EY Tax and Regulatory Alert

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Prepared for ACMA

Contents

Building a better working world

Indirect Tax

This Section of Tax alert summarizes the Indirect tax updates for the month of December 2018

Judicial Precedents

1. M/s Honda Motorcycle & Scooter India Pvt Ltd
   Vs
   CCE & ST, Alwar

   [2018-VIL-823-CESTAT-DEL-ST]

Background and facts of the case

- The brief facts of the matter are that the appellant/ assessee is engaged in manufacture of motorcycles and scooters falling under Central Excise Tariff Heading 87 of 1st Schedule to the Central Excise Tariff Act, 1985

- The appellants have been availing facility of Cenvat credit on inputs, capital goods and input services under Cenvat Credit Rules, 2004

- During the period from June 2011 to March 2016, the appellant have been availing input service credits on the services, such as :
  - Commission paid to agents of print media;
  - Services of authorized service stations provided by the appointed dealers of the appellant to the buyers of vehicles under free after sale service and warranty period services;
  - Service tax paid on the rent for common civil infrastructure services availed by the appellant from M/s Honda Siel Car India Ltd.

- The Department had entertained a view that the appellant have wrongly availed input service credit on the above-mentioned services and a show cause notice demanding reversal of Cenvat credit amounting to Rs. 9,85,38,215/- was demanded vide show cause notice dated 06/07/2016 which has been adjudicated by the learned Commissioner vide his order dated 09/02/2017, wherein the above-mentioned amount of the Cenvat credits have been confirmed under Rule 14 of Cenvat Credit Rules

- Accordingly, an appeal was filed before the CESTAT, New Delhi against the Order in Original dated 9 February 2017.

Discussions and findings:

1. Commission paid to agents of print media:

   Arguments by the Applicant

- It is contended that the learned Commissioner has erred in holding that the appellant are not entitled for the service tax paid by them on the commission charges charged by print media agents for providing the advertisement services to them from print media service providers.

- The learned Advocate has tried to explain that the Indian Newspaper Society (INS) being the Central Organisation for Indian Press and they were for 14 National newspapers for obtaining orders for printing of various kind of advertisement in these National newspapers. The INS charges a paltry commission of around 2% from the persons who are interested in getting the advertisement published in the national newspapers

- The service tax paid on this commission, the Department has denied them the Cenvat credit which is legally not sustainable in the sense that the commission paid is for the purpose of advertisement and not for any other purpose, and since the cost of advertising is integral part of the cost of their finished product, the services availed and any service tax paid on such services need to form a part of the cost of their finished product and they have actually included such cost into the price of their finished product namely two wheelers motorcycle/scooters and thus they are very much entitle for taking credit of such cost

Decision by the Tribunal

- The Tribunal is of the view that the activity of hiring of print media agent for ultimate purpose of advertising is very much part of advertising service and since the advertisement charges forms the part of assessable value of the appellants finished product any cost incurred and services availed in this regard form the part of assessable value and thus the appellant is entitled for credit of such input services

- The Tribunal has relied on the decision in the case of Indian Oil Corporation Ltd. vs. CCE, Mumbai – II – 2014 (36) S.T.R. 833 (Tri. – Mum.) - 2014-VIL-311-CESTAT-MUM-ST

2. <u>Services of authorized service stations provided by the appointed dealers of the appellant to the buyers of vehicles under free after sale service and warranty period services:</u>

Arguments by the Applicant

- The learned Advocate appearing on behalf of the appellant has contended that repair and maintenance services received by the appellant from his authorized service stations cannot be denied to them as the scope of input service as mentioned under Rule 3 of the Cenvat Credit Rules and defined under Rule 2(l) of the Cenvat Credit Rules has a specific mention that the appellant are entitled for credit on all input services used directly or indirectly, in or in relation to manufacture or clearance of final product

- It can be seen from the scope of the definition of input service that it not only covers any services used directly or indirectly in relation to manufacture or clearance of the manufactured product, since the free after sale service coupons provided by them to the buyer of two wheelers have already formed part of the assessable value of the two wheelers manufactured and cleared by them and therefore the appellant is entitled for availment of Cenvat credit of input services used by them in this regard

Decision by the Tribunal

- So far as the credit on services received by appellant from their authorized service stations with regard to free after sale services and repairs etc. of warranty period, the matter is no longer res-integra as CESTAT, New Delhi in the case of Carrier Airconditioning & Refrigeration Ltd. vs. CCE, Gurgaon – 2016 (41) S.T.R. 1004 (Tri. – Del.) - 2016-VIL-188-CESTAT-DEL-ST has held that services provided by the authorized representative/ service stations are on behalf of the manufacturer and the service tax paid on availment of such services by the manufacturer, they are entitled for Cenvat credit of such input services

- Accordingly, it is held that since the value of free after sale services and the warranty period repairs and maintenance are already included in the assessable value of the two wheelers, the service tax paid on availment of such input services by the manufacturer from their authorized representatives the appellant/assessee is entitled for credit of such input services

3. <u>Service tax paid on the rent for common civil infrastructure services availed by the appellant from M/s Honda Siel Car India Ltd.:</u>

Arguments by the Applicant

- The basic contention of the learned Advocate has been that appellant has been granted a right to use and enjoy the common infrastructural facility developed by M/s Honda Cars for a consideration which is being paid by the appellant and by virtue of which they have obtained a right to use and enjoy the common infrastructural facilities

- It is further been added that appellant cannot undertake manufacturing activity in the absence of infrastructural such as availability of electricity, water, road, the boundary wall for the manufacturing premises for the safety purpose because for making use of the factory premises the common infrastructural facilities are dovetailed with the main manufacturing facility and thus become integral for the purpose of creating manufacturing capability in the factory and, therefore, the services used by them in the form of common infrastructural facility are very much integral to the creation of infrastructural for manufacturing

Decision by the Tribunal

- It is held that the common facilities such as road, water supply facility, boundary wall infrastructure for supply of electricity etc. are absolutely essential for making the manufacturing facility to work

- Further, the common facilities availed by the appellant on rent basis are in 'relation to the manufacture of goods' and then on integral part of overall activity of manufacturing

- Further, since the charges of rent/license fee paid by the appellant must have been included in the cost of the finished product manufactured by the appellant as per the provisions of Cenvat Credit Rules they are entitled for credit of service tax paid by them as the facilities were in relation to manufacturing of their finished product

- The Tribunal has relied on the decision in the case of CCE, Raigad vs. Heidelberg, Cement India Ltd. – 2017 (6) G.S.T.L. 473 (Tri. – Mumbai)

- Accordingly, it was held that the appellant has rightly availed Cenvat credit of service tax paid on rent of infrastructural facilities

2. M/s Borgwarner Morse Systems India Private Limited

[Tamil Nadu AAR]

[2018-VIL-279-AAR]

Background and facts of the case :

- Brief facts of the case are that the applicant is engaged in manufacture and sale of automotive chains which are used as a major component in manufacture of motor engines for motor vehicles (i.e., for both two wheelers and four wheelers).

