hotel for provision of GRS is chargeable to tax in India under Section 9(1)(i) of the Act as well as under Articles 5 and 7 of the India-Luxembourg tax treaty as business income. Further, it is attributable to the applicant's PE in India since the applicant is carrying on the entire business operations from the fixed place in India.

FRS Hotel Group (LUX) S.A.R.L. [2018] 404 ITR 676 (AAR)

For further details, please refer to our Flash News dated 6 June 2018 available at this [link](#)

The majority members of the special bench of the Delhi Tribunal hold that foreign telecom company does not have a PE in India. However, dissenting view by the third member

The taxpayer, a company incorporated in Finland, was engaged in the manufacturing of advanced telecommunication systems and equipment (GSM Equipment) which were used in fixed and mobile phone networks. These GSM equipment was also used in trading of telecommunication of hardware and software.

During the year 1994, the taxpayer had established a Liaison Office (LO). Subsequently, on 23 May 1995, a wholly owned subsidiary was incorporated. During the period when LO was in operation, the GSM equipment manufactured in Finland were sold to Indian telecommunication operators from outside India on principle to principle basis under independent buyer-seller arrangements as well certain contracts for installation was also entered into.

Subsequent to the incorporation of subsidiary in May 1995, the installation activities were carried out by the Indian subsidiary under its independent contracts with the Indian telecommunication operators. Various contracts were entered into by the taxpayer through which the installation activities were performed by the Indian subsidiary under separate agreement entered into between Indian subsidiary and the Indian cellular operators.

In so far as supply/contracts of equipment entered into with two contractors, the same were signed prior to incorporation of Indian subsidiary in 1995. The installation activities qua these contracts earlier form part of the original equipment supply contract but later on were subsequently assigned to the subsidiary.

For the offshore supply of equipment, the taxpayer did not file return of income in India for Assessment Years 1997-98. The taxpayer claimed that it does not have a PE in India, and therefore, income was not taxable in India. Further, it does not have any business connection in India as it had supplied goods to Indian telecom operators on principle to principle basis, no income could be taxed in India.

The Delhi Tribunal dealt with issues with respect to PE, business connection and profit attribution. The majority (two) members of the Special Bench of the Delhi Tribunal held that Indian subsidiary of the taxpayer does not constitute a fixed place PE under the India-Finland tax treaty since place of business is not at the disposal of the taxpayer. Activities of the taxpayer in India were purely pertaining to network planning, negotiation and signing of contracts before offshore supply of equipment and sale of goods. Further, the taxpayer does not have agency PE in India under the India-Finland tax treaty since the Indian subsidiary company had not negotiated or concluded any contract of supply of equipment on behalf of the taxpayer.

When installation activity was not carried out by the taxpayer in India and was carried on by Indian subsidiary on principal to principal basis with the customers, there was no question of examining the installation activity for purpose of PE. Thus, provision of Article 5(7) of the India-Finland tax treaty will also not apply.

Further, the taxpayer does not have 'business connection' in India under the Act since the title of the goods was transferred outside India and the payments were received by the taxpayer outside India.

The concept of 'virtual projection' has to be seen in the context of any of the ingredient of PE enshrined in Article 5 of the India-Finland tax treaty. The concept of virtual projection does not mean that even without a

fixed place, virtual projection itself will lead to an inference of a PE. If on a facts there was no establishment of a fixed place and disposal test was not satisfied, then virtual projection itself cannot be held to be a factor for creation of a PE.

However, third member of the Special Bench of the Delhi Tribunal held that the taxpayer was having a 'business connection' in India by way of its Indian subsidiary which was acting for the furtherance of the business interests of the taxpayer in India. The Indian company was a proxy/virtual projection of foreign parent company. The Indian subsidiary of the taxpayer constitutes a fixed place PE under the India-Finland tax treaty. Therefore, 35 per cent of global profit on sales can be reasonably attributed to the PE in India.

Nokia Networks OY v. JCIT [2018] 65 ITR(T) 23 (Del)

For further details, please refer to our Flash News dated 13 June 2018 available at this [link](#)

Indian subsidiary does not constitute a PE of a foreign company in India under the India-Saudi Arabia tax treaty

The applicant is a tax resident of Saudi Arabia and a fully integrated global petroleum and chemical enterprise. It is the world's largest crude oil exporter producing one in every eight barrels of world's oil supply. Presently, the applicant is making offshore crude oil sales to Indian refineries from outside India and payment is received by the applicant in a designated bank account outside India. It does not have any office in India.

To expand its India operations and for having a long-term presence, the applicant has established a subsidiary (Aramco India) in India. Though the primary object of the subsidiary is to provide procurement support services, it would also create awareness about Aramco and Saudi Arabian crude oil amongst crude buyers and refineries in India. Aramco India provides certain support services in furtherance of the sales operations. Aramco India will be helping in strategic sourcing and registration of major Indian oil and gas equipment manufacturers and engineering procurement and construction contractors, performing engineering and inspection evaluations, and plant audits for identified manufacturers and suppliers.

With regard to the negotiation of the material terms or conclusion of contracts with Indian customers as well as the signing of such contracts for and on behalf of the applicant, such activities will only be carried out by applicant's own employees based in Saudi Arabia. Aramco India started operations in India during Financial Year 2016-17, and in pursuance of the 'Service Agreement' dated 1 August 2016, it renders procurement, sourcing and logistic support and quality inspection support services to the applicant and other affiliates.

The AAR held that the Indian subsidiary of the applicant does not constitute a fixed place PE in India under Article 5(1) of India-Saudi Arabia tax treaty since the applicant is not carrying on its main business from the premises of its subsidiary and the fixed place is not available to the foreign company at its disposal. The foreign company's services are in the nature of support services. Further, the activities of the Indian subsidiary are duly compensated on an arm's length basis in accordance with the transfer pricing regulations.

Since none of the services are rendered by an employee of the applicant to its customers in India, the applicant does not have a service PE in India. Further, the Indian subsidiary of the applicant does not constitute an agency PE in India since the Indian company does not have the authority of a binding nature to conclude contracts which are specifically prohibited by the service agreement. The AAR held that exclusions provided under Article 5(4) of the India-Saudi Arabia tax treaty are applicable only if the applicant has a PE within the meaning of Articles 5(1) to 5(3) of the India-Saudi Arabia tax treaty.

Saudi Arabian Oil Company [2018] 405 ITR 83 (AAR)

For further details, please refer to our Flash News dated 20 June 2018 available at this [link](#)

Global payment solution provider company has a permanent establishment in India

The applicant belongs to the MasterCard Incorporated group of companies. The applicant is the regional headquarter for the Asia Pacific, Middle East and Africa (APMEA) region and carries out the MasterCard group's principal business of transaction processing and payment related services under a family of products including 'MasterCard', 'Maestro' and 'Cirrus' in the APMEA region.

Pursuant to Master License Agreements (MLA), the applicant provided services to APMEA customers (Banks, Financial Institutions, etc.). In terms of MLA, the applicant charges its customers' transaction processing fees relating to authorisation, clearing and settlement of transactions. The applicant also receives assessment fees for building and maintaining a processing network that serves the needs of

customers globally, for setting up and maintaining a set of rules that govern the authorisation, clearing and settlement process for every payment transaction. Additionally, it receives miscellaneous revenue for the provision of services which are ancillary to the transaction processing activities.

The processing of electronic payment transactions involves steps such as initial level verification and validation of the transaction, authorisation, and thereafter clearing and settlement. Till December 2014, MasterCard International Incorporated (MCI) had a LO in India. Thereafter, the applicant had shut down the LO and had transferred that work to the Indian subsidiary [MasterCard India Services Private Limited (MISPL)]. The customer is provided with a MIP that connects to MasterCard's Network and processing centers. The applicant has a subsidiary in India and Indian subsidiary owns and maintains the MIPs placed at the customers' locations in India.

In view of the above facts, the applicant filed an application before the AAR to determine the taxability of the services rendered in this regard.

The AAR while dealing with an issue whether the global payment solution provider company facilitating various stakeholders worldwide to use electronic forms of payment has a PE in India and whether payments for such services are taxable in India, held as follows:

The applicant has MasterCard Interface Processor (MIP) and MasterCard's Network to provide transaction processing services to its customers in India. This constitutes a fixed place PE in India under the India-Singapore tax treaty as the applicant is carrying out its business of facilitation of authorisation of the transaction through such MIPs and network which are situated in India and are at the disposal of the applicant. The AAR also held constitution of service PE on account of applicant's employees visiting India and constitution of Dependent agent PE on account of Indian subsidiary securing orders for the applicant.

Prior to December 2014, MCI had accepted its PE in India under MAP and attributed 100 per cent of income from transaction processing activity in India to such PE. However, after December 2014, with all operations remaining same, the TP report mentioned that the Indian subsidiary was undertaking only support functions and not actual transaction processing, which MCI was doing earlier. Thus, it was observed that there are some functions and risk related to transaction processing which were earlier carried out by MCI in India and are still carried out by Indian subsidiary but not shown in the Functions, Assets, and Risk (FAR) of the Indian subsidiary. Therefore, the AAR held that the subsidiary company creates a PE of the applicant in India.

A portion of the fees received by the applicant has also held to be categorised as royalty under the India-Singapore tax treaty. Further, AAR also clarified that as the payment is effectively connected with the PE in India, it would be taxable as business income under the India-Singapore tax treaty and not as royalty.

The AAR held that the relation between final consumer and the applicant is of use of a standard facility and hence, transaction processing service rendered by the applicant cannot be taxed as FTS under the India-Singapore tax treaty. With respect to services other than transaction processing services, they are in the nature of warning bulletin fees for listing invalid or fraudulent accounts either electronically or in paper form, cardholder service fees, program management services, account and transaction enhancement services, holograms and publication fees and advisory services, etc. AAR observed that these services are not standard facility and these specific services are required to be rendered to a specific customer who has requested for such services. Hence, these are technical services. However, they do not 'make available' technical knowledge, experience, skill, know-how to the service recipient. Hence, they cannot be classified as FTS under Article 12 of the India-Singapore tax treaty.

With regard to the attribution of income to the Indian PE, the AAR agreed that all the revenues received by the applicant from customers in India would not be attributed to the Indian PE since significant activities are also carried out by the applicant outside India. Thus, there is a need for attribution which is required to be done by the AO. On such attribution of income to the PE, the tax is required to be withheld at full applicable rate at which the non-resident is subjected to tax in India.

MasterCard Asia Pacific Pte. Ltd [2018] 406 ITR 43 (AAR)

For further details, please refer to our Flash News dated 17 July 2018 available at this [link](#)

The taxpayer does not constitute Installation PE in India under the India-Cyprus tax treaty

The taxpayer is a Cyprus based company which was awarded contract by another foreign entity Allseas Marine Contractors S.A, (AMC) for placement of rock in seabed for laying of gas pipelines and providing umbilical for sub structures in oil and gas field developed at Krishna Godavari Basin.

AMC was awarded a contract from the Reliance group and Niko Resources for extraction of gas and for laying of gas pipeline. In order to carry out its contract work AMC has given a contract to the taxpayer for the placement of rock in the oil and gas field.

Under the terms of the contract, the work was intended to commence from 4 January 2008 which has been mentioned as 'effective date' in the contract. Under the said contract itself, the completion of the work was reckoned from the date issuance of completion certificate by AMC which was 30 September 2008.

The contract lasted for less than 12 months which is the threshold period for the establishment of PE in India in terms of installation PE under Article 5(2)(g) of the India-Cyprus tax treaty. Therefore, it was claimed by the taxpayer that no income earned from such contract can be attributed or taxed in India.

The Delhi Tribunal held that the taxpayer does not constitute Installation PE under Article 5(2)(g) of the India-Cyprus tax treaty since threshold period of 12 months have not exceeded. The Delhi Tribunal observed that preparatory work for tendering purpose before entering into contract cannot be counted while calculating the threshold period.

Accordingly, no income of the taxpayer on the contract executed by the taxpayer in India is taxable in terms of Article 7 of the India-Cyprus tax treaty.

Bellsea Ltd v. ADIT [ITA No 5759/Del/2011] – Taxsutra.com

For further details, please refer to our Flash News dated 6 August 2018 available at this [link](#)

Royalty and fees for technical services

Fees received for domain name registration are taxable as royalty under Section 9(1)(vi) of the Income-tax Act

The taxpayer is a Limited Liability Company (LLC) located in the U.S. It is engaged in the business as accredited domain name registrar authorised by Internet Corporation for Assigned Names and Numbers (ICANN). The taxpayer is a registrar of the customers who need these services and provide the services to its customers. ICANN is the central organisation who appoints a registrar like the taxpayer and charges fee under a fixed predetermined formula.

As per the agreement between the taxpayer and ICANN, the taxpayer has the right to register, assign, transfer and manage specific domain names. The clients all over the world apply for services as per proforma given by the taxpayer and pay fees for the same. One part of the fees is allegedly received by the taxpayer for web-hosting which is being offered for tax as royalty and the other part is taken for domain name registration. During the Assessment Year 2013-14, the taxpayer received income from domain registration fees which was claimed to be not taxable in India.

The Delhi Tribunal, while relying on the decisions of the Supreme Court and other High Courts¹, held that the rendering of services for domain registration is rendering of services in connection with the use of an intangible property which is similar to trademark. Therefore, the charges received by the taxpayer for services rendered in respect of domain name is royalty within the meaning of Section 9 (1)(vi) read with Clause (iii) of Explanation 2 of the Act.

Godaddy.com LLC v. ACIT [2018] 170 ITD 217 (Del)

For further details, please refer to our Flash News dated 10 April 2018 available at this [link](#)

Payment for marketing and distribution rights of Google Adwords Program is taxable as royalty

The taxpayer is a wholly-owned subsidiary of Google International LLC, U.S. (Google U.S.). The taxpayer is engaged in the business of providing Information Technology (IT) and Information Technology enabled Services (ITES) to its group companies. It also acts as a distributor for Adwords Program in India.

¹ Satyam Infoway Ltd. v. Sifynet Solutions Pvt Ltd [2004] Supp (2) SCR 465 (SC), Tata Sons Limited v. Mr. Manu Kishori & Ors. 90 (2001) DLT 659 (Del), Rediff Communications Ltd AIR 2000 Bombay 27

On 1 April 2004, the taxpayer entered into a service agreement with Google U.S. to render software development services. The taxpayer's R&D units located at different locations in India provide IT services including application development, maintenance and testing services. Similarly, the taxpayer entered into a service agreement with Google Ireland Limited (GIL) to render IT-enabled services. Its service centres at two different locations in India provide ITES service relating to the administration of advertisements in accordance with the guidelines provided by GIL and provide customer support services.

Under the Google Adwords Program Distribution Agreement dated 12 December 2005 entered into between the taxpayer and GIL, the taxpayer was appointed as a non-exclusive authorised distributor of Adwords Program to the advertisers in India. Subsequently, the taxpayer entered into a Google Reseller Agreement on 1 July 2012, pursuant to which the earlier agreement dated 12 December 2005 was terminated and the taxpayer was appointed as non-exclusive, authorised reseller of online advertising space to advertisers in India under the Google Adwords Program.

Under the Adwords Program distribution agreement, the taxpayer acquired the marketing and distribution rights of Adwords program for the territory of India from GIL. The taxpayer is remunerated on cost plus market basis for the distribution services under Adwords Program.

During the Financial Year 2012-13, the taxpayer has made payments to GIL for marketing and distribution rights of Adwords Program without deduction of tax at source. The taxpayer claimed that the amount paid to GIL was not in the nature of royalty under the provisions of the India-Ireland tax treaty.

Bangalore Tribunal's decision

Taxability of Adwords Program

The amended and restated Google Adwords Program distribution agreement was executed on 12 December 2005 between the taxpayer and GIL through which the taxpayer was appointed as Adwords Program distributor. This distributor agreement was further renewed under different title of agreement i.e., Google Reseller agreement on 1 July 2012. Though nomenclature of agreement was changed, but the functions and obligations of the taxpayer almost remain the same.

The obligations cast upon the taxpayer under the Google Adwords distribution agreement can only be discharged with the help of the ITES division. Therefore, the Google Adwords distributor agreement and the service agreement are to be read together as they are interconnected and without resorting to the service agreement the terms and conditions under the Google Adwords Distribution Agreement cannot be complied with. Therefore, in order to understand the function of Google Adwords Program, both the agreements are to be read together.

Under the service agreement, ownership of intellectual property, confidential information, software technologies, and documentation shall remain the exclusive property of the GIL but the taxpayer was allowed under the licence to use it in order to fulfil the obligations cast upon it under the Adwords distributor agreement.

On perusal of the Adwords distribution agreement and the service agreement, it has been observed that the taxpayer has not only purchased the advertisement space from the GIL and resold it to the advertisers against certain advertisement charges but the taxpayer was required to provide on sale and post-sale technical services to the advertiser and the GIL, which are not possible without resorting the service agreement. In fact, the taxpayer obtained the advertisement space under the Adwords distribution agreement and resell it to different advertisers along with on sale and after sale services.

With the aid of ITES division, the taxpayer is required to execute the programs and also provide all technical support to the advertisers and GIL. As per the agreement with the advertisers, the advertisers are required to approach only the taxpayer and not the GIL. The taxpayer is in fact required to sort out all glitches to be faced by the advertisers while putting the ads on the Adwords Program. Having examined functioning of the taxpayer, the literatures in the form of book, it has been observed that Google Adwords Program is a complex program.

While discharging its obligation under the Google Adwords Program and service agreement, the taxpayer has an access to the trade marks, IPRs, derivative works, brand features and the confidential information of the GIL. Therefore, it cannot be called that whatever payments were made by the taxpayer to GIL was simpliciter a payment towards the purchase of Adwords space from the GIL for its resale to advertisers.

Therefore the payments of advertisement fees made by the taxpayer after retaining a particular part is royalty in the light of definition of royalty given under Section 9(1)(vi) of the Act and the tax treaty. Accordingly, it has been held that the payment made by the taxpayer to GIL is a payment of royalty and as per provisions of Section 9(1)(vi) of the Act, it is an income deemed to accrue or arise in India.