- The applicant has preferred an application seeking Advance Ruling on "Whether automotive chains (i.e., silent chains used in petrol engines and roller chains used in diesel engines) manufactured by the applicant are classifiable under HSN 8409 or 7315?"

Appellant's Submission

- Appellant has submitted that as the automotive chains manufactured by the Applicant are used in further manufacture of engines for motor vehicles, the Applicant had classified their product under following HSN code :

HSN	Description
8409	Parts suitable for use solely or principally with the engines of heading 8407 or 8408

- The customers of Applicant had insisted that they should categorize the automotive chains under HSN 7315 and charge GST @ 18% instead of 28%. The relevant entry from the GST rate schedule is tabulated below :

HSN	Description
7315	Chain and parts thereof of iron or steel falling under 7375 20, 7315 81, 7315, 82, 7315 89, 7315 90

Decision taken

- Heading 7315 includes articulated link chains such as roller chains or silent chains which are used as transmission chains for engines of automobiles or machinery.

- Though these form parts of engines under Chapter 8407 or 8408, they are covered under definition of 'parts of general use' which are specifically excluded from chapter heading 8409.

- Therefore, articulated link chains i.e. 'Roller chains' supplied by the applicant are classifiable under CTH 73151100 and 'Inverted tooth chains or silent chains' under CTH 73151290 of the Customs Tariff made applicable to GST.

3. The Excise & Taxation Commissioner, Himachal Pradesh

Vs

M/s Shivalik Tyres

[2018-VIL-527-HP]

Background and facts of the case

- M/s Shivalik Tyres, respondent-assessee, is in the business of retreading of tyres was assessed to tax under the provisions of the Himachal Pradesh General Sales Tax Act, 1968 (hereafter referred to as the 'State Act').

- The Assessing Officer, vide order dated 27.11.2003 found the assessee to have furnished incorrect returns resulting into evasion of tax and as such, after carrying out addition, assessed the component of tax and resultant penalty payable by the Assessee. In all the amount of tax assessed is ₹ 1,21,000/-

- In an appeal preferred by the Assessee, the said order came to be affirmed by the Excise & Taxation Commissioner, Himachal Pradesh, Shimla, vide order dated 28.8.2009 passed in Appeal No. 171/06/07, titled as M/s Shivalik Tyres Kumarhatti vs. Deputy Excise & Taxation Commissioner.

- However, the Tribunal, vide order dated 21.5.2010, while remanding the matter back to the Assessing Authority held the case of the Assessee to fall within the ambit and scope of the Central Sales Tax Act, 1956 (hereinafter referred to as the 'Central Act') and not the 'State Act'.

- Accordingly vide order dated 4.2.2011, the Tribunal has made the instant Reference.

- There is no dispute about the Assessee being subjected to levy of tax. The only issue being applicability of the Statutes, Central or the State Act. If the case of the Assessee was to fall within the ambit and scope of the provisions of Section 14 of the 'Central Act', the Assessee is liable to be assessed at a lesser amount of duty.

Court findings and Ruling

- The word "tyres" in entry (xiv) of sub-section (iv) of Section 14 of the 'Central Act' cannot be read in isolation and has to be read in the group of items in which the entry is made. Sub-section (iv) starts with the words "iron and steels", thus items referred to in entry (xiv) necessarily has to be read contextually in that background along with other entries being the 'wheels, tyres, axles and wheels sets'. Here the word "tyres" cannot be read so as to mean rubber tyres. It has to be read conjunctively with other entries, genus of which is iron and steel. Tyres necessarily would not acquire the connotation of rubber tyres so understood in common parlance, unlike a trader specifically dealing with the product.

- The principle to be adopted for construction of tariff entries is no longer res integra. In the absence of statutory definitions, excisable goods mentioned in tariff entries are to be construed according to the trade practice.

- The origin of the word "tyres", as is so described in the dictionary, was in the 15th century denoting curved pieces of iron with which the carriage wheels were shod. In fact, it is also described as a strengthening band of metal fitted around the rim of a wheel especially of a railway vehicle.

- There can be a case where such tyres may be having a rubber covering, but then it would definitely not cover the activity of the Assessee who is in the business of retreading of rubber tyres.

- The entry "tyres" in the central legislation would not be construed as tyres retreaded with rubber, even though the main classification is that of iron and steel. Thus the Assessee would be liable to be assessed as per the 'State Act' and not the 'Central Act'.

4. M/s Renault Nissan Automotive India Pt Ltd

Vs

The Deputy Commissioner-II (FAC), Large Taxpayers Unit, Chennai

[2018-VIL-542-MAD]

Background and facts of the case

- The appellant is a registered dealer on the file of the respondent under the provisions of the Central Sales Tax Act, 1956 (hereinafter called the Central Enactment) and the Tamil Nadu Value Added Tax Act, 2006 (hereinafter called the State Enactment).

- The appellant has filed the said writ petitions challenging the assessment orders for two assessment years namely 2014-15 and 2015-16 under the Central Enactment.

- The assessee had categorically stated that they were not questioning the merits of the assessments, but were only questioning the assessment orders on the ground of lack of jurisdiction and also on the ground of violation of the principles of natural justice.

- The assessment orders were challenged only on two grounds namely on the ground of violation of the principles of natural justice and also on the ground of want of jurisdiction.

- Both the grounds raised by the appellant were negatived and the writ petitions were dismissed giving liberty to the appellant to file statutory appeals before the First Appellate Authority.

Appellant's submission

- It has been stated that though the buyers namely M/s. Nissan Motor India Private Limited and M/s. Renault India Private Limited are not entitled to claim exemption, the respondent has not assessed them to tax rejecting the exemption claim since he has no jurisdiction to make assessment in respect of the dealers, who got registered in other States.

- It is submitted that this can hardly be a reason for increasing the appellant's turnover by adding 25% to the reported turnover and that the same is without jurisdiction. It is further pointed out that increase in turnover cannot be done in the circumstances as pointed out by the respondent and therefore, the said impugned common order is in total violation of the principles of natural justice and lacking in jurisdiction.

Court's findings and decision

- The assessee has not canvassed the merits of the assessments in the said writ petitions. This submission is reiterated before High Court.

- The assessee was issued with the notices proposing revision of assessments vide notices dated 24.1.2017. The said notices set out the circumstances, under which, the Assessing Officer proposed to add 25% to the appellant's reported turnover. The appellant did not challenge the revision notices nor contended that they were beyond the jurisdiction of the respondent under Section 27 of the State Enactment, but submitted to the jurisdiction of the respondent and also sent their reply vide objections dated 24.2.2017. It has been found that the objections are elaborate and that the appellant also sought for an opportunity of personal hearing in their objections.

- The respondent acceded to the request made by the assessee and afforded an opportunity of personal hearing not once, but twice. It is submitted by the respondent that the case was discussed, after which, the Assessing Officer completed the assessments and passed the assessment orders dated 28.7.2017.

- On a perusal of the objections given by the assessee dated 24.2.2017, it is clear that the assessee was fully aware as to what is the case they have to meet. Therefore, it cannot be stated that there had been violation of the principles of natural justice.

- There is no error in the said impugned common order passed by the learned Single Judge in dismissing the said writ petitions and simultaneously granting liberty to the assessee to file appeals before the First Appellate Authority. Furthermore, the learned Single Judge extended the time for filing the appeals for a period of 30 days and directed the Appellate Authority to entertain the appeals on merits without reference to the period of limitation. One more protection granted to the assessee is by directing the respondent not to take any coercive steps against the assessee till the appeals are filed within the time stipulated. Thus, the learned Single Judge committed no error in dismissing the said writ petitions and issuing consequential directions. In the light of the above discussions, the appellant has not made out any case for interference.

- Accordingly, the above writ appeals fail and are accordingly dismissed. No costs. Consequently, the connected CMPs are also dismissed.

- The appellant has been granted 30 days' time from the date of receipt of a copy of this common judgment to file appeals before the First Appellate Authority and if the same are filed within the said period, the Appellate Authority shall entertain the appeals without reference to the question of limitation. Till the expiry of 30 days time period, the respondent shall not initiate any coercive action against the assessee.

5. Shri Shylesh Damodaran, Ahemdabad

Director General Anti-Profiteering, Central Board of Indirect Taxes and Customs, New Delhi

Vs

M/s Landmark Automobiles Pvt Ltd, Ahmedabad

[2018-VIL-15-NAA]

Backgrounds and facts of the case

- An application dated 12.08.2017 was filed before the Standing Committee on Anti profiteering under Rule 128 of the Central Goods and Service Tax (CGST) Rules, 2017, by the Applicant No. 1 alleging that he had purchased one Honda City Car from the above Respondent vide Tax Invoice No. A-Tax/998/17-18 dated 14.10.2017 by paying an amount of Rs. 9,54,234/- on which GST @ 28% and Cess @ 17% was charged, however the benefit of Input Tax Credit (ITC) was not passed on to him by the above Respondent and therefore action should be taken against the Respondent for contravention of the provisions of Section 171 of the CGST Act, 2017.

- The application was examined by the Standing Committee on Anti- profiteering and on 04.01.2018 it was forwarded to the Director General of Anti-Profiteering (DGAP) to initiate an investigation and collect evidence necessary to determine whether the benefit of ITC on the said Car had been passed on by the Respondent to the above Applicant or not.

- The DGAP after scrutiny of the application had returned the same to the Standing Committee for reconsideration on the ground that no meaningful investigation could be conducted as no evidence had been furnished by the above Applicant. The Standing Committee had returned the above application on 28.02.2018 to the DGAP stating that once the application had been recommended for investigation, it couldn't reconsider it's decision as it had become 'functus officio'.

- The Report submitted by the DGAP was considered by the Authority and vide it's order dated 24.04.2018 passed in Case No. 2/2018, it had directed the DGAP to conduct fresh investigation in the case and submit a comprehensive and detailed report as no opportunity of being heard had been granted to the above Applicant by the DGAP during the course of the investigation.

DGAP'S findings and decision

- Section 171 (1) deals with two situations one relating to the passing on the benefit of reduction in the rate of tax and the second pertaining to the passing on the benefit of the ITC.

- On the issue of reduction in the tax rates, it is clear from the DGAP's investigation report that there was no reduction in the tax rate in this case hence, the allegation of profiteering by the Respondent on account of change in tax rate is not sustainable.

- It is also revealed from the perusal of the record that the profit margin of the Respondent had got reduced from Rs. 28,589/- which he was receiving in the pre-GST period to Rs. 16,621/- in the post-GST period and after taking in to account the discounts of Rs. 4,500/- and Rs. 9,000/-, which the Respondent had received for achieving pre-defined purchase and sale targets for the above two periods the total post-GST profit margin of the Respondent was Rs. 25,621/- (Rs. 16,621/- + Rs. 9,000/-), which was less than the pre-GST profit margin of Rs. 33,089/- (Rs. 28,589/- + Rs. 4,500/-).

- It is also apparent that the reduced profit margin was due to the fact that the post-GST purchase price of the Respondent was Rs. 6.906.05 less than the pre-GST purchase price. It is also clear from the record that the post-GST sale price charged by the Respondent was Rs. 15,683.50/- less than the pre-GST sale price.

- The record also reveals that the base price charged by the Respondent in the post-GST sale invoice dated 14.10.2017 was Rs. 1,73,346/- less than the base price in the pre-GST sale invoice dated 28.04.2017 due to the reason that in the pre-GST period, the credit of Excise Duty, NCCD and Cesses etc. was not available to the Respondent as only credit of VAT was admissible while in the post-GST period, the Respondent was entitled to claim the ITC on the entire GST paid @ 45% and when the post-GST purchase invoice dated 29.09.2017 and sale invoice dated 14.10.2017 issued by the Respondent were compared, it was evident that the Respondent had not passed on the burden of the input GST paid @ 45% amounting to Rs. 2,88,661.95/- to the Applicant due to the reason that he was eligible to claim ITC on this amount.

- It is also clear that there was increase in the ITC which the Respondent could avail in the post-GST era as compared to the pre-GST era and the pre-GST and post-GST sale invoices issued by the Respondent revealed that the base price charged from the above Applicant had been reduced as the benefit of ITC was passed on by the Respondent to the Applicant No. 1.

- Therefore, the allegation that the above Applicant had not been given the benefit of ITC by the Respondent was not proved.

- In view of the aforementioned findings, this Authority finds that the provisions of Section 171 (1) of the CGST Act, 2017 quoted above have not been contravened in the present case. Accordingly, the application filed by the Applicant No. 1 requesting for action against the Respondent for violation of the provisions of the Section 171 (1) of the CGST Act, 2017 is not maintainable and hence the same is dismissed.