Equalisation levy

The Legislature has introduced the equalisation levy at 6 per cent vide Finance Act, 2016 to tax the considerations paid by resident to a non-resident who is not having a PE in India. No doubt, it may be business profit in the hands of the recipient and the Legislature intend to tax the business profit as it has arisen out of the activities performed in India. However, it does not affect other kind of services in which technology, the know-how, copyrights or IPRs are involved.

The equalisation levy is to be charged only on consideration for specified services and not others where there is use of IPR, copyright and other intangibles. In the present case, under Adwords distribution and service agreement, the taxpayer has acquired licence to use IPRs, copyright and other intangibles to provide better services either to GIL or to advertisers. Therefore, the introduction of equalisation levy would not convert the nature of payment made by the taxpayer to GIL.

Beneficial ownership

Since there are four layers of holdings of the Adwords Program, it is not clear how much right in license were conferred to different holdings and how the revenue collected on Adwords Program is to be distributed amongst the above holdings.

On perusal of operating license agreement executed between Google Netherlands Holdings BV (GNHBV) and GIL, it has been observed that GIL has acquired certain right to use certain proprietary technology as well as certain trademark and intangible. Through this license agreement, the license to use, license trademarks, license technology, license improvements was given by GNHBV to GIL.

It is also clear from a reading of various clauses that the licensee i.e., GIL is not the legal owner of the license trademarks and the license technology which include Adwords Program and GIL has only acquired certain rights in intangibles from GNHBV.

Though there is a clause for license fee statement, it is not clear as to how much license fees is to be paid by GIL to GNHBV on account of sub-license of Adwords` Program. Revenue generated on account of sale of Adwords space to different advertisers is to be distributed amongst all the holdings as they have some beneficial interests therein.

In the present case, the taxpayer has not filed license agreements executed between Google Inc. U.S. and Google Ireland Holdings (GIH) and GNHBV. Only one license agreement between GNHBV and GIL was filed and from its careful perusal, it has been observed that out of the rights acquired in the Adwords program and intangibles, Google Netherlands has sub-licensed certain rights to GIL for Adwords Program. On the basis of that license, GIL executed Adwords distributor agreement with the taxpayer for selling the Adwords space to advertisers.

Since other parent holdings of GIL were involved in the Adwords Programs directly or indirectly, they have a right to share the revenue generated under the Adwords distributor agreement. Though the onus was cast upon the taxpayer to place the relevant evidence in order to establish that GIL is the beneficial owner of the royalty received, but it could not place any evidence on record in this regard, except the oral submissions.

From a reading of the agreement, it is not clear as to how much revenue is shared by different holdings. In the absence of the relevant evidence either in the form of agreement executed between the various holding companies or otherwise, it is not clear as to whether GIL has full control over the receipt received under Google Adwords Program or GIL was acting as a conduit of its parent holdings.

The Bangalore Tribunal held that this aspect requires a fresh look by the AO in the light of all the relevant evidences. Accordingly, the matter is restored to the file of AO after setting aside the order of the Commissioner of Income-tax (Appeals) [CIT(A)] in this regard in all these appeals to re-adjudicate the

issue of beneficial ownership in the light of the license agreements executed between the parent holdings of GIL.

Google India (P.) Ltd. v. JDIT [2018] 194 TTJ 385 (Bang)

For further details, please refer to our Flash News dated 23 May 2018 available at this [link](#)

Amount received for providing training services and access to Centralised Reservation System is not chargeable as Fees for Technical Services under the India-Netherlands tax treaty

The taxpayer is a tax resident of Netherland and is a part of the Marriott group. The taxpayer is engaged in conducting training programs and providing access to various computer systems, viz. Centralized Reservation System (CRS), property management systems and other systems to Marriott chain of hotels across the world.

During the course of the assessment proceedings, it was observed by the AO that the taxpayer had entered into a Training and Computer Systems Agreements (TCSA) with Viceroy Hotels Ltd., Hyderabad and Chalet Hotels Ltd., Mumbai (Indian hotels) for conducting training programs of their employees and also other services. The taxpayer during the year under consideration, was in receipt of consideration for the services rendered to the Indian hotels.

The Mumbai Tribunal held that consideration received by the taxpayer for providing training services is for the managerial/leadership training provided to the employees of the Indian Hotels and is not chargeable as FTS under the India-Netherlands tax treaty.

Access to CRS, property management services and other systems were common facilities provided to the members of the entire group across the world by the taxpayer and were not tailor made services to suit the specific requirements of the taxpayer and the said facilities could not be construed as technical services. Therefore, such services are also not chargeable as FTS under the India-Netherlands tax treaty.

The taxpayer had not granted any right of enjoyment of the brand to the Indian Hotels and thus the receipt of fees for providing various services are not taxable as royalty under Article 12(4) of the India-Netherlands tax treaty.

Renaissance Services BV v. DDIT [2018] 171 ITD 381 (Mum)

For further details, please refer to our Flash News dated 15 June 2018 available at this [link](#)

Base erosion and profit shifting

OECD interim report on the tax challenges arising from digitalisation pursuant to BEPS Action Plan 1

The 2015 Base Erosion and Profit Shifting (BEPS) Action Report 1, *Addressing the Tax Challenges of the Digital Economy*, was released in October 2015 as part of the BEPS package. The full BEPS package was endorsed by the G20 Leaders in November 2015, with more than 110 countries and jurisdictions having committed to its implementation as members of the Inclusive Framework on BEPS, which was established in June 2016.

Action Plan 1 of the BEPS Project undertook to consider the tax challenges raised by digitalisation for both direct and indirect taxation. To carry out this work, the Task Force on the Digital Economy (TFDE) was established as a subsidiary body of the Committee on Fiscal Affairs with the participation of more than 45 countries including all Organisation for Economic Cooperation and Development (OECD) and G20 members. In preparing the 2015 BEPS Action Plan 1 Report, the TFDE drew from previous work on this topic, including the 1998 Ottawa report on *Electronic Commerce: Taxation Framework Conditions*, as well as the work of the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits.

The 2015 Action Plan 1 Report also identified a number of broader tax challenges raised by digitalisation, notably in relation to nexus, data and characterisation. These challenges go beyond BEPS and chiefly relate to the question of how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries. The 2015 Action Plan 1 Report also recognised that in the area of indirect taxation, new challenges arose in particular with respect to the collection of Value Added Tax/Goods and Services Tax (VAT/GST) on the continuously growing volumes of goods and services that are purchased online by private consumers from foreign suppliers.

To address these indirect tax concerns, it was recommended that countries implement the OECD's International VAT/GST Guidelines, and in particular the destination principle for determining the place of

taxation of cross-border supplies, and consider implementing the mechanisms for the effective collection of VAT/GST presented in the Guidelines. The 2015 Action 1 Report also identified a number of possible approaches for a more effective VAT/GST collection on the significantly growing volume of imports of low value goods from online sales.

To tackle the broader direct tax issues raised by digitalisation, the TFDE analysed three options, namely (i) a new nexus rule in the form of a Significant Economic Presence test, (ii) a withholding tax which could be applied to certain types of digital transactions, and (iii) an equalisation levy, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction. Though, none of these options were ultimately recommended in the 2015 Action Plan 1 Report, however it was concluded that countries could introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. It was agreed to continue to monitor developments in respect of the digital economy, with a further report to be delivered by 2020.

With the establishment of the Inclusive Framework in June 2016, a further mandate of the TFDE was agreed in January 2017, including for the delivery of an interim report by the end of 2018 and a final report in 2020. In March 2017, the G20 called on the TFDE to deliver an interim report by the 2018 IMF/World Bank Spring Meetings, which was also reiterated by the G20 Leaders at their July 2017 Hamburg Summit.

With this timeframe in mind, the TFDE resumed its work, including the monitoring of developments in digital technology and business models, the individual measures taken by countries to address the broader tax challenges raised by digitalisation, and the extent of implementation and impact of the relevant Actions from the BEPS package. On 16 March, 2018, the OECD released an interim report - Tax Challenges Arising from Digitalisation – Interim Report 2018

Tax Challenges Arising from Digitalisation – Interim Report 2018 www.oecd.org

For further details, please refer to our Flash News dated 23 March 2018 available at this [link](#)

Place of effective management

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

The Finance Act, 2015 amended the provisions dealing with the residential status of a company under Section 6(3) of the Act. It provides that a company would be resident in India in any previous year if it is an Indian company or its Place of Effective Management (POEM) in that year is in India. In the context of the implementation of POEM based residence rule, certain issues relating to the applicability of current provisions of the Act to a company which is incorporated outside India and has not earlier been assessed to tax in India have arisen. In particular, the issues are related to applicability of specific provisions of the Act like advance tax payment, Tax Deduction at Source (TDS) provisions, computation of total income, set off of losses and manner of application of transfer pricing provisions. In order to provide clarity in respect of the implementation of POEM based rule of residence and also to address concerns of the stakeholders, provisions of Section 115JH of the Act have been introduced with effect from Assessment Year 2017-18.

Section 115JH of the Act, inter alia, provides that the central government may notify exception, modification and adaptation subject to which, provisions of the Act relating to computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply.

In 2017, the Central Board of Direct Taxes (CBDT) issued draft notification providing such exception, modification and adaptation for application of provisions of the Act. Recently, CBDT has issued final notification dealing with special transitional provisions for a foreign company said to be a resident in India on account of POEM. The notification deemed to come into force from 1 April 2017.

CBDT Notification No. 29/2018, dated 22 June 2018

For further details, please refer to our Flash News dated 28 June 2018 available at this [link](#)

MFN Clause

Benefits under MFN clause under the India-Israel tax treaty are automatic and it does not require anything more than subsequent favourable tax treaty coming into force

The taxpayer is a large pharmaceutical company. During the assessment years under consideration, the taxpayer made payments to an Israel based entity on account of Active Pharmaceutical Ingredient and formulation services.

The taxpayer claimed that the payments were not in the nature of FTS under the India-Israel tax treaty. It was claimed that FTS article was to be read along with the MFN clause provided in the Protocol to the India-Israel tax treaty. India-Israel tax treaty along with the protocol was signed on 29 January 1996, and subsequent to the said date, India-Portugal tax treaty was notified which contains a 'make available' clause. Therefore, the 'make available' clause provided in India-Portuguese tax treaty, must be read into the India-Israel tax treaty.

The Ahmedabad Tribunal observed that MFN clause contained in the Protocol to the India-Israel tax treaty is applicable prospectively. The MFN clause provided in the Protocol to India-Israel tax treaty does not require anything more than such a more favourable tax treaty coming into force.

The definition of FTS under the India-Portuguese tax treaty covers rendition of only such 'technical or consultancy services' which 'make available' technical knowledge, skills or experience. The Ahmedabad Tribunal referred various decisions² which held the decision in favour of the taxpayer.

The Ahmedabad Tribunal observed that it is an ongoing contract that the taxpayer has entered into with the service provider, and the thrust of the arrangement is essentially for supervisory and consultancy services. These services do not 'make available' technical knowledge, experience, skill, know-how or processes. Therefore, it cannot be treated as FTS by virtue of MFN clause under the India-Israel tax treaty.

DCIT v. Sun Pharmaceutical Laboratories Ltd [2018] 96 taxmann.com 105 (Ahd)

For further details, please refer to our Flash News dated 28 July 2018 available at this [link](#)

If certain benefits/limitations are given in a Protocol then it shall apply to the respective tax treaty because the Protocol is part of the tax treaty

The taxpayer, a Sweden based entity, is engaged in the field of telecommunication and mobile telephony. During the year, the taxpayer, *inter alia*, received fees for rendering certain services.

The AO relied on the AAR ruling in the case of Ericsson Telephone Corporation and held that receipts were taxable as FTS under the India-Sweden tax treaty. Further, the AO invoked the provisions of Section 44D of the Act and held that no deduction should be allowed. The tax rate of 20 per cent under Section 115A of the Act was applied by the AO.

The taxpayer relied on the Protocol to the India-Sweden tax treaty. As per the MFN clause in the Protocol, if India had entered into a tax treaty with a third country which is a member of OECD, where it had limited its taxation rights in terms of rate or scope, which are more beneficial than that provided in the India-Sweden tax treaty, then such lower rate or scope shall apply in preference to the rate or scope of FTS provided in the India-Sweden tax treaty.

The taxpayer contended that India entered into a tax treaty with Finland, which is a member of the OECD. Article 12 of the India-Finland tax treaty deals with 'Royalties and FTS' which contains the 'make available' clause, which was absent in the India-Sweden tax treaty. When the AAR rendered its Ruling in 1996, the new tax treaty between India and Sweden was not entered into. Subsequently, it was notified on 17 December 1997 and came into effect after the AAR ruling was rendered. However, in the instant case, the Assessment Year under consideration is 2000-01. The taxpayer contended that the Protocol under the tax treaty of 1998 had the effect of changing the complexion of the case.

The Delhi Tribunal observed that the Protocol to the India-Sweden tax treaty is to be considered as part and parcel of the tax treaty. There is no question of resorting to a Protocol only if some clarity is needed in the tax treaty. If a particular benefit is being conferred, expanded or reduced by the Protocol, which is absent in the tax treaty, then the provisions of the Protocol shall apply only to that extent. A Protocol cannot be viewed as a document independent of the tax treaty and has to be considered as its addendum.

Since the new India-Sweden tax treaty and the Protocol have not been considered by the AO who has gone by the ruling rendered by the AAR, the matter was remitted back to the AO for fresh adjudication.

Ericsson Telephone Corporation India AB v. DDIT [2018] 96 taxmann.com 258 (Del)

² DIT v. Guy Carpenter & Co Ltd [2012] 346 ITR 504 (Del), CIT v. De Beers India Pvt Ltd [2012] 346 ITR 467 (Kar)

For further details, please refer to our Flash News dated 19 July 2018 available at this [link](#)

Foreign tax credit

Foreign Tax Credit is allowed in India in proportion to the income arising in the foreign country and the balance is allowed as business expenditure

During the Assessment Year 2010-11, the taxpayer had some receipts from the contract in Singapore and Indonesia. As per the rules of the income tax in those countries, the tax had been deducted on the payment. The taxpayer therefore claimed the deduction on account of taxes paid in those countries from the income tax payable on the income in India.

The AO after examining the provisions of Section 90 of the Act and the relevant clauses of India-Singapore and India-Indonesia tax treaties, allowed only part of the tax paid as against full credit of foreign tax deducted claimed by the taxpayer. For this purpose, he computed proportionate profit on the receipts from these countries and calculated the income which was being taxed again in India. For calculating the Foreign Tax Credit (FTC), the AO calculated the tax payable on that proportionate income and allowed the credit off the proportionate tax out of the FTC.

The Ahmedabad Tribunal held that the amount of tax paid in respect of income arising in a foreign country and subjected to tax both in India and the foreign country shall be allowed as a FTC against Indian tax payable in respect of such profits or income in such manner that the credit should not exceed the Indian tax which is proportionate to the income arising in the other country.

The Ahmedabad Tribunal also held that when FTC is not allowed in India on the taxes paid abroad for carrying out business activity then such taxes should be allowed in the hands of taxpayer as 'business expenditure' under Section 37 of the Act.

Elitecore Technologies Pvt Ltd v. DCIT [2018-TII-121-ITAT-AHM-INTL]

For further details, please refer to our Flash News dated 19 April 2018 available at this [link](#)

Tax residency certificate

Even though the taxpayer has not furnished TRC, the benefit of a tax treaty cannot be denied

During the years under consideration, the taxpayer made payments to the U.S. company for the installation and commissioning services of certain equipment. These payments were made without deduction of tax at source.

The taxpayer contended that the payments made were not taxable in India since the installation and commissioning activities were inextricably linked to the purchase of the equipment and there was neither a transfer of technology nor was the technology being made available under the India-U.S. tax treaty.

The AO held that the U.S. company had a high degree of technical expertise and it had the desired level of expertise in installing and commissioning of a machine owned by the taxpayer and therefore, the services were taxable as Fees for Included Services (FIS) under the India-U.S. tax treaty.

The CIT(A) held that in the absence of a Tax Residency Certificate (TRC) and in view of the specific provisions of Section 90(4) of the Act, the U.S. company cannot be granted tax treaty benefits. The installation and commissioning services cannot be said to be for the purchase of equipment and thus covered by exclusion clause provided under Article 12(5)(a) of the India-US tax treaty.

The Ahmedabad Tribunal held that held that the taxpayer cannot be denied the benefit under the India-U.S. tax treaty on the ground that it has not furnished a TRC. However, the taxpayer has to satisfy the eligibility for the tax treaty benefit. The onus is on the taxpayer to give sufficient and reasonable evidence in support of his residential status so as to satisfy the conditions laid down under Article 4(1) of the India-US tax treaty.

Since the eligibility of U.S. company for tax treaty entitlement in the present case was not established, and therefore, all the arguments of the taxpayer on the scope of various provisions of the tax treaty were irrelevant. Therefore, the taxpayer was asked to submit evidence in support of his residential status so as to satisfy the conditions laid down under Article 4(1) of the India-U.S tax treaty. The AO did not deal with this aspect of the matter at all and simply proceeded to apply the law on the assumption that the U.S. entity was entitled to the benefits of the tax treaty. However, the CIT(A) had taken note of this legal requirement

and asked the taxpayer to produce a TRC under Section 90(4) of the Act which does not dilute the superiority of the tax treaty law over the domestic law.

Accordingly, the matter was remitted to the CIT(A) for fresh adjudication, *inter alia*, on the fundamental aspect of tax treaty entitlement.