Key Indirect Tax updates

This section summarizes the regulatory updates for the month of December 2018

ORDER No. 1/2018-Central Tax dated 11 December 2018 issued by Ministry of Finance

- The Government has extended the due date for filing of the annual return for the period from the 1st July, 2017 to the 31st March, 2018 till 31st March, 2019

31st GST Council Meeting

The Below are the summarized key updates :

- Rate reductions :
  - The GST rate on products of Chapter Heading 8483 like pulleys, transmission shafts, etc. have been reduced from 28% to 18%
  - Third party insurance premium of goods carrying vehicles from 18% to 12%;
  - The GST rate on Fly ash blocks have been reduced from 12% to 5%
  - The GST rate on re-treaded or used pneumatic tyres of rubber has been reduced from 28% to 18%
  - The GST rate on monitors and TVs of up to screen size of 32 inches has been reduced from 28% to 18%
  - For EPC contracts executed for setting up of solar power plants, it shall be deemed that 70% of the gross value of the contract is the value of goods attracting 5% rate and the remaining portion (30%) of the aggregate value of such EPC contract shall be deemed as the value of supply of taxable service attracting standard GST rate. However, the exact entry in the Notification for the said change would need to be analysed, to better understand as to whether the deemed valuation is obligatory and its scope.
  - Exemption on services provided by Central or State Government or Union Territory Government to their undertakings or PSUs by way of guaranteeing loans taken by them from financial institutions has been extended to guaranteeing of such loans taken from banks.
- Rate clarifications :
  - Movement of Rigs, Tools & Spares and all goods on wheels on own account where such movement is not intended for further supply of such goods but for the provision of service does not involve a supply (e.g., movement of testing equipment etc.) and is not be liable to GST.
- Miscellaneous :
  - Security services (supply of security personnel) provided to a registered person, except Government Departments which have taken registration for TDS and entities registered under composition scheme, shall be included under the RCM category
  - The new return filing system shall be introduced on a trial basis from 1 April 2019 and on mandatory basis from 1 July 2019
  - ITC in relation to invoices issued by the supplier during FY 2017-18 may be availed till the due date for furnishing of FORM GSTR-3B for the month of March, 2019, subject to specified conditions.
  - The due date for furnishing the annual returns in FORM GSTR-9, FORM GSTR-9A and reconciliation statement in FORM GSTR-9C for the Financial Year 2017 – 2018 shall be further extended till 30 June 2019
  - Certain clarifications in relation to the scope of disclosures in Form GSTR-9 and GSTR-9C would be issued; inter-alia including disclosures would need to be made for the transactions made during the year and not only those disclosed in the returns filed, HSN code for inward supplies would only need to be disclosed for those whose value independently accounts for 10% or more of the total value of inward supplies, etc.
  - The due date for submitting FORM GST ITC-04 for the period July 2017 to December 2018 shall be extended till 31 March 2019
  - Extension of Form GST RFD -01A for refunds to be filed for excess payment of tax, tax paid as intra-state but subsequently held to be inter-state or any other refund
  - Changes made by CGST (Amendment) Act, 2018, IGST (Amendment) Act, 2018, UTGST (Amendment) Act, 2018 and GST (Compensation to States) Amendment Act, 2018 and the corresponding changes in SGST Acts would be notified with effect from 1 February 2019
- Legislative changes proposed :
  - Creation of a Centralized Appellate Authority for Advance Ruling for cases where there are conflicting Rulings by two or more State Appellate Authorities of Advance Ruling

- Interest to be charged only on the net tax liability of the taxpayer ie, after taking into account the admissible ITC

Extension of due dates for filing GST Returns

S No	Return/ Form	Extended Due date	Taxpayers eligible for extension
1	**FORM GSTR-3B** for the months of September and October, 2018	30th November, 2018	Taxpayers whose principal place of business is in the district of Srikakulam in Andhra Pradesh
2	**FORM GSTR-3B** for the month of October, 2018	20th December, 2018	Taxpayers whose principal place of business is in the 11 specified districts of Tamil Nadu
3	**FORM GSTR-1** for the months of September and October, 2018	30th November, 2018	Taxpayers having aggregate turnover of more than 1.5 crore rupees and whose principal place of business is in the district of Srikakulam in Andhra Pradesh
4	**FORM GSTR-1** for the month of October, 2018	20th December, 2018	Taxpayers having aggregate turnover of more than 1.5 crore rupees and whose principal place of business is in the eleven specified districts of Tamil Nadu
5	**FORM GSTR-1** for the quarter July-September, 2018	30th November, 2018	Taxpayers having aggregate turnover of upto 1.5 crore rupees and whose principal place of business is in the district of Srikakulam in Andhra Pradesh
6	**FORM GSTR-4** for the quarter July to September, 2018	30th November, 2018	Taxpayers whose principal place of business is in the district of Srikakulam in Andhra Pradesh
7	**FORM GSTR-7** for the months October to December, 2018	31st January, 2019	All taxpayers

Direct Tax

This Section of Tax alert summarizes the Direct tax updates for the month of December 2018

Key Direct Tax Developments

1. Mumbai Tribunal rules inter-company deposits between sister-subsidiaries not deemed dividend under domestic law; rules on application of tax treaty provisions in hands of Mauritius taxpayer

Background and facts

- The Income tax law (ITL) provides for deemed dividend taxation in respect of payment by a closely held company by way of advance or loan given to (a) a beneficial shareholder holding not less than 10% of the voting rights in such company; or (b) any concern in which such shareholder (viz. holding 10% or more voting power) is a member or a partner and such shareholder has a substantial interest in the said concern.
- Taxation of deemed dividend is restricted to the extent of accumulated profits of a closely held company. For the years under consideration, deemed dividend is taxable in the hands of shareholder and it is no subject to dividend distribution tax (DDT) under the ITL.
- The India-Mauritius tax Treaty defines "dividend" to mean "income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the Contracting State (India) of which the company making the distribution is a resident". Such dividend is taxed at the rate of 5% in the hands of the shareholder company, being the beneficial owner holding directly at least 10% of the capital of the company paying the dividends.
- The Taxpayer is a Mauritius-based company and is principally an investment holding concern.

During the relevant tax years, the Taxpayer was holding majority shareholding in two Indian companies viz. 99.99% in Indian Company 1 (I Co 1) and 99.88% in Indian Company 2 (I Co 2). I Co 2 holds 100% in another Indian company (I Co 3).

- During the first year under consideration, I Co 1 advanced an amount of INR 130 million as an Inter-company deposit (ICD) to I Co 2. I Co 2 in turn used the funds for purchase of fixed assets, to improve commercial distribution network and to meet working capital requirements.
- In the subsequent year (year 2), I Co 1 advanced INR 900 million to I Co 3, which was then a step-down subsidiary of I Co 2, in three tranches. The Taxpayer also became 100% shareholder of I Co 3 in Year 2 itself, post-date of advancement of money to I Co 3.

Tax Authority's contentions

- In year 1, the ICDs given by I Co 1 to I Co 2, amounts to grant of "loan" out of accumulated profits in the hands of I Co 1. Further, since the Taxpayer was a common shareholder in both I Co 1 and I Co 2 on the date of advancement of loan, the amount advanced by I Co 1 to I Co 2, qualifies as deemed dividend in the hands of the Taxpayer under the ITL, taxable at a rate of 42.23% on gross basis. Lower rate under the Treaty is not available since the ICD does not amount to dividend under the Treaty.
- In year 2, amounts paid by I Co 1 to I Co 3 qualifies as deemed dividend in the hands of the Taxpayer who though, not a shareholder on the date of loan, became subsequently direct shareholder of both I Co 1 and I Co 3.
- The First Appellate Authority/ the Dispute Resolution Panel (DRP), upheld the validity of taxation of amount as deemed dividends in the hands of the Taxpayer.