Skaps Industries India Pvt Ltd v. ITO [2018] 171 ITD 723 (Ahd)

For further details, please refer to our Flash News dated 27 June 2018 available at this [link](#)

Indirect transfer

Capital gains arising from indirect transfer of shares of an Indian company on sale of shares of German company are not taxable in India

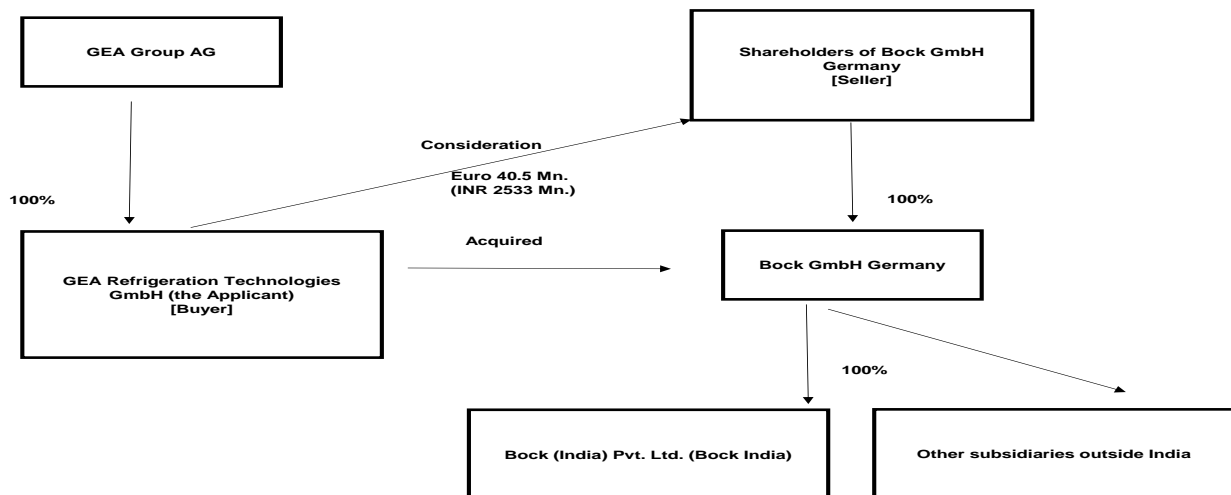
The applicant is a German company engaged in the business of industrial refrigeration. The applicant has extensive experience in the fields of the food and beverage industry, petroleum and gas, etc. The GEA group is one of the largest system providers for food and energy processes, and is a market and technology leader in its business areas.

In order to gain access to wider range of cooling applications and to enhance the know-how with regard to environment friendly solutions, on 31 March 2011, the applicant entered into a Share Purchase Agreement (SPA) to acquire an unrelated German company, Bock Kaltmaschinen GmbH (Bock GmbH) at a purchase price of Euro 40.50 million.

Bock GmbH is a family owned company. The consideration of Euro40.50 million was paid to the shareholders of Bock GmbH (9 nos.), all of whom are residents of Germany. Bock GmbH holds 100 per cent shares in Bock India, and also holds, directly or indirectly, shares in the companies located in various countries³. Bock GmbH also holds, directly or indirectly, majority of the voting rights in a Thailand company, and a minority stake in an Australian company.

Bock India is an operating company with its own manufacturing facilities in India and as a result of the aforementioned transaction, there was an indirect change in the ownership of Bock India due to the acquisition of Bock GmbH by the applicant.

A diagrammatic representation of the said transaction is as under



The AAR held that capital gains arising from indirect transfer of shares of an Indian company on sale of shares of German company shall not be taxable in India under the provisions of Section 9(1)(i) the Act. German company has derived its value substantially from its other companies³ whereas its value of assets in Indian company is a mere 5.40 per cent, far lower than the requirement of 50 per cent. Hence, it fails the test of deriving value substantially from the Indian company.

³ Situated in Germany, China, England, Czech Republic, Singapore, Malaysia, Thailand, Australia, etc.

Since the AAR ruled that the gains arising from the indirect transfer of shares of Bock GmbH are not chargeable to tax in India in view of the provisions of the Act, in view of Section 90(2) of the Act, the applicant would be entitled to take advantage of the provision that was more beneficial to it.

The AAR thus held that since the transfer is effected in Germany, and the payments have also been made in Germany, the gains arising from the alienation of shares by the shareholders of Bock GmbH can be brought to tax only in Germany.

The liability to deduct tax arises only if the sum so paid was chargeable to tax in view of the decision of the Supreme Court in the case of GE Technology Centre P. Ltd.⁴. Respectfully following that decision, it has been held that there is no obligation on an applicant to withhold tax.

GEA Refrigeration Technologies GmbH [2018] 401 ITR 115 (AAR)

For further details, please refer to our Flash News dated 23 January 2018 available at this [link](#)

Capital gains

Issue of fresh equity shares is not a transfer of capital asset and therefore not taxable under the Income-tax Act

The Mumbai Tribunal in the case of Supermax Personal Care Private Limited dealt with the taxability of amount received on account of issue of fresh equity shares. The Mumbai Tribunal held that issue of fresh equity shares is not a transfer of capital asset. It is a capital receipt and therefore not taxable under the Act. The Mumbai Tribunal observed as follows:

- The tax was to be levied on the capital value of certain assets, the capital value being computed in a particular manner. In other words, all assets were not taxed, but only those assets which were either sold, transferred or exchanged.
- It is not the intention of the Legislature to tax the full value of the capital asset as represented by the sale proceeds, but permissible deduction towards the actual cost can be made from the sale proceeds of that capital asset.
- Under Section 45 of the Act, the 'profits or gains arising from the transfer of a capital asset' are taxable, and the charge of income-tax on the capital gains is on the income of the previous year in which the transfer takes place. The only condition in order to attract tax under Section 45 of the Act is that the property transferred must be a capital asset on the date of transfer.
- In the present case, there was no transfer of capital asset to invoke the provisions of Section 45 of the Act. The taxpayer during the year sold some vehicles, and no other asset was sold. If no asset other than vehicles were sold, then the capital gain would not arise with respect to the shares.
- The concept of 'creating of interest in any assets in any manner' and transferring 'interest/stake' was introduced in the year 2013, and it was not part of the word 'transfer' for the year under consideration, and hence it was not applicable. On reference to the Explanation 5 of Section 9 of the Act, it has been observed that the Explanation covers the non-residents and not a resident entity. In the present case, the taxpayer is a resident company.
- The AO held that a multi-layered holding structure was deliberately created to avoid taxes in India and to conceal the information about the ultimate beneficiaries. However, the Tribunal observed that having AEs outside India in itself cannot be held against the taxpayer. Because of advancement of technology, the globe has become a village, and hence, the nature of business has altered. The taxpayers are free to decide the manner in which they want to run their businesses.
- As far as non-cooperation of the taxpayer in providing necessary information is concerned, it has been observed that for not extending cooperation, the taxpayer should be dealt with relevant provisions of the Act. However, for that tax liability cannot be fastened to it without establishing the basic fact of existence and transfer of capital asset.
- Accordingly, the Tribunal held that the money received by the taxpayer for issuing shares has to be treated as capital receipt and cannot be brought to tax.

Supermax Personal Care Private Limited v. ACIT (ITA No. 6107/Mum/2016) – [taxsutra.com](#)

For further details, please refer to our Flash News dated 6 June 2018 available at this [link](#)

The Mumbai Tribunal decision on taxation aspects of conversion of a private limited company into a limited liability partnership

⁴ GE Technology Centre P. Ltd. v. CIT [2010] 327 ITR 456 (SC)

During the year, a private limited company was converted into an LLP (the taxpayer) under the Limited Liability Partnership (LLP) Act, 2008 (LLP Act). The taxpayer claimed that the conversion of a company into an LLP did not involve any transfer of the property, assets, liabilities, etc. The AO observed that the conversion did not satisfy one of the conditions of the exemption provisions under the Act. Accordingly, the conversion resulted into transfer of capital assets and capital gains on the same was liable to tax in the hands of the taxpayer as per the provisions of Section 47A(4) of the Act. Further, the claim of the taxpayer with respect to carry forward losses of the erstwhile company was also rejected. Similarly, the deduction claimed by the taxpayer under Section 80-IA of the Act was also rejected on account of failure to file the 'audit report'.

Mumbai Tribunal's decision

Whether the conversion resulted into 'transfer' of capital assets

Though the transactions referred to in exemption provisions are 'transfers', however, the same are subject to cumulative satisfaction of the conditions contemplated in the respective sub-sections and would fall beyond the sweep of chargeability to income-tax as capital gains. A perusal of the memorandum explaining the purpose and intent behind the enactment of exemption provisions suggests that prior to its insertion, the 'transfer' of assets on conversion of a company into an LLP attracted levy of capital gains tax. The legislature vide the Finance Act, 2010 made Section 47(xiiib) (exemption provisions) available on the statute, with the purpose that the transfer of assets on conversion of a company into an LLP in accordance with the LLP Act, subject to fulfillment of the conditions contemplated therein, shall not be regarded as 'transfer'.

The Mumbai Tribunal observed that the 'transfer' of the property by the company to an LLP under the LLP Act would in itself satisfy the requirement of Transfer of Property Act, 1882 (TOPA). The scope of the term transfer has to be read in the context of the Act and cannot be narrowed down to that defined in TOPA. Therefore, conversion of a company into an LLP which does not satisfy the conditions of exemption was to be treated as 'transfer' of capital assets. Since the taxpayer failed to satisfy the conditions of exemption provisions, the transaction was treated as 'transfer' of capital assets.

Withdrawal of exemption under Section 47A(4) of the Act

Section 47A(4) of the Act dealing with the withdrawal of exemption comes into play only for the purpose of withdrawing an exemption earlier availed by the taxpayer under the exemption provisions of the Act dealing with conversion of company into LLP. In the instant case, the taxpayer failed to satisfy the conditions provided in 'exemption provisions' itself. Thus, the issue in the present case does not relate to withdrawing of an exemption earlier availed by the taxpayer.

Liability of successor LLP

As per Section 170(1)(b) of the Act, a 'successor entity' which continues to carry on the business of the person who has been succeeded shall be liable to be assessed only in respect of the income of the previous year after the date of succession. However, the said liability of a successor entity is subject to an exception carved out in Section 170(2) of the Act. It provides that where the predecessor cannot be found, the assessment of the income of the previous year in which the succession took place up to the date of succession, and of the previous year preceding that year shall be made on the successor in the like manner and to the same extent as it would have been made on the predecessor. Since, on conversion, the company stood dissolved, if there is any capital gains arising to the predecessor company on conversion of company into an LLP, it would be taxable in the hands of the successor LLP i.e. the taxpayer.

Capital gain computation on conversion

The conversion of the assets and liabilities of the erstwhile company to the taxpayer LLP took place as per the LLP Act at the 'book value' itself. The entire undertaking of the erstwhile company got vested into the LLP, and hence no separate cost other than the 'book value' was attributable to the individual assets and liabilities. The provisions of Section 48 of the Act which provides for the mode of computation of the capital gains have to be read as an integral part of the charging provision in Section 45 of the Act. The expression full value of consideration used in Section 48 of the Act cannot be construed as the 'market value' of the asset on the date of transfer. Since assets and liabilities of the erstwhile private limited company had been taken over at book value, such 'book value' could only be regarded as the full value of consideration for the purpose of computation of 'capital gains' under Section 48 of the Act. The Mumbai Tribunal observed that the difference between the transfer value and the cost of acquisition was nil, therefore, while computing the 'capital gains' the machinery provision was rendered as unworkable.

Carry forward losses of erstwhile company

Section 72A(6A) of the Act which allows an LLP, carry forward losses of the erstwhile private limited company, is in clear terms preconditioned by a statutory requirement that the taxpayer should have complied with the exemption provisions of the Act. Since the taxpayer had failed to satisfy the conditions of such provisions, the lower authorities had rightly declined the carry forward losses.

The taxpayer relying on the provisions of LLP Act stated that conversion of LLP in the present case stood vested the right of carry forward losses of erstwhile private limited company. However, provisions of LLP Act are only in the context of the tangible and intangible property, interests, rights, etc., and has nothing to do with the carry forward losses.

Benefit of Section 80-IA of the Act

The Mumbai Tribunal was in agreement with the order of the CIT(A). The taxpayer was under bonafide belief that it was eligible to set-off the losses of the erstwhile private limited company and therefore, upon setting off of such losses its total income was nil. Thus, for the said reason it had not raised a claim of deduction under Section 80-IA in its 'return of income' for the year under consideration. Further, the taxpayer was under a bonafide belief that non-filing of the audit report would not jeopardise its entitlement towards the claim of deduction under Section 80-IA of the Act. The taxpayer had in the course of the appellate proceedings before the CIT(A) filed the audit report. The Tribunal observed that filing of an audit report is procedural and directory in nature and the same could also be validly filed by the taxpayer at the appellate stage. Accordingly, the Mumbai Tribunal allowed the claim of deduction raised by the taxpayer under Section 80-IA of the Act.

ACIT v. Celerity Power LLP (ITA No. 3637/Mum/2015) – Taxsutra.com

For further details, please refer to our Flash News dated 4 December 2018 available at this [link](#)

Disallowance under Section 14A

Disallowance under Section 14A of the Income-tax Act is applicable to expenditure in relation to exempt income from strategic investment/stock-in-trade - Supreme Court

The Supreme Court in the case of Maxopp Investment Ltd dealt with the applicability of disallowance under Section 14A of the Act to the expenditure relating to exempt income from strategic investment/stock-in-trade. The Supreme Court observed as follows:

Shares held as controlling interest in investee companies

- It is that expenditure alone which has been incurred in relation to the income which is not includible in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure.
- The dominant purpose for which the investment into shares is made by the taxpayer may not be relevant. No doubt, the taxpayer may have made the investment in order to gain control of the investee company. However, that does not appear to be a relevant factor in determining the issue in the present case. Fact remains that such dividend income is non-taxable.
- If expenditure is incurred on earning the dividend income that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure. Keeping this objective behind Section 14A of the Act in mind, the said provision has to be interpreted, particularly, the word 'in relation to the income' that does not form part of total income.
- The principle of apportionment was made available only where the business was divisible. It is to find a cure to the aforesaid problem that the Legislature has not only inserted Section 14A by the Finance (Amendment) Act, 2001 but also made it retrospective, i.e., 1962 when the Act itself came into force. The aforesaid intent was expressed loudly and clearly in the Memorandum explaining the provisions of the Finance Bill, 2001.

Shares held as stock in trade

- When the shares are held as 'stock-in-trade', certain dividend is also earned, though incidentally, which is also an income. However, by virtue of Section 10(34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in Walfort Share and Stock Brokers P Ltd. case. Therefore, to that extent, depending

upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned and disallowed.

- The Punjab and Haryana High Court in the case of State Bank of Patiala has arrived at a correct conclusion by affirming the view of the Tribunal, though the Supreme Court are not subscribing to the theory of dominant intention applied by the High Court. Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, the Supreme Court also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the taxpayer, suo moto disallowance under Section 14A was not correct.
- It will be in those cases where the taxpayer in his return has himself apportioned but the AO was not accepting the said apportionment, the AO have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the taxpayer for purchasing the shares/making the investment in shares is to be examined by the AO.

Maxopp Investment Ltd v. CIT [2018] 402 ITR 640 (SC)

For further details, please refer to our Flash News dated 17 March 2018 available at this [link](#)

R&D – Weighted deduction

Prior to amendments introduced in the Rules, the weighted deduction under Section 35(2AB) cannot be disallowed based on DSIR certification

The taxpayer is engaged in the business of manufacturing and sale of IC engines. During the Assessment Year 2009-10, the taxpayer had claimed a deduction of INR38.9 million under Section 35(2AB) of the Act being 150 per cent of expenditure incurred of INR25.94 million. The taxpayer claimed that under the provisions of Section 35(2AB) of the Act, DSIR is empowered to approve only an Research & Development (R&D) facility and not the expenditure. Once an R&D facility was approved by DSIR in Form No.3CM, then the expenditure incurred by the taxpayer has to be allowed under Section 35(2AB) of the Act. The AO had granted short deduction under Section 35(2AB) of the Act by INR675, 000 based on expenditure approved by DSIR in Form No. 3CL. Subsequently, the Dispute Resolution Panel (DRP) upheld the order of the AO.

The Pune Tribunal observed that the amendment⁵ made in the Rules requires certification of the amount of expenditure from year to year and lays down the procedure to be followed by DSIR⁶. Prior to the aforesaid amendment in 2016, there was no such procedure. In the absence of the same, there was no merit in the order of AO in curtailing the expenditure and consequent weighted deduction claim under Section 35(2AB) of the Act on the presumption that DSIR has only approved part of the expenditure in Form No.3CL.

The Courts have held that for deduction under Section 35(2AB) of the Act, the first step was the recognition of taxpayer by the DSIR and entering an agreement between the taxpayer and DSIR. Once such an agreement has been executed, under which recognition has been given to the facility, then thereafter the role of the AO is to look into and allow the expenditure incurred on in-house R&D facility as a weighted deduction under Section 35(2AB) of the Act. Accordingly, the Pune Tribunal held that the AO cannot curtail the expenditure claimed as deduction under Section 35(2AB) of the Act.

Cummins India Ltd. v. DCIT [2018] 96 taxmann.com 576 (Pune)

For further details, please refer to our Flash News dated 28 May 2018 available at this [link](#)

Buy-back transaction

The taxpayer was engaged in the business of trading in shares and derivatives. During AY 2014-15, the taxpayer made an offer to existing shareholders for buy-back of 25 per cent of its existing share capital at a price of INR26 per share. One of the directors offered 12,19,075 shares under the buy-back scheme and accordingly, the taxpayer bought those shares and paid consideration of INR 31.69 million. The AO observed that the book value of shares as on 31 March 2013 was INR 32.80 per share. However, the taxpayer had bought back the shares at INR26 per share. The AO invoked provisions of Section 56(2)(viiia) of the Act and assessed the difference between the book value of shares and purchase price of shares amounting to INR 8.29 million as income of the taxpayer under Section 56(2)(viiia) of the Act.