Taxpayer's Contentions

Arguments for non-taxability in Year 1

- Amounts given by I Co 1 to I Co 2 is not in the nature of loan or advance, but is in the nature of a deposit. It is a deposit of surplus funds placed by I Co 1 with I Co 2, to be utilized by I

Co 2 for its internal activities. Reliance was placed on the decisions of jurisdictional Bombay High Court (HC) in the case of Durga Prasad Mandelia v. ROC and Pennwalt India Ltd. v. ROC to contend that a loan and deposit are distinct transactions.

- The following key distinguishing factors between a loan and deposit were indicated by the Taxpayer:

Feature	Deposit	Loan
Initiation	At the instance of the depositor i.e. the giver who has surplus funds	At the instance of the borrower, who is in need of the money
Repayment	On demand	On the conclusion of the tenure
Repayment schedule	No predetermined schedule. Principal repaid in unequated instalments	Defined repayment schedule exists

- The Board resolution of I Co 1 clearly set out the terms of ICD. Further, the provisions of the Indian Companies Act, which deal with the power of the Board of directors of a company to invest monies are distinct from those that deal with the power to make loans.

- Various terms of the ICD agreement were highlighted to substantiate that I Co 1 had made a deposit with I Co 2 and there was no loan transaction.

- Reference was made to various Mumbai Tribunal decisions, where it has been held that ICD being a deposit, will not fall within the purview of deemed dividend of the ITL.

- As an alternate argument, the Taxpayer sought protection under the Treaty, as it contended that the amount under consideration does not qualify as "dividends" as defined in the Treaty. Further, such amount is not taxable as business profits, since the Taxpayer did not have a permanent establishment in India. The amount should be covered under the residuary article, 'Other income', of the Treaty, as per which the amount can be taxed only in the state of residence of the Taxpayer (i.e. Mauritius in this case).

- Without prejudice to above, if the amount is taxed as deemed dividend, the lower rate of 5% for taxing dividend income under the Treaty should be levied.

Arguments for non-taxability in Year 2

- The amounts were advanced by I Co 1 to I Co 3 before the Taxpayer had acquired the shares in I Co 3. Amount cannot be taxed in the hands of the Taxpayer as deemed dividends, as the Taxpayer was not a substantial shareholder of I Co 3 when the amount was given, even if the amount advance by I Co 1 to I Co 3 is considered to be a loan.

- Reliance was placed on the ruling of the Allahabad High Court in the case of CIT vs H.K.Mittal, [219 ITR 420 (All)] and certain other rulings, wherein it is held that for the purpose of deemed dividend taxation, the relationship of shareholder must exist on the relevant date when the amounts have been advanced.

Tribunal's Ruling

Taxability in Year 1

Based on evidence the Tribunal held that the transaction of ICD is in the form of a "deposit" and not a "loan'" and that taxation of the amounts as deemed dividend under the ITL, was not warranted for the reasons as laid out hereafter.

- Deemed dividend taxation under the ITL creates a deeming fiction in terms of which an amount paid otherwise than as dividend is brought into the tax net as "dividend", subject to the fulfilment of specified conditions. Reliance was placed on the decision of SC in the case of Gopal and Sons (HUF), where it was held that since dividends are taxed on an artificial basis, strict interpretation is to be given to tax any amount under these provisions.

- Various judicial precedents, including decisions of jurisdiction HC and Tribunal (relied on by the Taxpayer), have accepted the distinction between ICD and loan and held that ICD is not a loan for the purposes of deemed dividend taxation. The Tax Authority has not brought out any judicial ruling to the contrary.

- Based on the board resolution, financial statements and the ICD agreement between I Co 1 and I Co 2, the Tribunal accepted arguments of the Taxpayer that ICD is in the nature of deposit and not loan. The following features were noted by the Tribunal, in coming to its conclusion:

  - There was availability of surplus funds with I Co 1 which were not immediately required by it. The best utilization of surplus funds was done by deploying funds with I Co 2.

  - Merely because the funds are used by I Co 2 to finance its activities (i.e. for purchase of fixed assets, to improve commercial distribution network, to meet working capital requirements), it cannot be said (as contended by the Tax authority) that I Co 2 was in need of funds and therefore money was lent by I Co 1 as a loan . It is the cumulative effect of the entire evidences which should be taken into account to infer the nature of transaction.
  - As one of principal distinction, in case of deposit, the sum is repayable on demand, whereas in a loan, it is repayable on completion of the agreed tenure. As per ICD agreement between I Co 1 and I Co 2, repayment clause is quite open-ended as per which I Co 2 can repay in unequated instalments over the tenure of deposit depending on its cash generation and, hence, such clause could not suggest the transaction is of raising a loan. Further, the termination clause
entitles I Co 1 to seek immediate repayment of the deposit in certain situations and such a clause to seek immediate repayment, would be generally absent in a loan transaction.

  - Dealing with the Taxpayer's alternative contention of non-taxability of the amount under the Treaty, the Tribunal rejected the Taxpayer's contention and held that amount paid as ICD would be dividend under the Treaty, taxable at a lower rate of 5%.

- The Tribunal noted that under the Treaty, the expression "dividend" covers (i) income from shares i.e. dividend per se (ii) income from other rights, not being debt claims, participating in profits; and (iii) income from corporate rights which is subjected to same taxation treatment as income from shares by the laws of contracting state of which the company making the distribution is a resident.

- According to the Tribunal, basis the Treaty definition, an amount if advanced as a loan can be covered under (iii) above.

- The expression "same taxation treatment as income from shares ", leads to the inference that so long as the ITL consider "deemed dividend" also as "dividend", then the same is also to be understood as "dividend" for the purpose of the Treaty.

Taxability in Year 2

The Tribunal decided issue in favor of the Taxpayer by accepting the contention that the Taxpayer was not a substantial shareholder on the date of the grant of loan. The Tribunal held as under:

- The Tribunal noted that the Tax Authority had invoked the deemed dividend taxation in the hands of the Taxpayer basis the common shareholding criteria. However, the contention is not tenable, since the Taxpayer was not a shareholder in I Co 3 on the dates on which the amounts were advanced.

- The provision of the deemed dividend taxation has to be strictly interpreted and thereby without any direct holding, the Taxpayer cannot be treated as beneficial owner. Further, there is no material to point out that the amount advanced by I Co.1 was for individual benefit of the shareholder of I Co. 1. Hence, provision of deemed dividend taxation does not trigger.