The Mumbai Tribunal observed that the provisions of Section 56(2)(viiia) of the Act would be attracted when 'a firm or company (not being a company in which public are substantially interested)' receives a 'property,

⁵ These Rules have been substituted by IT (Tenth Amendment) Rules, 2016 with effect from 1 July 2016

⁶ The amended Form No. 3CL

being shares in a company (not being a company in which public are substantially interested)'. Therefore, in order to attract the provisions of Section 56(2)(viiia) of the Act the shares should become 'property' of a recipient company and in that case, it should be shares of any other company and could not be its own shares. Own shares cannot become a property of the recipient company. Accordingly, it has been held that the provisions of Section 56(2)(viiia) of the Act should be applicable only in cases where the receipt of shares become property in the hands of the recipient and the shares shall become property of the recipient only if it is 'shares of any other company'. In the present case, the taxpayer had purchased its own shares under buy-back scheme and the same had been extinguished by reducing the capital and hence the tests of 'becoming property' and also 'shares of any other company' fail in the present case. Accordingly, the provisions of Section 56(2)(viiia) of the Act cannot be invoked for buy-back of own shares.

Vora Financial Services P. Ltd. v. ACIT [2018] 171 ITD 646 (Mum)

For further details, please refer to our Flash News dated 6 July 2018 available at this [link](#)

Rights issue

Provisions of Section 56(2)(vii)(c) of the Income-tax Act do not apply to the proportionate issue of right shares

The taxpayer is a director in a closely held company. As on 1 April 2009, the taxpayer had held 1,04,179 shares in the company, which was equivalent to 34.57 per cent of the total issued share capital of the company. The closely held company had a wholly-owned U.S. subsidiary. During Assessment Year 2010-11, the subsidiary intended to acquire the chemical business of another U.S. company. To finance the acquisition, the subsidiary entered into a loan agreement. The loan agreement required the promoters of the company to increase the total net worth of the company to INR1500 million by 31 March 2010. In order to comply with the covenant in the loan agreement, the board of directors of the company passed a resolution on 7 September 2009 to issue 6.3 million shares at face value of INR100 to the existing shareholders in proportion to their holding in the company so as to increase the share capital by INR630 million. Based on the existing shareholding of 34.57 per cent, the taxpayer was offered 2.18 million shares at face value of INR 100. However, the taxpayer accepted the part offer of the shares only to the extent of 2.09 million shares. The shares were formally allotted by the company pursuant to the acceptance by the shareholders in September 2009. The AO held that there was disproportionate allotment of shares to the taxpayer. The AO taxed the difference in face value and Fair Market Value (FMV) of shares under Section 56(2)(vii)(c) of the Act. Alternatively, the AO also held that the shares allotted to the taxpayer being a salaried employee was to be treated as perquisite or profit in lieu of salary under Section 17 of the Act. The CIT(A) held the decision in favour of the taxpayer.

Mumbai Tribunal's decision

Applicability of Section 56(2)(vii)(c) of the Act

Relying on the decision in the case of Sudhir Menon (HUF), the Mumbai Tribunal observed that the provisions of Section 56(2)(vii) of the Act would be attracted only when a higher than a proportionate allotment of shares was received by a shareholder. In the instant case, the taxpayer applied for and was allotted a lesser than the proportionate shares offered to him. Anti-abuse provisions specified under Section 56(2)(vii) of the Act do not apply to the bona fide business transaction. In the instant case, the transaction of an issue of shares was carried out to comply with a covenant in the loan agreement with the bank to fund the acquisition of the business by the subsidiary in the U.S. The shares were issued by the company for a bona fide reason and as a matter of business exigency. Therefore, such a bona fide business transaction cannot be taxed under Section 56(2)(vii) of the Act.

The provisions of Section 56(2)(vii) of the Act are applicable only from 1 October 2009. In the instant case, the offer was made by the company to the shareholders to subscribe for the shares on 7 September 2009 pursuant to a board resolution passed on the same date. Further, on 21 September 2009, the company informed the shareholders about the acceptance of shares offered by the company. Therefore, the offer made by the company was accepted by the shareholders before 1 October 2009, hence, the contract between the company and the shareholder for the issue of shares was completed before 1 October 2009. Accordingly, the provisions of Section 56(2)(vii) of the Act do not apply as the contract was executed prior to 1 October 2009.

Applicability of Section 17 of the Act

The provisions of Section 17 of the Act do not apply to the taxpayer as the shares were not allotted by the company to the taxpayer in his capacity of being an employee of the company. The shares were offered

and allotted to the taxpayer by the company by virtue of the taxpayer being a shareholder of the company. In the instant case, the shares were offered to the taxpayer and other shareholders at a uniform rate of INR 100, and therefore, the difference between the FMV and issue price cannot be brought to tax as a prerequisite under Section 17 of the Act.

ACIT v. Shri. Subhodh Menon (ITA No. 676/Mum/2015, dated 7 December 2018) – Taxsutra.com

For further details, please refer to our Flash News dated 18 December 2018 available at this [link](#)

Carry forward and set off of loss under Section 79

Carry forward and set off of losses are permissible even when 51 per cent of the voting power is beneficially held by the same persons during the year of loss as well as in the year of set-off

The taxpayer is a private limited company controlled by Wadhwa Group. During the Assessment Year 2009-10 and 2010-11, the entire share capital of the taxpayer was held by R Ltd, SND Ltd, and WGH Ltd in equal proportion in 33.33 per cent. Mr. Vijay Wadhwa and Mrs. Vinita Wadhwa held 80 per cent in WGH Ltd and 90 per cent in R Ltd as on 31 March 2009. Similarly, Mr. Vijay Wadhwa and Mrs. Vinita Wadhwa held together 72.5 per cent in WGH Ltd and 87 per cent in R Ltd as on 31 March 2010. The shareholding pattern of the taxpayer remained unchanged from inception till AY 2011-12. However, in AY 2012-13 the shares held by R Ltd, SND Ltd, and WGH Ltd in the taxpayer were transferred to Shri Vijay Wadhwa and Smt. Vinita Wadhwa for consolidation and reorganisation of business.

The taxpayer incurred a loss under the head 'income from house property' for AY 2009-10 and AY 2010-11. In AY 2012-13, the taxpayer claimed set off of a loss against income. The taxpayer claimed that Mr. Vijay Wadhwa and Mrs. Vinita Wadhwa through R Ltd and WGH Ltd are exercising voting rights exceeding 51 per cent in the taxpayer. The taxpayer claimed that as on 31 March 2009, 31 March 2010 and 31 March 2012, 51 per cent of the voting power in the taxpayer is held by same persons and therefore the taxpayer was entitled to set off the aforesaid loss. The AO denied the aforesaid set off by invoking the provisions of Section 79 of the Act and held that since 51 per cent shareholding as on 31 March 2009, 31 March 2010 and 31 March 2012 was not with the same persons, the loss cannot be set off. The CIT(A) upheld the order of the AO.

Mumbai Tribunal's decision

Beneficial voting power v. direct ownership

The object⁷ of Section 79 of the Act is to discourage persons claiming a reduction of their tax liability on the profits earned in companies which have sustained losses in earlier years. It was not unusual for a group of persons to acquire a company, which had suffered losses in earlier years, in the expectation that the company would earn substantial profits after such acquisition, and they would benefit by a reduction of the tax liability on those profits on a set off of losses carried forward from earlier years before the acquisition. The acquisition of a company in such a case would be effected by a change in its shareholding and the control over the company could be ensured by securing the beneficial ownership of shares carrying 51 per cent or more of the voting power.

Section 79(a) of the Act lays emphasis on the 'voting power' beneficially held by same persons as on the last day of the previous year when the loss is incurred and on the last day of the previous year when the set off is claimed. The condition under Section 79(a) of the Act is not holding of the shares but exercising voting power. If the intention of the legislature was to lay down the condition of shareholding, then there was no need to specify 'voting power'. Second proviso to Section 79(a) provides that the section would not apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that 51 per cent shareholders of the amalgamating or demerged foreign company continued to be the shareholders of the amalgamated or the resulting foreign company. This proviso does not provide 'voting power' but lays down the condition of 'shareholding'. This indicates that the emphasis in the main Section 79(a) of the Act is not on shareholding but on voting power.

Similarly, Section 79 of the Act substituted by the Finance Act, 2017 also supports the interpretation of Section 79(a) as it stood for AY 2012-13. The substituted Section 79(b) of the Act provides for carry forward and set off of losses in the case of start-up companies and there also the emphasis is on holding of the shares carrying voting power and not voting power being beneficially held as used in Section 79(a) of the Act. The phrase 'beneficially held' in Section 79(a) of the Act goes with the voting power and not with the shareholding. However, clause (b) of Section 79 as substituted by the Finance Act, 2017 states that the

⁷ as explained by the Supreme Court in the case of CIT v. Italindia Cotton Co. P. Ltd. [1988] 147 ITR 160 (SC)

phrase 'voting power' goes with shareholding. The Mumbai Tribunal observed that the test to be satisfied is not whether 51 per cent shares should be held by same persons on the last day of the previous year in which loss is incurred and on the last day of the previous year in which the loss so incurred is to be set off. The test is whether 51 per cent of the voting power was beneficially held by same persons on the aforesaid two days.

Mr. Vijay Wadhwa and Mrs. Vinita Wadhwa through their shareholding in R Ltd and WGH Ltd can be said to be holding 51 per cent voting power in the taxpayer as on 31 March 2009 and 31 March 2010 and directly as on 31 March 2012. Therefore, the taxpayer is entitled to set-off the loss under consideration in the AY 2012-13.

Applicability of Section 79 to brought forward losses

Section 79 of the Act provides for carry forward and set off of losses. In the present case, the taxpayer is not seeking carry forward of losses to be set off but the taxpayer is seeking to set off the brought forward losses of the earlier years to be set off in the current AY, and therefore provisions of Section 79 of the Act may not be applicable. The said section would apply if there is a change in voting power in the AY when the loss sought to be carried forward and set off against the subsequent year losses. However, the taxpayer in the present appeal for AY 2012-13 is seeking to set off loss incurred in AY 2009-10 and 2010-11.

Mr. Vijay Wadhwa and Mrs. Vinita Wadhwa through their shareholding in RPL and WGH as on 31 March 2009 and 31 March 2010, i.e. the last day of the previous year in which the loss was incurred held voting rights to the extent of 56 per cent and 53 per cent respectively and as on 31 March 2012 held 100 per cent of shares carrying voting rights directly and therefore the taxpayer is entitled to carry forward and set off of loss of AY 2009-10 and 2010-11 against income of AY 2012-13.

Wadhwa & Associates Realtors Private Ltd v. ACIT [2018] 92 taxmann.com 37 (Mum)

For further details, please refer to our Flash News dated 9 March 2018 available at this [link](#)

Deduction/expenses

Deduction under Section 80-IC of the Income-tax Act availed for the first five years at 100 per cent would be available at 25 per cent only even if 'substantial expansion' has been carried out in the subsequent year – Supreme Court

The taxpayer derives income from manufacturing of printed embossed book binding cover material of cotton and security fibre of dual coloured combination. The taxpayer started its business activity on 11 July 2005 and initial Assessment Year for claiming the deduction under Section 80-IC of the Act was 2006-07. The taxpayer had already claimed deduction under Section 80-IC of the Act to the extent of the 100 per cent of the eligible profit for five Assessment Years from 2006-07 to 2010-11. However, the taxpayer had again claimed 100 per cent deduction against eligible profits in the relevant Assessment Year 2012-13 which was the seventh year of production for the taxpayer by claiming 'substantial expansion' in financial year 2010-11. The AO denied the claim of the enhanced deduction and restricted the deduction to 25 per cent of eligible profits. The CIT(A) and the Tribunal, upheld the order of the AO. However, the High Court held the decision in favour of the taxpayer.

The Supreme Court observed that in the instant case the taxpayer has availed deduction under Section 80-IC of the Act alone. Initially, the taxpayer claimed the deduction on the ground that it had set up its units in the State of Himachal Pradesh. Subsequently, after availing the deduction at 100 per cent, the taxpayer wants a continuation of this rate of 100 per cent for the next five years also under the same provision on the ground that substantial expansion was made. Once the taxpayer had started claiming deduction under Section 80-IC of the Act and the initial Assessment Year has commenced within the aforesaid period of 10 years, there cannot be another initial Assessment Year thereby allowing 100 per cent deduction for the next 5 years also when Section 80-IC(3) of the Act, in no uncertain terms, provides for deduction at 25 per cent only for the next 5 years. It may be asserted again that the taxpayer accepts the legal position that they cannot claim a deduction of more than ten years in all under Section 80-IC of the Act. Accordingly, it has been held that after availing deduction for a period of five years at 100 per cent of such profits and gains from the 'units', the taxpayer would be entitled to a deduction for remaining five AYs at 25 per cent and not at 100 per cent.

CIT v. Classic Binding Industries [2018] 257 Taxman 324 (SC)

For further details, please refer to our Flash News dated 27 August 2018 available at this [link](#)

Disallowance under Section 40(a)(ia)

Amendment to Section 40(a)(ia) with respect to 'no disallowance if TDS has been deposited before the due date of return filing' is retrospective in nature – Supreme Court

During Assessment Year 2005-06, the taxpayer paid export commission⁸ to an agent after deducting tax at source. However, the tax was deposited on 1 August 2005, i.e. after the end of the financial year but before the due date for filing tax return. The AO disallowed the export commission in terms of the provisions of Section 40(a)(ia) of the Act as it stood then since the tax was not deposited before the end of the financial year⁹. The CIT(A) and the Tribunal allowed the taxpayer's appeal holding that the commission amount is eligible for deduction for the said Assessment Year. Subsequently, the High Court also held the decision in favour of the taxpayer. Aggrieved, the tax department filed an appeal before the Supreme Court.

Supreme Court decision

Amendment in the provisions in 2008 and 2010

Post amendment in 2008, the taxpayers were classified in two categories, i.e. (i) those who have deducted that tax during the last month of the previous year¹⁰ (ii) those who have deducted the tax in the remaining eleven months of the previous year¹¹. The net effect is that the taxpayer could not claim the deduction for the TDS amount in the previous year in which the tax was deducted, and the benefit of such deductions can be claimed in the next year only.

The amendment made in 2008 though has addressed the concerns of the taxpayer falling in the first category but with regard to the case falling in the second category, it was still resulting into unintended consequences and causing grave and genuine hardships to the taxpayers who had substantially complied with the relevant TDS provisions by deducting the tax at source and by paying the same to the credit of the government before the due date of filing of their returns under Section 139(1) of the Act.

The disability to claim deductions on account of such sum of TDS credited late in the assessment of the previous year in which it was deducted, was detrimental to the small traders who may not be in a position to bear the burden of such disallowance in the present Assessment Year. In order to remedy this position and to remove hardships which were being caused to the taxpayers belonging to such second category, amendments have been made in the provisions of Section 40(a)(ia) by the Finance Act, 2010.

Thus, the Finance Act, 2010 further relaxed the rigors of Section 40(a)(ia) of the Act to provide that all TDS made during the previous year can be deposited with the government by the due date of filing the return of income. Therefore, the controversy surrounding the above amendment was whether the amendment being curative in nature should be applied retrospectively or to be applicable from the date of enforcement.

Amendment of 2010 is retrospective in nature

The amendments made in 2008 and 2010 were steps in the said direction only. Legislative purpose and the object of the said amendments were to ensure payment and deposit of TDS with the government. A proviso which is inserted to remedy unintended consequences and to make the provision workable, a proviso which supplies an obvious omission in the section, is required to be read into the section to give the section a reasonable interpretation and requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the section as a whole.

The purpose of the amendment made by the Finance Act, 2010 is to solve the anomalies that the insertion of Section 40(a)(ia) was causing to the bona fide taxpayer. The amendment, even if not given operation retrospectively, may not materially be of consequence to the tax department when the tax rates are stable and uniform or in cases of big taxpayers having a substantial turnover and equally huge expenses and necessary cushion to absorb the effect. However, marginal and medium taxpayers, who work at low gross product rate and when expenditure which becomes subject matter of an order under Section 40(a)(ia) is substantial, can suffer severe adverse consequences if the amendment made in 2010 is not given retrospective operation, i.e., from the date of substitution of the provision. Shifting expenditure to a subsequent year, in such cases, will not wipe off the adverse effect and the financial stress. Such could not be the intention of the legislature. Hence, the amendment made by the Finance Act, 2010 being curative in nature required to be given retrospective operation, i.e., from the date of insertion of the said provision.

The Supreme Court observed that the amended provision of Section 40(a)(ia) of the Act should be interpreted liberally and equitable and applies retrospectively from the date when Section 40(a)(ia) was

⁸ The export commission was paid on 7 July 2004, 7 September 2004 and 7 October 2004 respectively

⁹ 31 March 2005

¹⁰ No disallowance under Section 40(a)(ia) of the Act shall be made if the tax deducted by them during the last month of the previous year has been paid on or before the last day of filing of return in accordance with the provisions of Section 139(1) of the Act for the said previous year

¹¹ No disallowance under Section 40(a)(ia) of Act shall be made where the tax was deducted before the last month of the previous year and the same was credited to the government before the expiry of the previous year.

inserted, i.e., with effect from the Assessment Year 2005-2006 so that the taxpayer should not suffer unintended and deleterious consequences beyond what the object and purpose of the provision mandates.

CIT v. Calcutta Export Company [2018] 404 ITR 654 (SC)

For further details, please refer to our Flash News dated 9 May 2018 available at this [link](#)

Other direct tax developments

Foreign companies may attract penalties and prosecution proceedings for non-filing of a tax return in India

Under the Act, a company is mandatorily required to file its tax return in India on or before the specified due date. Generally, the provisions of the Act (including provisions dealing with the return of income) apply to a foreign company if it has a nexus with India. Earlier, a minimal penalty was levied on failure to file a tax return in India.

The Finance Act, 2016 introduced the provisions (Section 270A) in the Act for levy of penalty for under-reporting and misreporting of income with effect from 1 April 2017 (Financial Year 2016-17). As per these provisions, the tax officer may direct the taxpayer (who has under-reported his income) to pay the penalty of a sum equal to 50 per cent of the amount of tax payable on under-reporting of income. However, in certain situations where the under-reported income is in consequence of any misreporting thereof by any person, the penalty may be levied at 200 per cent of the tax payable on under-reported income.