Source: ITA No. 1381/MUM/2017 & 564/MUM/2018

2. Delhi High Court rules amendment in time limit cannot lead to reopening of time

barred proceedings

Background and facts

- Section 147 (S. 147) of the Income Tax Act ("ITA" or "The Act"), provides that if the Tax Authority has "reasons to believe" that any income chargeable to tax has escaped assessment for any assessment year, then the Tax Authority can assess or reassess such income and also any other income chargeable to tax, which has escaped assessment and which comes to his notice subsequently in the course of assessment proceedings.
- S.149 of the ITA provides for the time limit for issuance of notice of reassessment. It provides an outer limit of 16 years, if the income in relation to any asset (including financial interest in any entity) located outside India, has escaped assessment. The outer limit of 16 years, was provided vide Finance Act, 2012 through an amendment to S.149. However, there was no specific mention on whether the amendment was retrospective.
- Taxpayer, an individual, was a Non Resident (NR)/Not Ordinarily Resident (NOR) in India for the Assessment Years (AYs) 1984-85 to 2003-04. Taxpayer was working and residing in foreign countries and was deriving income primarily from salary and professional receipts.
- For the AYs 1984-85 to 2003-04, Taxpayer filed return of income (ROI) in India. Since he was a NR/NOR, he disclosed only his Indian sourced income which was liable to tax in India.
- A search and seizure operation was conducted on the Taxpayer under section (u/s) 132 and during the search proceedings, the Taxpayer revealed that he did not maintain any foreign bank accounts, but had settled an offshore trust and had contributed an amount of approximately 2-3 million USD to the offshore trust, out of his income earned from sources outside India.
- Based on the above statement of the Taxpayer, the Tax Authority issued a notice u/s 148 dated 24 March 2015, to initiate reassessment proceedings for the AY 1998-99, on the suspicion that the income of the Taxpayer had escaped assessment.
- The Taxpayer aggrieved by the notice of initiation of reassessment, filed a writ petition before the Delhi HC.

Taxpayer's contentions

- Reopening of assessment vide notice dated 24 March 2015, is barred by limitation period prescribed u/s 149. The Act empowers the Tax Authority to reopen assessments u/s 147, however such power is subject to the limitation period u/s 149.
- S. 149 was amended, w.e.f. 1 April 1989 to provide for an outer time limit of ten years from the end of the relevant assessment year for reopening of assessments. The section was further amended with effect from 1 June 2001, where the limitation period was reduced to six years. Since the assessment was open at the time of this amendment, the reassessment proceedings should have been initiated within a period of six years from the end of the relevant AY 1998-99 i.e. before 31 March 2005. Thus, the reassessment notice dated 24 March 2015 is barred by limitation u/s 149 of the ITA.
- Various decisions of the SC and HC provide that once the period of limitation ends, it is not open to the tax authority to revisit issues which are final, further matters that attain finality under the existing law due to bar of limitation cannot be reopened for revival, unless the amended provision is given retrospective effect.
- The amendment to S.149 which took place in the year 2012, which provides for an outer limit of 16 years for reopening of assessment are expressly prospective and cannot enhance or extend limitation for re-opening assessment for matters that have attained finality.

Tax Authority's Contentions

- The reassessment proceedings were initiated within a period of 16 years from the end of the relevant assessment year, as per the time limit provided u/s 149, which was amended with retrospective effect from 1 July 2012.

- The intent of the amendment to S.149 in the year 2012, was to empower the tax department to reopen assessments by 16 years, if it is revealed that the taxpayer held an asset abroad. Such amendment is procedural in nature and procedural amendments can be effective at any point of time, even in ongoing proceedings.

- The Tax Authority had valid reasons for reopening of assessment u/s 148, as an amount of INR 125 million, used for settling an offshore trust had escaped assessment. Since the Taxpayer had failed to disclose foreign asset, he could not complain about reopening of assessment.

- The Taxpayer did not produce any evidence of being a NR in AY 1998-99 and the Taxpayer had also failed to produce any evidence for the source of income for investing in the offshore trust and how such amount was related to the Taxpayer's source of income outside India, either through ROI filed in a country outside India or through bank statements.

HC Ruling

The Delhi HC quashed the re-assessment proceeding and ruled in favour of the Taxpayer as under:

Tax authority cannot revisit matters barred by limitation under the existing law, unless amended provision extending limitation period is given retrospective effect

- SC decisions in the case of K.M.Sharma and S.S.Gadgil envisages that the provision regulating period of limitation ought to receive strict construction and therefore, proceedings, which had attained finality under the existing law due to bar of limitation, could not be held to be open for revival unless the amended provision was clearly given retrospective operation so as to allow upsetting of proceedings, which had already been completed and attained finality.

- The ratio of the SC in the cases of K.M.Sharma and S.S.Gadgil, are applicable to the facts of the present case and hence the reassessment for AY 1998-99, could not be opened beyond 31 March 2005, in terms of provisions of S.149, as applicable at the relevant point of time.

- Revival of the period of limitation for reopening assessment for AY 1998-99 by taking recourse to the subsequent amendment made in Section 149 of the Act in the year 2012, cannot be done as per the SC ruling in the case of K.M.Sharma.

Unless the terms of a statute expressly so provide, retrospective operation should not be given to a statute.

- Tax Authority's interpretation that the amendment to S.149 in the year 2012 is retrospective in nature, has the potential to re-open settled matters, in respect of issues where the citizen could be genuinely sanguine. Further, in the absence of a clear indication every statute is presumed to be prospective.

- Further, various SC rulings, in the context of whether an amendment is prospective or retrospective, have held that unless the terms of a statute expressly so provide or necessarily require it, retrospective operation should not be given to a statute. The liability to pay tax is computed according to the law in force at the beginning of the tax year and any change in law upsetting the position and imposing tax liability after that date, even if made during the currency of the tax year, unless specifically made retrospective, does not apply to the assessment for that year.

Source: TS-713-HC-2018(DEL)

3. Delhi Tribunal rules that applicability of threshold limit for withholding obligation in relation to sale of immovable property qua each co-owner

Background and facts

- Income tax laws (ITL) requires any person, being a buyer of an immovable property, to withhold taxes at the rate of 1% if the consideration is in excess of INR 5 Mn at the earlier of (a) credit of consideration in the account of the seller; or (b) payment of consideration (hereinafter referred as withholding provision).

- Taxpayer buyer who makes default on complying with tax withholding obligation is treated as an "assessee-in-default" and is liable for payment of interest and penalty. However, if the seller has furnished its tax return which includes the income on sale of immovable property and pays taxes due thereon, the interest liability is limited upto the date of filing of tax return by such seller provided a certificate to that effect has been provided by the seller.

- In the present case, the Taxpayer, along with three family members, purchased a property in joint name for a consideration of INR 15 Mn under the registered agreement dated 3 July 2012 with equal share.

- Consideration due to each co-owner INR 3.75 M has been paid to seller by each co-owner from their respective bank accounts.

- The Tax Authority has issued a notice to the Taxpayer and other co-owners to inquire about the compliance of the withholding obligation in respect of said purchase of immoveable property.

- The Taxpayer contended that as the individual share of each co-owner did not exceed INR 5 M, the threshold of withholding obligation does not trigger. Consequently, there was no obligation on the taxpayer to deduct tax while making payment of consideration to seller.

- The Tax Authority, however, was of the view that as the total consideration of the transfer of property was more than INR 5 M, tax withholding provision triggered. As there was no tax withholding compliance, the Tax Authority held the Taxpayer and other co-owners as "assessee-in-default" and raised demand of tax together with interest. The First Appellate Authority confirmed the order of the Tax Authority.

- On being aggrieved, the Taxpayer and other co-owners filed further appeal before the Tribunal.

Tribunal's Ruling:

- The Tribunal accepted the Taxpayer's contention and held that there was no withholding obligation on the Taxpayer and other co-owners in the facts of the case and, accordingly, set aside the order of the Tax authority which held the taxpayer and other co-owners as "assessee-in-default" basis the following reasons:

- The withholding provision and limit provided therein is applicable qua each co-owner. Thus, if the share of each co-owner does not exceed the minimum threshold limit, there shall be no obligation to withhold taxes.

- The intention to bring the threshold limit was to reduce the compliance burden on the small taxpayers.

- Explanatory Memorandum explaining the object of introducing tax withholding provision also states that withholding provision is not to apply where amount of consideration for transfer of immoveable property is less than INR 5 M.

- If each co-owners were to purchase 1/4th interest in the property under a separate agreement for consideration of INR 3.75 M, withholding provision would not be applicable. Law cannot be interpreted differently merely because each co-owner purchases 1/4th interest in the property under a single agreement.

Source: ITA No. 2736/Del/2015

4. Conversion of company into LLP under LLP Act results in "transfer" subject to capital gains tax

Background and facts

- The Limited Liability Partnership (LLP) Act in India provides for a process under which a company can be converted into an LLP. Conversion is defined under the LLP Act to mean transfer of the property, assets, interests, rights, privileges and obligations and the undertaking of the company to the LLP. Furthermore, as per the LLP Act, on conversion, all the assets, rights, privileges and obligations of the company are automatically transferred to and vest in the LLP. Upon conversion, the converted company stands dissolved.

- Under the ITL, capital gains arising from transfer of a capital asset are subject to tax in India. Capital gains for this purpose are computed by deducting the "cost of acquisition (COA)" of the capital asset from the "full value of consideration (FVC)" on transfer of the capital asset.

- However, any transfer of a capital asset that takes place on conversion of a company into an LLP in accordance with the LLP Act and satisfies certain specified conditions, is not subjected to capital gains tax under the ITL (exemption provision). Also, under the ITL when the business of a company is succeeded by an LLP on conversion under the LLP Act and such conversion satisfies the conditions specified in the exemption provision, then the business losses and unabsorbed depreciation (UAD) of the converting company are deemed to be the losses and the UAD of the successor LLP and allowed to be carried forward and set off by the successor LLP (carry forward provision).

- If any of the conditions, subject to which the exemption is granted, is breached, then the capital gains which was exempted under the ITL in the year of conversion is subjected to tax in India. The capital gains tax is however levied in the hands of the successor in the year of breach of the conditions (claw back provision).

- Furthermore, under the ITL where any business carried on by any person (predecessor) is succeeded by any other person (successor) and the predecessor cannot be found, then the assessment of the income of the tax in the year in which the succession takes place is assessed in the hands of the successor in the same and like manner as it would have been assessed in the hands of the predecessor (succession provision). The term "income" for the purposes of the succession provision is defined to include gains arising to the predecessor on the succession.

- Separately, the ITL contains an incentive provision in terms of which profits derived by an undertaking of a taxpayer by carrying on certain eligible business, is eligible for a deduction under the ITL for a specified period of time and subject to certain conditions specified therein (profit-linked deduction). A taxpayer claiming such deduction is required to file an "audit report" under the ITL along with tax return.

- In the relevant year, the Taxpayer was formed by conversion of an Indian company into an LLP under the LLP Act. However, on conversion, one of the conditions specified in the exemption provision was not satisfied.

- The Taxpayer contended that the event of conversion under the LLP Act resulted in vesting of assets and liabilities of the company into the successor LLP and, hence, did not involve transfer of any capital asset. The Taxpayer also argued that, as per the LLP Act, the losses and the UAD of the company vests with it and, hence, it carried forward and set off such losses and the UAD in computing its income for the relevant tax year. The Taxpayer also claimed the profit-linked deduction in respect of the business taken over on conversion.

- However, the Tax Authority noted that the conversion did not satisfy one of the conditions in the exemption provision under the ITL. Accordingly, conversion of a company into an LLP involved "transfer" of capital assets, triggering capital gains tax in the hands of the Taxpayer under the claw back provision of the ITL. The Tax Authority also denied carry forward of losses and the UAD in the hands of the Taxpayer. Furthermore, as the Taxpayer failed to furnish the audit report along with the tax return, the Tax Authority denied the profit-linked deduction claimed by the Taxpayer.

- On appeal, the First Appellate Authority (FAA) held as under:

- The FAA upheld the Tax Authority's contentions that conversion of a company into an LLP was not covered by the exemption provision or the carry forward provision. Thus, the FAA held that the conversion resulted into transfer of capital asset, which was subject to capital gain tax.

- The FAA denied carry forward and set off of losses and the UAD of the company by the Taxpayer.
- It further held that the conversion resulted into vesting of assets into the LLP. However, the book value of the assets transferred by the company was considered as the FVC. Since the difference between the FVC and COA of the capital assets transferred was NIL, it was held that the computation of capital gains under the ITL was unworkable and, hence, there cannot be levy of capital gains tax under the ITL.
- Furthermore, it held on merits that the profit-linked deduction under the ITL was attached to the "undertaking", and not to the Taxpayer. On conversion, since the undertaking was transferred to the Taxpayer, it was eligible to claim deduction of the profit-linked deduction for the unexpired period. Basis the audit report filed by the Taxpayer during the proceedings before it, the FAA upheld the profit-linked deduction claimed by the Taxpayer.
- Aggrieved, both the Taxpayer and Tax Authority filed an appeal before the Tribunal

Issues under consideration

The issues under consideration before the Tribunal were as follows:

- Whether conversion of a company into an LLP under LLP Act, which does not satisfy one of the conditions specified in the exemption provision, results in "transfer" of a capital asset.
- If yes, in whose hands is the capital gains taxable in India – whether the company which ceases to exist on conversion or the successor LLP, and how is the capital gains to be computed.
- Whether losses of the converted company should be carried forward and set off by the successor LLP.
- Whether profit-linked deduction in respect of the undertaking taken over on conversion of the company into an LLP can be allowed to the Taxpayer, although it failed to furnish the audit report under the ITL.