Subsequently, the Finance Act, 2017 introduced new provisions (Section 234F) under the Act and prescribed a fee for default in furnishing a tax return within the specified time. Further, the Finance Act 2018 rationalised the prosecution related provisions (Section 27CC of the Act).

The prosecution provisions are applicable if the person willfully fails to file a tax return within the due date. In case any default is committed in this regard by a company, including a foreign company, it may be deemed to be guilty of such default and shall be liable to be proceeded against and punished for failure to file the tax return. The principal officer of a company, including a foreign company, may be liable to prosecution proceedings for failure to file the tax return.

For further details, please refer to our Flash News dated 31 August 2018 available at this [link](#)

Interest on inter-corporate deposits which have become NPA is not taxable under the Income-tax Act – Supreme Court

The taxpayer is an Non-banking Financial Company (NBFC) and is bound by the directions given by the Reserve Bank of India (RBI). These directions, *inter alia*, mandate a NBFC to declare such advances as NPA when the accrued interest therein is not paid by the debtor continuously for six months. During the year under consideration, the taxpayer had advanced certain Inter-Corporate Deposits (ICD) to Shaw Wallace Company. The interest on said deposits was not received by the taxpayer for more than six months. The taxpayer did not show interest income treating the said ICD as NPA which, according to the taxpayer was not realisable.

The AO added the interest as income of the taxpayer holding that it had 'accrued' to the taxpayer even if it was not actually realised as the taxpayer was following a mercantile system of accounting. Subsequently, the CIT(A) affirmed the order of the AO. However, the Tribunal deleted the aforesaid interest income. The Tribunal has taken the view that the provisions of Section 45Q of the RBI Act override the provisions of the Act. The action of the taxpayer in not crediting income from the loan advanced to Shaw Wallace, following the RBI Act and the Prudential Norms issued thereunder, was correct and in accordance with law. The Tribunal held that in terms of Section 145 of the Act, no addition could be made in the hands of the taxpayer in respect of such unrealised interest when the loan/ICD was admittedly NPA. Subsequently, the High Court upheld the order of the Tribunal.

Supreme Court's ruling

Having gone through the impugned judgement, the Supreme Court was of the view that the consideration of the question has been given a full and meaningful reasoning and the Supreme Court agreed with the same.

The Supreme Court on recorded the tax departments' statement, permitted the tax department to file review petition in certain appeals before the High Court.

CIT v. Vasisth Chay Vyapar Ltd (Civil Appeal No. 5811 of 2012) – Taxsutra.com

For further details, please refer to our Flash News dated 22 January 2018 available at this [link](#)

Lease equalisation charge determined in accordance with ICAI Guidance Note is allowed as a deduction while computing the lease rental income under the Income-tax Act – Supreme Court

During Assessment Year 1999-2000, the taxpayer claimed deduction for lease equalisation charges. The AO disallowed the deduction claimed of the lease equalisation charges. The CIT(A) upheld the order of the AO. However, the Tribunal allowed the appeal of the taxpayer while setting aside the orders of the CIT(A) and the AO. Subsequently, the High confirmed the decision of the Tribunal.

The Supreme Court while referring to Section 211 of the Companies Act, 1956 as it stood before the amendment, observed that the purpose behind the amendment in Section 211 of the Companies Act was to give clear sight that the accounting standards, as prescribed by the Institute of Chartered Accountants of India (ICAI), shall prevail until the accounting standards are prescribed by the Central Government under this sub-section. The purpose behind the accounting standards was to arrive at a computation of real income after adjusting the permissible depreciation. It is not disputed that these accounting standards are made by the body of experts after extensive study and research.

Upon referring to the Guidance Note on Accounting for Leases, revised in 1995, it was observed that the annual lease charge represents recovery of the net investment/fair value of the asset lease term. The finance income reflects a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease. While the finance income represents a revenue receipt to be included in income for the purpose of taxation, the capital recovery element (annual lease charge) is not classifiable as income, as it is not, in essence, a revenue receipt chargeable to income tax. The bifurcation of the lease rental is, by no stretch of imagination, an artificial calculation and, therefore, lease equalisation is an essential step in the accounting process to ensure that real income from the transaction in the form of revenue receipts only is captured for the purposes of income tax. There is no express bar in the Act which bars the bifurcation of the lease rental. This bifurcation is analogous to the manner in which a bank would treat an EMI payment made by the debtor on a loan advanced by the bank. The repayment of principal would be a balance sheet item and not a revenue item. Only the interest earned would be a revenue receipt chargeable to income tax.

The taxpayer can be charged only on real income which can be calculated only after applying the prescribed method. The Act is silent on such deduction. For such calculation, it is obvious that the taxpayer has to take course of Guidance Note prescribed by the ICAI if it is available. Only after applying such method which is prescribed in the Guidance Note, the taxpayer can show fair and real income which is liable to tax under the Act. Therefore, it is wrong to say that the taxpayer claimed deduction by virtue of Guidance Note rather it only applied the method of bifurcation as prescribed by the expert team of ICAI. Further, on a conjoint reading of Section 145 of the Act read with Section 211 (un-amended) of the Companies Act make it clear that the taxpayer is entitled to do such bifurcation and there is no illegality in such bifurcation as it is according to the principles of law.

The rule of interpretation says that when internal aid is not available then for the proper interpretation of the Statute, the court may take the help of external aid. If a term is not defined in a Statute then its meaning can be taken as is prevalent in ordinary or commercial parlance. Hence, there is no force in the contentions of the tax department that the accounting standards prescribed by the Guidance Note cannot be used to bifurcate the lease rental to reach the real income for the purpose of tax under the Act. Accordingly, the taxpayer is entitled for bifurcation of lease rental as per the accounting standards prescribed by the ICAI. Moreover, there is no express bar in the Act regarding the application of such accounting standards.

CIT v. Virtual Soft Systems Ltd. [2018] 255 Taxman 352 (SC)

For further details, please refer to our Flash News dated 3 May 2018 available at this [link](#)

Tax authorities may allow deposit of less than 20 per cent of demand to grant stay of demand on the basis of facts of each case – Supreme Court

During the Assessment Year 2007-08 the AO passed an order raising a demand of INR320 million and directed the taxpayer to deposit the said amount on or before 31 July 2017. On an appeal before the Principal Commissioner of Income Tax (PCIT), the PCIT directed the taxpayer to pay 20 per cent of the tax demand. The High Court set aside the impugned order and issued a direction that the taxpayer's

application would once again be heard by the PCIT on merits and without reference to the OM dated 31 July 2017, which, on the face of it, appears to curtail his discretion. The PCIT will dispose of the application with a reasoned order not later than two weeks from the date of receipt of the order. The CIT(A) shall also consider the request of the taxpayer for an expeditious disposal of the appeal.

The taxpayer contended that the administrative circular will not operate as a fetter on the commissioner since it is a quasi-judicial authority. However, the Supreme Court clarified that in all cases like the present one, it will be open to the tax authorities, on the facts of individual cases, to grant deposit orders of a lesser amount than 20 per cent, while appeal is pending.

PCIT v. LG Electronics India Pvt Ltd (Civil Appeal No. 6850 OF 2018) – Taxsutra.com

For further details, please refer to our Flash News dated 30 July 2018 available at this [link](#)

CBDT notification - Rules for determination of FMV for taxability of conversion of inventory into capital asset

On 30 August 2018, the CBDT issued a Notification introducing the new Rule 11UAB for determination of FMV of inventory and also amended existing Rule 11U which defines various expressions used in FMV determination. Rule 11UAB of the Rules prescribes that the FMV of the inventory:

- Being an immovable property, being land or building or both, shall be the value adopted or assessed or assessable by any authority of the central government or a state government for the purpose of payment of stamp duty in respect of such immovable property on the date on which the inventory is converted into, or treated, as a capital asset.
- Being jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, shares or securities, the valuation shall be determined as per Rule 11UA of the Rules and for this purpose the reference to the valuation date in Rule 11U and Rule 11UA of the Rules shall be the date on which the inventory is converted into, or treated, as a capital asset.
- Being the property, other than those specified above, the price that such property would ordinarily fetch on sale in the open market on the date of conversion.

The term 'balance sheet', used in FMV determination, in Rule 11U(b)(ii) of the Rules has been amended to substitute with the following:

- in relation to an Indian company, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under the laws relating to companies in force; and
- in relation to a company, not being an Indian company, the balance-sheet of the company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company, if any, appointed under the laws in force of the country in which the company is registered or incorporated.

These Rules shall come into effect from 1 April 2019 and shall apply in relation to Assessment Years 2019-20 and subsequent years.

CBDT Notification No. 42/4018 (F. No. 370142//05/2018-TPL, dated 30 August 2018)

For further details, please refer to our Flash News dated 5 September 2018 available at this [link](#)

CBDT final notification clarifying the nature of acquisitions of equity shares where the requirement of payment of STT shall not apply to avail concessional tax rate on long-term capital gains

The CBDT issued final Notification under Section 112A(4) of the Act. The final Notification prescribes transactions in the nature of acquisition of equity shares entered into (i) before 1 October 2004 or (ii) on or after the 1 October 2004 which are not chargeable to STT, other than the following –

- a. Where the acquisition of existing listed equity shares in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue.

However, the above provision shall not apply to the acquisition of listed equity shares in a company –

- Which has been approved by the Supreme Court, High Court, National Company Law Tribunal (NCLT), Securities and Exchange Board of India (SEBI) or RBI
- By any non-resident in accordance with Foreign Direct Investment (FDI) guidelines issued by the government of India

- By an investment fund referred to in Explanation 1(a) to Section 115UB of the Act or a venture capital fund referred to in Section 10(23FB) of the Act or a Qualified Institutional Buyer (QIB); and
 - Through preferential issue to which the provisions of chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply.
- b. Where transaction for the acquisition of existing listed equity share in a company is not entered through a recognised stock exchange of India.

However, the above provision shall not apply to the acquisition of listed equity shares in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, and is

- Through an issue of share by a company other than issues referred above.
- By scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business
- Approved by the Supreme Court, High Courts, NCLT, SEBI or RBI in this behalf
- Under employee stock option scheme or employee stock purchase scheme framed under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999
- By any non-resident in accordance with FDI guidelines of the government of India
- In accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011
- From the government
- By an investment fund referred to in clause (a) to Explanation 1 to Section 115UB of the Act or a venture capital fund referred to in Section 10(23FB) of the Act or a QIB and
- The draft notification provided the acquisition by mode of transfer referred to in Sections 47 or 50B of the Act, if the previous owner of such shares has not acquired them by any mode referred to in point (a) or (b) or (c) [other than the transactions referred to in the proviso to point (a) or (b)]. The final notification additionally provides the acquisition by mode of transfer referred to in Section 45(3)¹² or 45(4)¹³ of the Act.
- Acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with SEBI Act, 1992 (15 of 1992) and the rules made there under.
- The notification shall come into effect from 1 April 2019 and accordingly apply to the assessment year 2019-20 and subsequent assessment years.

CBDT Notification No. 60/2018, dated 1 October 2018

For further details, please refer to our Flash News dated 4 October 2018 available at this [link](#)

No disallowance on year end provision of expenses for non-deduction of tax at source – Gujarat High Court

During Assessment Year 2009-10, the taxpayer made provision for expenses on which tax was not deducted at source. The AO observed that these expenditures were a contingent liability and the same is not allowed under Section 37(1) of the Act. Further, no tax was deducted at the time of credit of expenditure and therefore, the said provisions were disallowed under Section 40(a)(ia) of the Act. The CIT(A) deleted the additions and held that bills in respect of the provision for expenses were not received during the year. The bills were received by the taxpayer in the next Financial Year and, therefore, the expenses could not be claimed on an actual basis. Since the taxpayer had a fair idea about the quantum of the expenditure, which was pertaining to the current Financial Year as the bills were received before finalisation of the accounts, the taxpayer made a provision for those expenditures. Therefore, these provisions were made not on estimate basis but were made on the basis of actual estimation of the liability. The expenditure had already

¹² Section 45(3) of the Act provides that transfer of capital asset by a person to a firm or other association of persons or body of individuals (not being a company or co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as his income of the previous year in which such transfer takes place and for the purpose of Section 48, the amount recorded in the books of account of the firm, association or body as the value of the capital asset shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset

¹³ Section 45(4) of the Act provides that the profits and gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and for the purpose of Section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer

been incurred, but the exact quantification was not known before the end of the FY. Therefore, it cannot be said that the provisions were in the nature of contingent liability. The Tribunal upheld the order of the CIT(A). Aggrieved, the tax department filed an appeal before the High Court.

The High Court observed that the tax was not deducted on the aforesaid expenses since the same were a contingent liability and for which bills were not issued. Subsequently, as and when the final bills were received/issued, the tax was deducted. Accordingly, the High Court deleted the disallowance under Section 40(a)(ia) of the Act and upheld the orders of the Tribunal as well as the CIT(A).

Pr.CIT v. Sanghi Infrastructure Ltd. [2018] 257 Taxman 371 (Guj)

For further details, please refer to our Flash News dated 3 August 2018 available at this [link](#)

Waiver of loan taken for purchase of a capital asset is not taxable as business income under the Income-tax Act – Supreme Court

During the year under consideration, an American company (KJC) was taken over by another American company (AMC). KJC had provided loan to the taxpayer at the rate of 6 per cent. Upon acquisition, AMC agreed to waive the principal amount of loan advanced by the KJC to the taxpayer and to cancel the promissory notes as and when they got matured. The taxpayer filed its return showing INR5.77 million as cessation of its liability towards the AMC. The AO held that with the waiver of the loan amount, the credit represented income and not a liability. Accordingly, the AO held that the sum of INR5.77 million was taxable under Section 28 of the Act. The CIT(A) upheld the order of the AO. The Tribunal and High Court decided the case in favour of the taxpayer.

Supreme Court decision

Taxability under Section 28(iv) of the Act

On a plain reading of Section 28 (iv) of the Act, it indicates that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28(iv) of the Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of INR5.77 million is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28(iv) of the Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, the amount of INR 5.77 million cannot be taxed under the provisions of Section 28(iv) of the Act.

Taxability under Section 41(1) of the Act

There is a difference between 'trading liability' and 'other liability'. Section 41(1) of the Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to a cessation of liability other than trading liability. Hence, Supreme Court are not inclined to interfere with the judgment and order passed by the High court in view of the following reasons:

- Section 28(iv) of the Act does not apply on the present case since the receipts of INR5.77 million are in the nature of cash or money.
- Section 41(1) of the Act does not apply since waiver of loan does not amount to cessation of trading liability. It is a matter of record that the taxpayer has not claimed any deduction under Section 36(1)(iii) of the Act qua the payment of interest in any previous year.

The Commissioner v. Mahindra and Mahindra Ltd. [2018] 255 Taxman 305 (SC)

For further details, please refer to our Flash News dated 8 May 2018 available at this [link](#)

Transfer pricing

Acceptance of arm's length price in case of one party cannot prevent the Revenue to determine the arm's length price of the same transaction in the hands of the other party

During FY 2011-12, the taxpayer entered into international transactions related to payment of royalty and payment of administrative, financial and marketing services (here-in-after referred as 'management cross charge') with its Associated Enterprises (AEs) Filtrex Holdings Pte. Ltd. (FHPL) and Filtrex International Pte. Ltd. (FIPL) respectively. The Transfer Pricing Officer (TPO) examined the arm's length nature of the aforesaid international transactions. Due to lack of evidences submitted by the taxpayer to substantiate the need and benefit received for the payments made towards royalty and management cross charges, the TPO determined the Arm's Length Price (ALP) of both the transactions as nil. The Dispute Resolution Panel (DRP) upheld the action of the TPO and passed its directions in conjunction with the view of the

TPO. Aggrieved by the order passed by the AO incorporating the direction passed by the DRP, the taxpayer filed an appeal before the Bangalore Tribunal. Post DRP proceedings, the income tax return filed by the AEs i.e. FHPL and FIPL were selected for income tax scrutiny and the returned income of the aforesaid entities were accepted by the AO. It is pertinent to note that the AO did not make a reference to the TPO, thereby accepting the income declared in the tax return to be at arm's length. Before the Bangalore Tribunal, in addition to the primary grounds regarding determination of the ALP at nil, the taxpayer argued that the returned income of its AEs, being parties to the transactions under consideration with the taxpayer, have been accepted, thereby the Revenue presupposing that the amount received by AEs from the taxpayer is at ALP. Since the income is considered to be at ALP, the taxpayer contended that the expense should also be considered at ALP in the hands of the taxpayer. The taxpayer relied on the judicial precedent in case of UE Development India Pvt. Ltd.² to support its argument.

Bangalore Tribunal's ruling

- On merits, the Bangalore Tribunal noted that AO accepted the returns of the AEs without making any adjustment on account of ALP.
- The Bangalore Tribunal observed that AO has accepted the income earned by the AEs to be at arm's length, however has not accepted the expenditure claimed by the assessee, from the same transactions, to be at arm's length.
- The Bangalore Tribunal placed reliance on proviso to Section 92C(4) of the Act and Circular No. 14/2001, dated 9 November 2001 and held that income of one AE from which tax has been deducted (or to be deducted) shall not be recomputed merely by reason of an adjustment made in the case of the other AE on determination of arm's length price by the AO. Therefore, the Tribunal opined that in case of an adjustment in the hands of the taxpayer, a corresponding adjustment cannot be made in the hands on the AEs i.e. FHPL and FIPL.
- Further, the Bangalore Tribunal also held that in case of any transaction which could lead to tax base erosion, the AO is free to refer the case to the TPO for determination of the arm's length price. Whereas, corresponding adjustment in the assessment of the other enterprise to the transaction need not be made where there is no tax base erosion.
- The Bangalore Tribunal affirmed its aforesaid view in light of Section 92(3) of the Act which lays down that the provisions of ALP will not apply in case the determination of ALP would result in reducing the income chargeable to tax or increasing the losses as the case may be.
- Also, the Bangalore Tribunal highlighted that provisions of Section 92CA(4) and held that the AO is mandated to pass the order based on the adjustment made by the TPO and does not have a right to deny such adjustment. Therefore, in the instant case, the AO has to accept the adjustment made by the TPO in case of the taxpayer without making a corresponding adjustment in the hands of FIPL and FHPL in light of Sections 92C(4) and 92(3) of the Act.
- The Tribunal observed that there appears to a conflict between the provisions of Section 92CA(4) and 92(3) of the Act. However, held that a harmonious construction of these sections would mean that in respect of a same transaction the Revenue can opt to determine total income on the basis of ALP determined in accordance with Section 92(1) of the Act, in the hands of one party to the said transaction, wherever there is a tax base erosion.
- With respect to the determination of the ALP of the transactions in the nature of royalty and management cross charge, the Bangalore Tribunal opined that the TPO is required to examine the transaction in detail and the evidences in respect of the payments made and benefit received, prior to determining the ALP. Accordingly, the Bangalore Tribunal remanded back to the TPO for further examination and computation of the ALP.

Filtrex Technologies Pvt. Ltd v. ACIT [2018] 93 taxmann.com 301 (Bang)

For further details, please refer to our Flash News dated 25 April 2018 available at this [link](#)

Payment of marketing survey expenses made directly by AE on behalf of Indian taxpayer held to be at ALP

The taxpayer is engaged in the import of completely built units (CBUs) of BMW's motor vehicles, related spare parts and accessories from its Associated Enterprises (AEs), and resale in the Indian market. The taxpayer is also engaged in assembling of completely knocked down (CKD) kits of certain products imported from its AEs, for further resale in the Indian market. During this relevant Assessment Year, the AE of the taxpayer (BMW AG) arranged for a market survey report for the Indian market to be prepared by a third party. For these services, BMW AG made direct payment to the third party on behalf of the taxpayer and subsequently recovered it from the taxpayer, at cost (i.e. without any mark-up). The transaction was reported as 'payment of market survey expenses' in the taxpayer's Transfer Pricing (TP) documentation. The taxpayer justified the arm's length nature of the transaction by application of CUP method wherein the third party payment by the AE was referred to as CUP and thus, justified to be at ALP. The TPO however challenged this payment, stating that the market survey activity was performed at the request of, behest of, and to the ultimate benefit of the AE. Further, adding that the survey would have been conducted even in the absence of the taxpayer since India was a strategic market for the group, the TPO determined the arm's length price (ALP) of the said transaction as nil. Upon appeal, the CIT(A), while upholding the adjustment, held that the taxpayer has not been able to substantiate the rationale for the involvement of the AE in the survey. For the international transaction of 'payment of technical support cost', the taxpayer had entered into a 'service level agreement' with its AE for availing of technical training pertaining to setting and operating the taxpayer's production facility in Chennai, against which payments were made based on specified hourly rates. This transaction was substantiated to be at arm's length by application of CUP wherein the taxpayer relied on the data for hourly rates from comparable agreements sourced from the Royalty database. The TPO however, noted the differences in the geography of the comparable agreements vis-à-vis the taxpayer and rejected the same. The TPO then carried out his own search on the Internet for such hourly rates in the AE's geography and imputed the TP adjustment. On appeal, the CIT(A) upheld the approach of the TPO while only allowing the travel and lodging expenses included in such payments. Aggrieved, the taxpayer filed the appeal before the Delhi Tribunal.

Delhi Tribunal's ruling

Payment of market survey expenses

The Delhi Tribunal found merit in the distinction drawn by the taxpayer vis-à-vis a shareholder activity in the taxpayer's case. Further, the Delhi Tribunal acknowledged that the taxpayer had demonstrated that the AE had no direct sales to customers in India. The Delhi Tribunal also clearly laid out the facts that (i) the market survey report was clearly very specific to the Indian market, and (ii) the sole benefit arising from such expenditure accrued to the taxpayer, cannot be disputed. Thereby, the Delhi Tribunal directed the aforesaid adjustment to be deleted.

Payment of technical support cost

The Delhi Tribunal acknowledged that the search carried out by the taxpayer was comprehensive and appropriate. Further, the Delhi Tribunal found merit in the taxpayer's argument that the hourly rates mentioned on random websites were not reliable and could not be accepted as CUPs. Accordingly, the Delhi Tribunal upheld the taxpayers' comparability analysis to be correct and decided the issue in favour of the taxpayer.

BMW India Pvt Ltd v. ACIT (ITA No. 6160/Del./2014)

For further details, please refer to our Flash News dated 7 June 2018 available at this [link](#)

AMP transaction does not exist in the absence of an agreement with the AE

The taxpayer was 51 per cent subsidiary of Colgate Palmolive Inc., USA and was engaged in manufacturing and marketing of diversified pharmaceutical products. The TPO further noted taxpayer debited to financials (Advertisement, Marketing & Promotion) AMP expenses amounting to INR136.83 crore which constituted approx. 13 per cent of the sales achieved by the taxpayer as against industry average rate of 6.39 per cent. The TPO also noted the royalty payment made by the taxpayer reflected steep growth from 0.15 per cent in AY 1999-2000 to 0.96 per cent in AY 2005-06 and in absolute term the increase was from INR1.50 crores in AY 1999-2000 to INR10.32 crores in AY 2005-06. Basis the aforesaid details, the TPO contended that the relevant sales on which royalty was being paid recorded a faster growth benefiting the AE. Therefore, AMP expenses should be shared by the AE as the same were the driving forces for enhancing the business. The Taxpayer contended that AMP expenses incurred were for the taxpayer's business and there was no agreement with AE for the promotion of brand and hence the provisions of Section 92(2)/92B of the Act are not applicable. The TPO did not consider the taxpayer's

contentions and apportioned the AMP expenses in the ratio of royalty payment to total payment, i.e., 0.96 per cent and made an AMP addition. Aggrieved, the taxpayer filed an appeal before the CIT(A). The CIT(A), after considering taxpayer's submissions and the TPO's order, stated that the taxpayer is a full-fledged manufacturer and entrepreneur and retains profit from the business. It manufactures, markets and distributes its product for which the taxpayer incurs advertisement expenses. Therefore there are no direct benefits from AMP expense to its AE. CIT(A) further affirmed incidental benefits to AE does not change the character of the expenses incurred and deleted the addition made by the TPO. Before the CIT(A), the taxpayer also argued on considering the export benefits received from the government for the R&D services rendered to AE as operating income while computing the margin. CIT(A) relying on Mumbai Tribunal decision on Welspun Zucchi Textile Ltd² held it in favour of the taxpayer that the export benefits received were in connection to the R&D services rendered to AE and can be considered for margin calculation.

Mumbai Tribunal's ruling

On facts, the Mumbai Tribunal noted that there was no arrangement or agreement between the taxpayer and its AE which obliged the taxpayer to undertake any brand building on behalf of its AE. Further, the Mumbai Tribunal also held that nothing was brought on record to demonstrate that incurring of AMP expenses has resulted into a brand building or creating marketing intangibles for the AE. Tribunal affirmed that tax department has not produced any tangible evidence and has only argued that the brand value of the taxpayer group, as a whole, has reflected healthy growth during the period 2000 to 2006. Further, no co-relation has been explained between the AMP expenses incurred by the taxpayer and the growth of taxpayer Group's brand value. Mumbai Tribunal stated that no addition could be made on the mere assumption of certain facts. The Mumbai Tribunal also noted that the AMP expenses incurred are in the nature of meeting expenses, travelling expenses, hotel expenses which has been received as well as paid by the taxpayer to third parties, which in itself cannot be said to result in the creation of marketing intangibles. The Mumbai Tribunal observed that TPO had computed the said adjustment by applying Bright Line Test which is not one of the prescribed methods under Rule 10B of the Rules as per settled legal positions. Further, TPO did not carry out any analysis of the impugned expenditure to corroborate his stand. The Mumbai Tribunal referred to the Bombay High Court ruling in the case of Johnson & Johnson Ltd³, wherein transfer pricing adjustment was done by disallowing the payment, on the basis of an assumption that it is excessive. The Mumbai Tribunal held that such action is completely dehors the provisions of transfer pricing adjustment found in chapter X of the Act. Further, the Mumbai Tribunal held that the determination of ALP has to be done only by following one of the methods prescribed under the Act. The Mumbai Tribunal also referred to the Delhi High Court ruling in the case of Bausch & Lomb Eyecare (India) Private Limited⁴, wherein the High Court had held that the Revenue had been unable to demonstrate with tangible materials the existence of an international transaction involving AMP expenses between the taxpayer and foreign AE. Based on the aforementioned High Court decisions the Mumbai Tribunal upheld CIT(A) order and dismissed tax department's appeal. Further, the Mumbai Tribunal upheld the CIT(A)'s conclusion that export benefits received by the taxpayer are inter connected and are part and parcel of export of R&D services rendered by the taxpayer. Therefore the same can be considered as operating income for the purpose of computation of margins from R&D activities.

Colgate Palmolive (India) Limited v. ACIT [2018] 96 taxmann.com 515 (Mum)

For further details please refer to our Flash News dated 12 June 2018 available at this [link](#)

Individual taxation

While making payment for purchase of property from a non-resident, tax is to be deducted on actual sale consideration and not on stamp duty value

The taxpayer, an individual, purchased a residential flat located in India on 31 December 2009 from two non-resident Indians (NRIs) for a consideration of INR48.00 lakh. The instrument of transfer was executed by way of General Power of Attorney (GPA) of two non-resident Indians. Since the taxpayer had made a payment to a non-resident, but had not deducted tax at source before making the payment, the AO initiated TDS proceedings under Section 201(1) of the Act. The AO held that the non-residents are liable to pay tax on the capital gain arising on account of the sale of immovable property. The taxpayer accepted its failure to deduct tax on payment to non-residents but offered to pay tax on Long Term Capital Gain (LTCG) arising in the hands of the non-resident based on actual sale consideration of INR48 lakh (after claiming the indexed cost of acquisition of the property). However, the AO observed that the sale consideration should be taken under Section 50C of the Act at INR58.1 lakh. The AO determined the capital gain which is higher than the amount determined by the taxpayer. Thereafter, the tax was computed on such capital gains and interest was charged for the delay in payment of taxes under Section 201(1A) of the Act. The

taxpayer filed an appeal before the CIT(A) contending that by virtue of Article 26 of the India-USA tax treaty, the provisions of Section 195 of the Act are not attracted to this transaction and hence TDS proceedings raised by the AO under Section 201(1) and 201(1A) of the Act are not applicable to it. The CIT(A) dismissed the appeal on the ground of applicability of Article 26 of the tax treaty and also the computation of tax on LTCG and upheld the order of the AO.

Hyderabad Tribunal ruling

Withholding of tax liability

The liability of the taxpayer under Section 195 of the Act is different from the liability of the non-residents to admit the capital gains in their hands. Both the liabilities are independent and are mutually exclusive. There is no dispute that the provisions of Section 195 of the Act are attracted, and the liability of the taxpayer under Section 195 of the Act is established as the non-residents are required to file their returns of income and offer the capital gains to tax. Thus, the liability of the taxpayer precedes the liability of the non-residents. The taxpayer's claim that he has paid the sale consideration to the GPA holder in India and therefore, is not required to make TDS is not acceptable because, at best, the GPA holder can be considered as only a conduit between the taxpayer and the owners of the property and therefore, in the true sense, the taxpayer has made the payment to the non-residents only. The issue raised before the Hyderabad Tribunal is in relation to the liability of the taxpayer to deduct tax and it is not dealing with the liability of the non-resident to pay the taxes under the provisions of the Act. Accordingly, the taxpayer is required to deduct tax from the actual consideration credited or paid by it and not on what the non-residents are deemed to have received from the sale of their property. The taxpayer has already paid taxes on LTCG accruing to the non-residents on the actual payment made by him. Therefore, the taxpayer cannot be treated as an 'assessee in default' under Section 201(1) of the Act. However, the taxpayer is only liable for interest under Section 201(1A) of the Act till the date of payment of taxes by him. Therefore, the taxpayer is required to deduct the tax at source under Section 195 of the Act before making the payment.

Non-discrimination clause under the tax treaty

The underlying principle of Article 26 of the tax treaty is that the non-resident shall not be treated less favourably than the residents of the contracting state and the requirements connected with taxation shall not be more burdensome than they are for residents. In the present case the issue is with respect to the liability of the taxpayer to deduct TDS and not about the liability of the non-residents. Therefore, there is no discrimination against the NRIs.

Shri Bhagwandas Nagla v. ITO (ITA No. 143/Hyd/2017) – Taxsutra.com

For further details please refer to our Flash News dated 15 February 2018 available at this [link](#)

Deduction from long-term capital gains available in respect of investment in house property funded partially by home loan

During the Financial Year 2009-10, the taxpayer claimed LTCG earned as deductible under Section 54 of the Act, by virtue of investment in a new house property. The AO had restricted the deduction claimed by the taxpayer to the extent of INR9 lakh on the ground that the taxpayer had only invested that part of the capital gains earned by him for purchase of the house property and the balance funds were sourced by a housing loan. Aggrieved, the taxpayer had filed an appeal with the CIT(A). The CIT(A) upheld the order of the AO, but reduced the amount of addition made. Aggrieved, the taxpayer filed an appeal before the Kolkata Tribunal.

The Kolkata Tribunal observed that the law provides that the taxpayer has to construct or purchase a residential house property within the stipulated period in order to avail the benefit of deduction. However, the law does not provide for how the funding of the said house property should be done. The Kolkata Tribunal held that the entitlement of deduction under Section 54 of the Act does not depend on purchase of new residential property by utilising the entire amount capital gains but instead on satisfying conditions that a new house property for own residence has been constructed/purchased, within the time stipulated therein. The Kolkata Tribunal observed that the taxpayer had satisfied the conditions specified under section 54 of the Act and therefore was eligible to claim the deduction. Given the above, the Kolkata Tribunal allowed the appeal of the taxpayer and directed the AO to delete the addition.

Amit Parekh v. ITO [2018] 92 taxmann.com 295 (Kol)

For further details please refer to our Flash News dated 26 April 2018 available at this [link](#)

Redemption of stock appreciation rights are not taxable as perquisite under the erstwhile law – Supreme Court

The taxpayer, an individual, was employed as the Chairman cum managing director of an Indian company. Indian company is the subsidiary of the U.S. Company (P&G USA). The U.S. Company had issued Stock Appreciation Rights (SARs) to the taxpayer without any consideration from 1991 to 1996. The said SARs were redeemed on 15 October 1997, and in lieu of that, the taxpayer received an amount of INR68.04 million from US Company. However, when the taxpayer filed his return of income, he claimed this amount is exempt from the ambit of income tax. The AO held that the amount in question is taxable as 'perquisite' under Section 17(2)(iii) of the Act or alternatively it will be taxable as 'business income' under Section 28(iv) of the Act instead of capital gains. Subsequently, the CIT(A) upheld the order of the AO. The Tribunal held that the stock options are capital assets and hence, gain arising therefrom is liable to capital gain tax. On a further appeal, the High Court allowed the appeal of the taxpayer while dismissing the appeal of the tax department. Aggrieved, the tax department filed an appeal before the Supreme Court.

Supreme Court decision

Non applicability of the provisions

On a perusal of the amended¹⁴ perquisite provisions, it indicates that the case of the taxpayer falls under such provisions. However, since the transaction in the present case pertains to period prior to amendment, such transaction cannot be covered under the said clause in the absence of an express provision of retrospective effect. It is a fundamental principle of law that a receipt under the Act must be made taxable before it can be treated as income. Courts cannot construe the law in such a way that brings an individual within the ambit of the Act to pay tax which otherwise is not liable to pay. In the absence of any such specific provision, if an individual is subjected to pay tax, it would amount to the violation of his constitutional right. It is pertinent to note that on the point of applicability of clause (iiia) of Section 17(2) of the Act, the Supreme Court has settled the position in Infosys Technologies Ltd¹⁵.

The taxpayer got the SARs and, eventually received an amount on account of its redemption prior to the amendment of Finance Act, 1999 came into force. In the absence of any express statutory provision regarding the applicability of such amendment from retrospective effect, the Supreme Court did not find any force in the argument of the tax department that such amendment came into force retrospectively. It is well established rule of interpretation that taxing provisions shall be construed strictly so that no person who is otherwise not liable to pay tax, be made liable to pay tax. The CBDT Circular No. 710 dated 24 July 1995 deals with the taxability of shares issued at less than the market price. On a perusal of the same, it indicates that such circular dealt with the cases where the employer issued shares to the employees at less than the market price. In the present case, the taxpayer was allotted SARs by the (P&G) USA which is different from the allotment of shares. Hence, CBDT Circular has no applicability on the present case. Moreover, a Circular cannot be used to introduce a new tax provision in a Statute which was otherwise absent.

Redemption of SAR not taxable as business income

On a perusal of Section 28(iv) of the Act, it indicates that such benefit or perquisite shall have arisen from the business activities or profession whereas in the present case there is nothing as such. The applicability of Section 28(iv) of the Act is confined only to the case where there is any business or profession related transaction involved. Hence, the present case cannot be covered under Section 28(iv) of the Act for the purpose of tax liability.

ACIT v. Bharat V. Patel [2018] 302 CTR 110 (SC)

For further details please refer to our Flash News dated 4 May 2018 available at this [link](#)

Assured return received by a non-resident on advance payment to a developer is taxable as interest under the India-U.K. tax treaty

The taxpayer, a non-resident, invested in the project of the developer along with four other investors during FY 2007-08. The taxpayer made an advance payment of 95 per cent of the sale price and was provisionally allotted commercial floors in a proposed commercial complex. On such advance payment, the developer was to pay assured return on a monthly basis to the taxpayer till the possession of the commercial space. Such payment was made by the developer after withholding of tax under Section 195 of the Act at 15 per cent under the tax treaty. The AO reopened the assessment and asked the taxpayer to file its tax return. Consequently, the taxpayer filed a tax return offering tax at 15 per cent on such assured

¹⁴ The Legislature amended Section 17(2) of the Act through the Finance Act, 1999 with effect from 1 April 2000.

¹⁵ CIT v. Infosys Technologies Ltd. [2008] 297 ITR 167 (SC)

return treating the same as interest income. Consequently, the AO held that the assured return received by the taxpayer was not the interest income, rather the same was a return from investment and assessed the same as 'income from other sources' and addition was made to the total income of the taxpayer. The CIT(A) upheld the order of the AO.

Chandigarh Tribunal's decision

Re-opening of assessment

A perusal of the copy of the reasons recorded revealed that the AO has not used the word 'interest income' rather the AO revealed that he had the information that the taxpayer had been receiving assured returns on the investment made in commercial properties of the developer. Accordingly, the AO reopened the assessment and determined the nature of income as 'income from other sources' and computed the income of the taxpayer accordingly. It cannot be said that the AO was supposed to assume that the taxpayer was not required to file the tax return as per the provisions of Section 115A(5) of the Act or the AO was of the view that the taxpayer has been receiving interest income only. Accordingly, the reopening of the assessment was held to be valid.

Taxability of assured return

A perusal of the allotment letter issued by the developer revealed that unless and until the conveyance deed was executed and registered, the developer would continue to have full authority over the proposed unit and all the amounts paid by the taxpayer shall merely be a token payment and shall not give any lien or interest in the said unit. The property for which the taxpayer had paid the money was not in existence at the time of making payment and even subsequently it was not capable of yielding any income in the shape of rent, lease money, etc. Even otherwise it was not capable of being commercially exploited.

It cannot be said that the assured return was any return from the property in respect of which the taxpayer had paid the amount. The taxpayer had a debt claim against the developer which means the taxpayer had advanced money to the developer which was nothing but a debt claim till the proposed property was constructed, possession handed over to the taxpayer and the conveyance deed executed and registered. It was a financial transaction and the assured return received by the taxpayer was nothing else than the interest received by the taxpayer on the finances provided to the developer to be used for the construction of the property. Therefore, the developer had rightly deducted the tax at 15 per cent of the assured return paid to the taxpayer. Accordingly, it has been held that the assured return received by the taxpayer was in the nature of interest and the taxpayer has rightly offered the same as interest income under the tax treaty.

Sh. Mohinder Singh Sanghera and Jatinder Singh Chatta v. ADIT (ITA Nos. 372 to 374/Chd/2016) – Taxsutra.com

For further details please refer to our Flash News dated 24 September 2018 available at this [link](#)

Salary received in India by non-resident for services rendered outside India not taxable in India despite the absence of TRC

During the tax year (TY) 2012-13, the taxpayer, a salaried employee was deputed from India to the U.S and had received salary into her bank account in India in relation to services rendered in the U.S. During the said TY, the taxpayer had qualified to be a non-resident in India based on physical presence in India. The taxpayer had filed her India tax return (ITR) for the TY 2012-13 by disclosing the portion of income earned for services rendered in the U.S. as exempt income. The taxpayer had also duly paid her taxes and filed a return of income in the U.S for the period of employment services rendered in the U.S.

The ITR was subject to scrutiny assessment, and an order was passed under Section 143(3) of the Act, whereby the AO inter-alia denied the exemption in respect of salary income on the basis that the taxpayer failed to furnish TRC. Aggrieved by the order passed by the AO, the taxpayer filed an appeal before the CIT(A), who deleted the addition made by the AO with respect to exempt income, by relying on certain judicial precedents [first appellate order]. Subsequently, another appellate order was passed by CIT(A) in the same case wherein he had upheld the order of the AO exparte [second appellate order] and passed an order under Section 154 of the Act invalidating the first appellate order. Aggrieved by order of the CIT(A), the taxpayer had filed an appeal with the Bangalore Tribunal.

Bangalore Tribunal's decision

The Bangalore Tribunal was of the view that there could not be two appellate orders on the same appeal and quashed the second appellate order on the grounds of non-maintainability. On merits, the Bangalore

Tribunal, placing reliance on the judicial precedents¹⁶ had observed that salary is accrued where the employment services are rendered and accordingly, in the instant case salary for employment services rendered in the USA is not taxable in India. Additionally, the Bangalore Tribunal noted that furnishing of TRC is applicable only to cases where benefits under the tax treaty¹⁷ are claimed. Further, the Bangalore Tribunal, based on a judicial precedent held that absence of TRC cannot be a ground for denying the benefit of a tax treaty. The Bangalore Tribunal also stated that proof for the claim of exemption like details of stay abroad, overseas tax return, etc. would need to be submitted which the taxpayer has duly provided during the course of the assessment.

Smt. Maya C Nair v. ITO ITA No.2407/ Bag/2018 dated 31 October 2018

For further details please refer to our Flash News dated 13 December 2018 available at this [link](#)

In the case of joint buyers, the tax is not required to be deducted if the individual's share in a purchase consideration to acquire an immovable property does not exceed INR50 lakh

The taxpayers had jointly purchased an immovable house property on 3 July 2013 for a total consideration of INR150 lakh, and the share of consideration pertaining to each taxpayer is INR37.5 lakh. The respective share of consideration has been made by the taxpayers from their individual bank account. The AO contended that the total purchase consideration payable to a resident transferor for transfer of immovable property exceeded INR50 lakh and hence each taxpayer is required to deduct tax at the rate of 1 per cent as per Section 194-IA of the Act. In view of the same, the AO has called for specific information under Section 133(6) of the Act for which taxpayers have clarified that the individual share of consideration is less than INR50 lakh. The AO further contended that the total consideration was more than INR50 lakh and the transfer was effected by a single purchase deed. Based on the same, the AO opined that TDS provisions were applicable for individual taxpayers, and each taxpayer is required to deduct tax in spite of the individual share in consideration was less than INR50 lakh. The AO issued a common demand notice to all the joint buyers for the payment of TDS in addition to the interest payable by invoking the provisions under Section 201(1) and Section 201(1A) of the Act for non-deduction of taxes. The CIT(A) has passed an ex-parte order by dismissing the appeal of taxpayers and upheld the additions made by the AO. Aggrieved, the taxpayers filed an appeal before the Delhi Tribunal.

The Delhi Tribunal observed that each transferee has an equal share in the property and the payment of the individual share was made by the respective taxpayer from their respective bank accounts. Each transferee is a separate individual, and hence the purchase consideration paid by each transferee shall be the determining factor for the applicability of Section 194-IA of the Act. Whether a single purchase deed was executed for the purchase of property by four joint buyers, or four separate purchase deeds were executed separately by four buyers, does not change the nature of the transaction. The law cannot be interpreted and applied in two different ways for the same transaction. Accordingly, TDS provisions were not applicable on the purchase consideration paid by each taxpayer, which was less than INR50 lakh. With respect to interest under Section 201(1), the same was consequential in nature and hence not applicable in the instant case.

Vinod Soni and others v. ITO (ITA No. 2736/Del/2015) – Taxsutra.com

For further details please refer to our Flash News dated 13 December 2018 available at this [link](#)

Indirect taxes

Expenses and salary reimbursed by a foreign head office to its Indian liaising office not liable to GST

Habufa Meubelen B.V. (HO) is a company incorporated in Netherlands. The applicant is an Indian LO established with the prior permission of RBI. LO is not permitted to undertake any commercial activity without prior approval of RBI. LO does not charge any commission/fees nor receive any remuneration/income for providing liaison activities/services. The entire expenses including salary cost, rent, security, electricity, travel, etc. of the India operation are met exclusively out of funds received from abroad. HO is also responsible for payment of gratuity and other benefits of employees, etc. In view of the facts, the applicant has filed an application before the AAR to determine whether the reimbursement so received by LO would be subject to levy of GST and accordingly whether the LO will be required to obtain registration under the GST Law.

¹⁶ ITO v. Bholanath Pal [2012] 23 taxmann.com 177 (Bang)

¹⁷ Section 90(1) of the Act

The AAR observed that the LO was established under the Foreign Exchange Management Act, 1999 regulations. LOs are strictly prohibited to undertake any activity of trading, commercial or industrial nature or entering into any business contracts in its own name. No separate commission/fees charged for carrying out liaison service by LO. HO reimburses the expenses incurred by its LO for carrying out its operations in India. The applicant does not have any other source of income. The applicant is solely dependent on HO for all the expenses incurred. In light of the above background, HO and LO cannot be treated as separate persons. There cannot be a flow of services between them as one cannot provide services to the self. Accordingly, the reimbursement of expenses made by HO cannot be treated as consideration towards any service.

Habufa Meubelen B.V. [2018-VIL-98-AAR, dated 16 Jun 2018]

For further details please refer to our Flash News dated 23 July 2018 available at this [link](#)

Sub-contracted sourcing services provided to an associate concern abroad – Taxable Service

The applicant is the subsidiary of Hong Kong based company. Hong Kong based company (EDCFE) in turn is a fellow subsidiary of German company (EESG). EDCFE acts as a sourcing service provider to EESG. For sourcing activity in India, EDCFE has sub-contracted the applicant on a non-exclusive basis. In terms of the agreement, the applicant had undertaken to provide various sourcing support services to EDCFE in relation to the performance of the obligations under its contract with EESG. Activities provided by the applicant include market research, purchase of goods and trademark protection, identification and negotiation with suppliers, inspection and quality control, logistics, invoicing and payment. The applicant had filed an application to seek a ruling on whether the activities mentioned supra would qualify as taxable supplies. Further as to whether the services provided by the applicant would qualify as 'export of services' and accordingly treated as zero rated supply.

The AAR held that by virtue of the explanatory notes to the Scheme of Classification of Services read with Notification No. 11/2017 – Central Tax (Rate) dated 28 July 2017 (as amended), the activities carried out by the applicant would qualify as taxable services. The GST would be applicable on a forward charge basis at the rate prescribed in the notification. Further to qualify as export of services, the transaction is dependent upon the fact as to whether the place of supply of service (POS) is outside India or not. Section 97(2) of the Central Goods and Services Tax Act (CGST Act)/Haryana Goods and Services Tax (HGST) Act, does not empower advance ruling to decide on issues relating to the place of supply. In light of the same, the question whether the services would qualify as export of service cannot be taken due to lack of jurisdiction.

Esprit De Corp. [2018-VIL-108-AAA]

For further details please refer to our Flash News dated 26 July 2018 available at this [link](#)

Retained issuance charges on lapsed reward points subject to levy of GST

The applicant manages customer loyalty programme for its participating partners. The application was filed by the applicant to seek ruling on whether the value of points forfeited of the applicant cause of failure of the end customers to redeem the payback points within their validity period would amount to consideration for actionable claim other than lottery, gambling or betting and therefore outside the scope of levy of GST.

The AAR observed that the value of points forfeited on failure to redeem payback points are consideration received in lieu of services provided by the applicant to its clients. Accordingly, the same would not be considered as an actionable claim other than lottery, gambling or betting. Thus the value of forfeited points would be treated as supply of services and consequently be chargeable to levy of GST.

Loyalty Solutions and Research Pvt. Ltd. (AAR No. HAR/HAAR/R/2017/18/4, dated 11 April 2018)

For further details please refer to our Flash News dated 1 August 2018 available at this [link](#)

Discounts offered to be predetermined and agreed upon in the agreement

The applicant had filed for advance ruling on the following –

- Whether the amount paid to authorised dealers towards rate difference post supply of goods can be considered for the purpose of arriving the transaction value
- Whether the amount paid to authorized dealers towards "rate difference" after effecting the supply of goods would be allowed as Credit Note or Discount.

AAR Ruling

The discounts offered after the goods have been sold has to be established in terms of the agreement entered into at or before such supply i.e. it cannot be open ended. The quantum of discount cannot be arrived at without any basis. The supplier has to clearly mention the quantum of discount or percentage of discount which is to be worked out on the basis of certain parameters or criteria which may be agreed to between the supplier and the recipient and which are pre-determined and mentioned in the agreement in respect of supply of goods. Mere mention of the word 'discount' in an agreement without any parameters or criteria would not fulfil the requirements of section 15 of the CGST Act. Thus in the instant case the amount paid to the dealer towards rate difference and special discount post supply cannot be considered and allowed as discount for arriving at the transaction value.

Ultratech Cement Limited (2018-VIL-112-AAR, dated 27 June 2018)

For further details please refer to our Flash News dated 2 August 2018 available at this [link](#)

Exemption notification is to be interpreted strictly and therefore benefit of ambiguity in exemption notification cannot be claimed by the taxpayer – Supreme Court

Constitution Bench of the Supreme Court was setup to decide on the correctness of the ratio laid down in Sun Export Corporation on the question of the interpretative rule to be applied while interpreting a tax exemption provision or notification when there is an ambiguity. In Sun Export case, the Supreme Court had held that an ambiguity in a tax exemption notification or provision must be interpreted in favour of the taxpayer claiming the benefit of such exemption.

After examining the various precedents and the principles of statutory interpretation the Constitution bench observed that, every taxing statute including, charging, computation and exemption should be interpreted strictly. In case of an ambiguity in a charging provision, the benefit must necessarily go in favour of the taxpayer. However in case of an exemption notification wherein the benefit of ambiguity must be strictly interpreted in favour of the revenue.

CC v. Dilip Kumar and Company & Ors. [2018-TIOL-302-SC-CUS-CB dated 30 July 2018]

For further details please refer to our Flash News dated 6 August 2018 available at this [link](#)

Services by employees at the corporate office to units located in other states shall be treated as supply – AAR Karnataka

Employees based in IMO perform certain activities which are common across all the units located across six states in India. These activities are in the nature of accounting, administration and maintenance of IT system etc. Apart from the aforementioned, IMO receives services viz. rent on immovable property, communication expenses, consultancy services etc. the cost of which are allocated to other units in proportion to the taxable supplies of each unit and accordingly Integrated Goods and Services Tax (IGST) is paid on such allocation. The moot question in the instant case is whether the services provided by the employees towards performing common activities needs to be treated as a supply of service between distinct persons.

The AAR observed that by virtue of entry 2 of schedule I, activities carried out between related/distinct persons in the course or furtherance of business are treated as supplies even if there is no consideration. The related party has been defined under section 15 of the CGST Act to include person which directly or indirectly controls the other. GST law requires separate registration in each state/UT from where a supplier provides taxable supplies and accordingly each of the units are treated as a distinct person. Supply of goods or services, carried between the two or more units are treated as taxable supplies. Services provided by an employee to the employer are a transaction in the nature of employment and thus outside the scope of GST. However, since corporate office and units in different states are distinct persons under the Act, there is no relationship between the employees of one distinct entity with another distinct entity, (at least as per the GST Act) even if they belong to the same legal entity. Accordingly, it was held that activities performed by the employees at the corporate office in the course of or in relation to employment for units located in other states shall be treated as supply and accordingly, employee cost also needs to be taken into consideration for the purpose of levy of GST.

Columbia Asia Hospitals Private Limited [2018-VIL-126-AAR dated 27 July 2018]

For further details please refer to our Flash News dated 14 August 2018 available at this [link](#)

Service tax - Assessee cannot take shelter under a faulty software programme - Madras High Court

During the disputed period, basis the reports that the respondent was not paying appropriate service tax, the department had initiated an investigation against Sify. The investigation revealed that the respondent was calculating service tax liability based on a collection report generated by their accounting system. The accounting system did not provide for capturing of the amount of statutory TDS withheld by the client from the invoices of the respondent. The matter was adjudicated with demand for tax and interest thereon, and penalty was confirmed. The contention of the respondent was as under:

- The receipts were accounted on an actual basis. The people concerned with accounting were not aware of any invoice deductions
- Service tax on the TDS withheld by the clients have not been paid, as their personnel while giving credit to such deduction failed to attach the service tag to the transaction. In the absence of the service tax tag, the accounting software fails to recognise the applicability of the tax on such deduction
- While the aforesaid method ensures all accounting entries, due to a mistake in the legacy application, the quantification of service tax liability on TDS remained outstanding
- This being a system error, the short remittance cannot be construed as a wilful suppression.

The contention of the respondent was accepted by the appellate tribunal and accordingly the penalty amount was waived. Aggrieved, department had filed an appeal before the High Court.

High Court's order

Section 67 of the Finance Act, 1994 makes it clear that when the service tax is provided for a consideration of money, the tax is payable on the gross amount charged by the service provider. The respondent cannot blame the system error or a faulty software by which the service tax payable was calculated. The service tax was paid only after the investigation by the department and the full payment of service tax is not a mitigating circumstance. Violation of a statute in which there is no ambiguity and relying on the software programme as a reason for non-payment of tax in time cannot be a reasonable cause for failure to pay tax in time. The respondent cannot take shelter under a faulty programme when they themselves have designed the system. The order of the tribunal therefore deserves to be set aside and the respondent is liable to pay penalty.

Sify Technologies Ltd. [2018-TIOL-1656-HC-MAD-ST, dated 10-Aug-2018

For further details please refer to our Flash News dated 24 August 2018 available at this [link](#)

Service Tax – Acceptance of revenue neutrality as a grounds for defence, will make the entire scheme of RCM futile – CESTAT, Mumbai

The Board of Cricket Control in India (taxpayer) constituted a separate subcommittee namely Indian Premier League (IPL) for organising T-20 cricket competitions in India and abroad. For the purpose of producing live feed of the T-20 cricket matches played in India, to be telecasted on various TV channels, the taxpayer had hired non-resident service providers. On the compensation paid to the said service providers, the taxpayer had failed to pay the services tax liability under RCM. Aggrieved by the order of the adjudicating officer, the taxpayer had filed an appeal before the Customs Excise and Service Tax Appellate Tribunal (CESTAT), Mumbai on the ground of revenue neutrality i.e. service tax demanded under RCM if confirmed and recovered, would be available to the taxpayer as CENVAT credit.

CESTAT Order

Relying on the larger bench tribunal judgment of Jay Yushin² which had laid down criteria for determining revenue neutrality viz. Revenue neutrality being a question of fact, the same is to be established in the facts of each case and not merely by showing the availability of an alternate scheme. Where the scheme opted for by the taxpayer is found to have been misused the existence of an alternate scheme would not be an acceptable defence. With particular reference to modvat scheme it has to be shown that revenue neutral situation comes about in relation to credit available to the taxpayer and not by way of availability of credit to the buyer of the taxpayer's manufactured goods. In light of the above criteria, CESTAT held that the present case cannot be revenue neutral in view of the fact that in this case because, service tax is being demanded from the taxpayer only for the reason that the service provider is a nonresident. In case service provider was located in India, service tax would have been paid by him in respect of present transaction. Manner of payment of the tax would not change the nature of levy and in any case if the argument of revenue neutrality is accepted as permissible defence, the entire mechanism of payment of taxes under RCM will become irrelevant and no business liable to pay service tax would be required to pay

service tax in respect of services received by them from non-resident service providers, for the reason that the tax so paid will be available as credit to them.

The Board of Control for Cricket in India [2018-TIOL-2641-CESTAT-MUM dated 6-Aug-2018]

For further details please refer to our Flash News dated 30 August 2018 available at this [link](#)

CENVAT credit admissible on payments made for discharging CSR activities — CESTAT Mumbai

The taxpayer had made certain payments to a trust for imparting training to students from underprivileged sections of the society. The taxpayer had availed CENVAT credit on such payments, which was denied by the adjudicating authority. The taxpayer had made the following contention in its appeal before the CESTAT:

- Training imparted to students were activities in relation to manufacturing activity as the students were trained to prepare data sheet, maintain log books, support preventive maintenance of machines and so on. The student learns the job that could make them eligible to become future workers in factories
- Referring to the judicial precedent, the taxpayer has contended that the concept of business has changed over the period of time, and the expression involves complete care and concern for the society at large and the people of the locality in which business is located. Accordingly, the concept of business has a wider ramification, and CSR activity is within its ambit.

CESTAT order

In the order, CESTAT had analysed the reason for incorporation of CSR activity in the Companies Act to conclude whether CSR can be brought into the purview of the definition of input services under section 2(l) of the CENVAT Credit Rules or the same is a charitable activity. Referring to the handbook on CSR published by the Confederation of Indian Industry (CII), CESTAT has identified four components:

- Community participation provides the licence to operate companies as government licences would not suffice such smooth operations
- It attracts and boosts employee morale
- Investment in CSR activities ensure additional and secure supply of raw materials
- It enhances the reputation and goodwill of the company.

The essence of the above is that CSR is not a charity anymore since it has got a direct bearing on the manufacturing activity of the company, as it facilitates a smooth supply of raw materials and augments the credit rating of the company as well as its standing in the corporate world.

Further, CESTAT also observed that CSR is a mandatory requirement for public sector undertakings, which has been made obligatory for private sector undertakings. Unless the same is treated as input service in respect of activities relating to business and production, the sustainability of the company itself could be at stake. Basis the above, CESTAT held that CSR activities are input service for the purpose of availing CENVAT credit.

Essel Propack Ltd. [2018-VIL-621-CESTAT-MUM-ST]

For further details please refer to our Flash News dated 6 September 2018 available at this [link](#)

Supply of solar power generating system as a whole is a composite supply – AAR Uttarakhand

The applicant had made an application to seek a ruling on following issues:

Applicability of GST rate on the supply of solar inverter (CH 8504), Controller (CH 8504), battery (CH 8507) and panels (CH 8541) under SPGC (CH 8543) as a whole and whether such supply be called as 'composite supply or mix supply' Supply of solar inverter and solar panels together will fall under the definition of 'Solar Power Generating System' or it will be a 'mix supply' and the applicability of GST rate on the supply of solar inverter and solar panels together.

In response to the application, the jurisdiction officer (i.e. Joint Commissioner, Roorkee) had submitted a report. The report had summarised the classification as:

The items supplied in the assembled form it will be covered under 'Solar Power Generating System' (SPGC) and thus will not be treated as a composite supply. The items are supplied individually and the values are shown in the invoice individually, then the supply would be treated as mix supply. The combination of solar inverter and panels do not make 'Solar Power Generating System' thus the said supply will be treated as mix supply and rate of GST will be 18 per cent.

The AAR held that the term 'Solar Power Generating System' has not been defined either under the GST law or under the erstwhile Indirect Tax law. Thus in order to understand what constitutes SPGC, the AAR relied on the Judgments pronounced by the Tribunal in case of Rajasthan Electronics & Instruments Ltd.² and in case of Bhel, the Tribunal in both the cases has held that where a contract is awarded for a specified purpose of generating solar power from sunlight, supply of various components viz. solar inverter, controller, battery and panel, would be covered under the term SPGC as a whole. Thus the entire supply would fall under the definition of composite supply in as much as SPCG is predominant element in composite supply and it takes the character of the principal supply and therefor all the goods would be taxable at 5 per cent rate of GST.

Eapro Global Limited [2018-VIL-174-AAR]

For further details please refer to our Flash News dated 6 September 2018 available at this [link](#)

Pharmacy run by hospital dispensing medicine to out-patients not covered under the ambit of health care services – AAR, Kerala

The applicant had made an application to seek a ruling on the applicability of GST on the medicine supplied through the pharmacy to both inpatients and out-patients under the prescription of the doctors. The applicant was of the view that pharmacy run by hospital dispensing medicine and allied items are entitled to exemption extended to health care services on the following grounds –

- The medicines and surgical items are supplied under a medical prescription issued by the applicant's in-house doctors.
- Under the pre-GST regime, the supply of medicines, surgical items, X-ray, etc. to the patients in the course of treatment by the hospital were not treated as a sale for the purpose of levy of tax.

The AAR held that patients admitted to hospitals (in-patients) receive medical facility as per scheduled procedures and have a strict restriction. The medicines or allied goods supplies to in-patients are indispensable items, and it is a composite supply to facilitate health care services and is not taxable. In the case of out-patient, prescription issued by hospitals are advisory in nature, the patient has absolute freedom to follow the prescription or not. The patient also has the freedom to procure the prescribed medicines or allied items from the in-house pharmacy or from other medicine dispensing outlets.

Further referring to the clarification issued vide circular² it had been clarified that food supplied to in-patients as advised by doctors is a part of the composite supply of health care and hence not taxable. Other supplies of food by the hospital to patients not admitted are taxable. Applying the same principle, the AAR held that supply of medicines and allied items provided by the hospital through the pharmacy to out-patients is taxable.

Ernakulam Medical Centre Pvt. Ltd. [2018-VIL-179-AAR]

For further details please refer to our Flash News dated 3 October 2018 available at this [link](#)

Supply of complimentary tickets free of charge, subject to levy of GST – AAR, Punjab

The applicant is a franchisee of Board of Control for Cricket in India, for the purpose of establishing and operating a cricket team to participate in Indian Premier League T20 cricket tournament. The applicant proposes to provide complimentary tickets i.e. free of cost on account of courtesy/public relationship/promotion of business. In this regard, the applicant filed an application seeking an advance ruling on the following:

- Whether complimentary tickets issued free of cost would be subject to levy of GST?
- Whether input tax credit (ITC) would be available in respect of such free tickets?

The applicant had submitted that activity to qualify as supply for the purpose of levy of GST, the activity should have been made for a consideration in the course or furtherance of business. Activity carried out in

the course or furtherance of business without consideration is applicable only when the same is carried out between related or distinct persons. Thus the issue of complimentary tickets to the unrelated party will not be subject to levy of GST. The act of giving free supplies is similar to the promotional and advertising activities and is inevitable, and accordingly, the cost of such free supplies is always taken into account in fixing the price of the rest of supplies. Thus, albeit indirectly, the exchequer will get GST even on the value of the free supplies, and there is no revenue loss as such to the Government. Further, the Central Board of Indirect Taxes and Customs had issued a clarification circular no. 47/21/2018 dated 8 June 2018, where it had clarified that supply on free of cost (FOC) basis does not constitute a supply as there is no consideration involved.

The AAR held that the term 'consideration' as defined under the CGST Act includes the monetary value of any act of forbearance in respect of supplies made. The issue of the complimentary ticket is an act of forbearance and thus would naturally be pegged to the amount of money charged from other persons not receiving the complimentary tickets for availing the same services. Complimentary tickets are in consonance with the term 'token' or 'voucher' as both have been defined in the Oxford dictionary as 'one given as a gift' or one 'that may be exchanged for goods or services'. Thus the valuation provision i.e. rule 32 (6) of the CGST Rules, applicable to the valuation of the token/voucher would also apply in the instant case.

K.P.H. Dream Cricket Private Limited [2018-VIL-209-AAR]

For further details please refer to our Flash News dated 3 October 2018 available at this [link](#)

Time limit for claiming ITC in a statute does not violate the right guaranteed under the constitution – Supreme Court

The issue under contention was with respect to the period of limitation imposed for claiming of input tax credit (ITC) under section 19(11) of the Tamil Nadu Value Added Tax Act, 2006. The taxpayer had contended the provision imposing restriction is unreasonable, arbitrary and violates Articles 14 and 19 (1) (g) of the Constitution.

Relying on the principles of interpreting law dealing with economic activities and principle of statutory interpretation, the Supreme Court made the following observations:

ITC is in the nature of concession extended to a dealer under a statutory scheme. These are received by the beneficiary only as per the scheme of the statute. Whenever a concession is given by a statute the conditions thereof are to be strictly complied with in order to avail such concession.

When the input tax credit is to be allowed and when it is to be disallowed is elaborated in Section 19 which is self-contained scheme and benefit under Section 3 sub-Section (3) can be claimed only when conditions as enumerated in Section 19 are fulfilled. The use of word "shall make the claim" needs no other interpretation. Thus, the time period as provided in Section 19(11) is mandatory and not directory. In the scheme of Tamil Nadu VAT Act, 2006, there is no power conferred on any authority under the Act to dilute the mandatory requirement under Section 19(11). The statute having not given any indication for extension of time which is a condition for claiming Input Tax Credit, the submission that period could have been extended by assessing authority is unfounded and cannot be accepted.

ALD Automotive Pvt. Ltd. [2018-VIL-28-SC]

For further details please refer to our Flash News dated 19 October 2018 available at this [link](#)

Cost of the tools supplied for free should be added to the value of goods supplied – AAR, Karnataka

The applicant is in the business of manufacturing sheet metal pressed components and caters to various industries, ATM, printers, etc. In the course of its business, the applicant upon receipt of an order for specialised components manufactures the required tools. The value of tools is billed to the recipient along with the applicable GST. The recipient thereafter provides the tools back to the applicant free of cost for using the same in the manufacturing of the ordered specialised component. In light of the background, the applicant had filed an application seeking an advance ruling on whether the amortised cost of the tool to be added to arrive at the value of the goods supplied for the purpose of GST under section 15 of the Central Goods and Services Tax Act (CGST Act) read with rule 27 of the Central Goods and Services Tax Rules (CGST Rules)

The AAR observed that as per Section 15(1) of the CGST Act, value for the purpose of levy of GST shall be the transaction value carried out at an arm's length. Further, section 15(2) provides for the inclusion of other related amounts in determining the value of taxable supply. In the instant case, the applicant was required to supply certain specialised components, which requires specialised tools. These tools could either be manufactured by the applicant themselves or the said tools could be procured from a third party vendor, or the tools could be supplied by the recipient free of cost. The AAR relying on section 15(2) (b) of the CGST Act held that the cost of tools incurred by the recipient of the supply, provided free of cost to the applicant manufacturer shall form part of the value of specialised component for the purpose of levy of GST.

Nash Industries (I) Pvt. Ltd. [2018-VIL-266-AAR]

For further details please refer to our Flash News dated 15 October 2018 available at this [link](#)

Service Tax – Credit availed on telecom towers, shelter and accessories are admissible under the CENVAT Credit Rules – Delhi High Court

For the purpose of providing telecommunication services, telecom infrastructure companies³ (the taxpayer) are required to setup infrastructure consisting of public switching equipment, transmission equipment, base transceiver station (BTS), antennae, towers, pre-fabricated building, shelter, etc. The applicant had availed CENVAT credit on the excise duty paid on such towers, equipment, parts, and accessories thereon which were received in CKD/SKD form. The CENVAT credit availed was denied to the taxpayer, by the revenue, on the grounds that towers, shelter, and accessories used for providing telecommunication services are immovable property. The taxpayer, however, was of the view that to qualify such goods as immovable property, the said goods should be attached to the earth for the permanent beneficial enjoyment of the land. These goods are received in CKD/SKD form and are thereafter merely fastened to the civil foundation to make it wobble free and ensure stability. They can be unbolted and reassembled without any damage in a new location. However, the contention of the taxpayer was not accepted by the CESTAT, and thus the matter was appealed before the Delhi High Court.

High Court order

After considering the submission of all the parties, the Court answered all the questions framed in favour of the taxpayer, the key observations in the order are as under:

- **Permanency test** has to be applied in the context of various objective factors and cannot be confined to one single test. The entire tower and shelter are fabricated in the factories of the respective manufacturers, and these are supplied in CKD condition. They can be bolted and unbolted, assembled and re-assembled, located and re-located without any damage and the fastening to the earth is only to provide stability and make them wobble and vibration free.
- On question with respect to the emergence of the immovable structure at an intermediate stage, whether CENVAT credit can be denied, the court pronounced that denial of credit on the premises that the towers erected result in the immovable property at an intermediate stage, is erroneous and plainly contrary to Solid and Correct Engineering. The towers are received in CKD condition, are erected at the site, subsequently, giving rise to a structure that remains, safe and stable. It is a settled principle of law that entitlement of CENVAT Credit is to be determined at the time of receipt of the goods. If the goods that are received qualify as inputs or capital goods, the fact that they are later fixed/fastened to the earth for use would not make them a non-excisable commodity when received.

Vodafone Mobile Services Limited, Indus Towers Limited, Tower Vision India Pvt. Ltd. and Bharti Infratel Limited [2018-VIL-506-DEL-CE]

For further details please refer to our Flash News dated 15 November 2018 available at this [link](#)

Recovery of penal interest cannot be construed as additional interest – AAR, Maharashtra

The applicant is a non-banking financial company, engaged in providing various types of loan to the customers such as auto loans, loan against property, personal loans, consumer durable loans, etc. The installments of the loan are computed by taking into consideration the amount of loan, duration of the loan and the amount of Equal Monthly Instalment (EMI) that would be payable at a specified date. EMIs are used to pay-off both interest and principal amount. In case of a delay in the payment of EMI by the customer, the applicant collects penal/default interest (penal interest) as additional interest for the number

of days of delay in terms of the agreements executed by the customers. In light of the above, the applicant had filed an application seeking an advance ruling on the following: Can penal interest be treated as interest for the purpose of applying the exemption notification under the Central and State Goods and Services Act or it would be treated as a taxable supply for the purpose of levy of GST. The applicant had contended that in case of a delay in payment of EMI, the interest for the delayed period is not factored in the EMI and is therefore charged separately from the customers as penal interest. Penal interest collected represents the time value of money for the period of delay and thus is an additional interest on loan.

The AAR held that failure to repay EMIs by the customers result in a penalty, which is levied on the amount of EMI default. Effectively the penal interest is even charged on the original interest amount. This amount is over and above the interest amount received by the applicant on account of extending deposits, loans, etc. The said act clearly falls within the ambit of the term 'tolerating an act' of the customers for having defaulted the EMI payment on due date. Accordingly, it was held that penal interest would definitely fall within the scope of 'supply' under and thus subject to levy of GST.

Bajaj Finance Ltd [2018-VIL-275-AAR]

For further details please refer to our Flash News dated 20 November 2018 available at this [link](#)

No penalty on account of human error – High Court, Kerala

The petitioner had on realising a mistake in the e-way bill with respect to the place of delivery, cancelled the original e-way bill and had generated a new bill. In the new e-way bill it had erroneously mentioned the value of goods as INR388220/- instead of INR3882200/-. Taking exception to this the competent authority had detained the goods.

The fact that determining the value is a matter for decision by the competent authority, the High court took an exception for the reason that if the petitioner had paid IGST in accordance with the value as shown in the original bills, goods cannot be detained and shall be released on executing a simple bond. However, if the tax has not been paid in accordance with the correct value, the goods and vehicle need to be released only on furnishing a bank guarantee.

Rai Prexim India Pvt. Ltd [2018-VIL-553-KER]

For further details please refer to our Flash News dated 10 December 2018 available at this [link](#)

Registration not required of a location where goods are imported – AAR, Maharashtra

Applicants are importers of chemicals which are currently imported at JNPT port, Maharashtra and Kandla port, Gujarat and accordingly, are registered under GST Act in both the states. They wish to import chemicals at Haldia Port (Kolkata, West Bengal). In the absence of any operation in the state of West Bengal, the applicant rented custom warehouse at Haldia Port. It proposes to clear the goods from such rented warehouse (ex-bond) in the name of its registered Mumbai head office and sell the goods to customers in West Bengal and other nearby states.

The applicant had filed an application to seek an advance ruling on whether separate registration would be required in the state of import? If no, can the applicant do a transaction on its Mumbai GSTIN number, in which case for issuance of the e-way bill is it correct to mention the GSTIN of Mumbai and dispatch place of Haldia port?

The AAR observed that by virtue of section 11 of the Integrated Goods and Services Tax Act, 2017, the place of supply in case of imported goods shall be the location of the importer, in the instant case since the importer is registered in Mumbai, the place of supply shall be Mumbai, Maharashtra. Further by virtue of Section 22 of the Central Goods and Services Tax Act, 2017, the person liable to register shall be the location from where such person makes a taxable supply of goods or services or both. In the instant case, since the applicant has no establishment or place of operation or any godown or GSTIN in the state of West Bengal, i.e. the port of import, the applicant can clear the goods on the basis of invoice issued by the Mumbai head office and therefore they need not take separate registration in the state of West Bengal.

Sonkamal Enterprises Private Limited [GST-ARA-48/2018-19/B-123 dated 27 September 2018]

For further details please refer to our Flash News dated 10 December 2018 available at this [link](#)

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