Tribunal's Ruling

On whether conversion results into "transfer" of a capital asset:

- The presence of the exemption provision in the ITL suggests that, but for a specific exemption on compliance of conditions, the event of conversion of a company into an LLP, involves transfer. This is further supported by the explanatory memorandum introducing the exemption provision, wherein it is explained that, prior to insertion of the exemption provision, transfer of assets on conversion of a company into an LLP, attracted "capital gains tax". However, the ITL was amended to provide that transfer of capital assets on conversion of a company into an LLP in accordance with the LLP Act, will not be subjected to capital gains tax only on fulfilment of certain conditions.
- Reliance of the Taxpayer on the Bombay High Court (HC) decision in the case of Texspin Engg. & Mfg. Works, is misplaced for the following reasons:
- In the facts before the Bombay HC, there was a succession of a partnership firm by a company under Part -IX of the Indian Company Laws (ICL). As per Part-IX of the ICL, succession of a firm by a company results in statutory vesting of properties in the company. Basis this, the Bombay HC held that on conversion of a firm into a company, there is transmission of assets from the firm to the company and the cloak given to the firm is replaced by the cloak of the company. It was in this background that the Bombay HC held that conversion of a firm into a company under Part IX of the ICL, did not amount to transfer and no capital gains is triggered.
- As against that, in the facts of the present case, there is conversion of a company into an LLP under the LLP Act. The definition of "convert" provided in the LLP Act (as

explained above) indicates that conversion involves "transfer" of capital asset.

- While, under Part-IX of the ICL, there is only vesting of assets, having regard to the definition of "conversion" under the LLP Act, conversion of a company into an LLP under the LLP Act results in transfer of assets. Hence, conversion of a company into an LLP stands on a different footing when compared to succession of a firm by a company under the ICL.

- Even if the Taxpayer's contention that that the conversion results in vesting of assets and not transfer of property under the Transfer of Property Act (TOPA) is to be accepted, as explained above, there is a transfer under the ITL and the meaning of transfer under TOPA cannot narrow down to the meaning of transfer under the ITL.

- Thus, conversion of a company into an LLP, which does not satisfy the conditions prescribed in the exemption provision, qualifies as "transfer" of capital asset under the ITL.

Applicability of claw back provision

- In terms of the claw back provision, the capital gains which were claimed as exemption are deemed to be the gains of the successor LLP for the tax year in which the conditions prescribed in the exemption provision are breached. Bare reading of the claw back provision indicates that it can be invoked only for the purposes of withdrawing an exemption which is claimed under the exemption provision.

- As the Taxpayer did not satisfy one of the conditions specified in the exemption provision at the very inception, it was not possible for it to claim exemption under the exemption provision. If such be the case, then there is no question of withdrawal of exemption by invoking the claw back provision.

- Thus, the action of the Tax Authority that capital gains arising on conversion are taxable in the hands of the successor LLP as per the claw back provision, is incorrect.

Liability of LLP as a successor of the Company

- Under the ITL, capital gains arising on "transfer" of a capital asset are principally charged to tax in the hands of the person transferring the asset which, in the present case, is the converted company and not the LLP.

- However, as per the succession provision under the ITL, the successor LLP which carries on business of the predecessor company is liable to tax in respect of the profits and gains of the predecessor company, including the gains arising on succession of the company into an LLP. Since, on conversion, the company stood dissolved, the capital gains arising to the predecessor company on conversion of the company into an LLP is liable to be taxed in the hands of the successor LLP i.e. the Taxpayer.

Computation of capital gains on conversion

- FVC represents the consideration which a transferor receives in lieu of the assets it parts with. It is the price bargained for by the parties. The value of the asset parted with cannot be considered as the consideration of the transfer and, hence, the expression "FVC" for computation of capital gains cannot be construed as the "fair market value" of the asset on the date of transfer.

- Reliance in this regard was placed on the Bombay HC decision in the case of Texspin Engg. & Mfg. Works (supra) and the Supreme Court (SC) decision in the case of George Henderson and Gilanders Arbuthnot .

- On conversion of a company into an LLP under the LLP Act, the entire undertaking of the company got vested into the "LLP". Thus, the transfer of assets took place at the book value. It is such book value alone which can be considered as the FVC of the assets transferred.

- As the difference between the FVC and COA is NIL, the capital gains computation becomes unworkable and, hence, not taxable in the hands of the successor LLP.

Carry forward and set off of losses of the predecessor company by the successor LLP

- The carry forward provision provides for transition of the losses and the UAD of the successor company to an LLP, provided the succession is by way of a conversion under the LLP Act and it satisfies the conditions specified in the exemption provision.

- The right to carry forward losses and the UAD of the predecessor is a right granted under the ITL, subject to satisfaction of the conditions specified in the exemption provision. It is a specific right granted under the ITL.

- The provisions of the LLP Act, which provide that all assets, rights, privileges and obligations of the company are automatically transferred to and vest in the LLP by superseding all other Acts, pertain only to the tangible and intangible properties and does not have anything to do with carry forward of losses which is a specific creature of the ITL.

- Carry forward of the losses and the UAD of the predecessor company, in case where conversion does not satisfy the conditions under the exemption provision, is contrary to the carry forward provisions under the ITL and, hence, not admissible.

Eligibility of the successor LLP to claim the profit-linked deduction for the residual period

- The Taxpayer did not claim profit-linked deduction in its return of income since it filed NIL income return after set-off of losses of the predecessor company. However, when the issue of non-admissibility of the losses and the UAD of the predecessor company was raised during assessment proceedings, the Taxpayer claimed the profit-linked deduction before the Tax Authority and filed the audit report before the FAA, which was admitted by the FAA after due process of law.

- The requirement of filing the audit report is a procedural and a directory requirement under the ITL and, hence, can be complied with even during the appeal proceedings.

- On merits, as the profit-linked deduction is attached to the "undertaking" and not to the "owner of the undertaking", the Taxpayer was eligible to claim such deduction. Furthermore, the Taxpayer was also under a bona fide belief that it was eligible for claiming profit-linked deduction. However, it was prevented by sufficient cause from furnishing the audit report at the prescribed time. Nevertheless, the audit report was furnished by the Taxpayer before the FAA. Thus, the FAA was right in allowing such deduction to the Taxpayer.

Source: [TS-684-ITAT-2018(Mum)]

5. Delhi High Court reiterates no disallowance of expenditure u/s 14A in absence of exempt income during the tax year even after SC ruling in Maxopp's case

Background and Facts

- S. 14A inserted by the Finance Act, 2001, with retrospective effect from 1 April 1962, provides that for the purposes of computing total income, no deduction shall be allowed for expenditure incurred by a taxpayer, in relation to the exempt income.

- In the present case, during tax year 2007-08, although the Taxpayer had investments which could give rise to exempt income, the Taxpayer did not disallow any expenditure u/s 14A of the ITA since no exempt income was earned during the relevant tax year.

- The Tax Authority rejected the Taxpayer's contentions and disallowed certain expenditure under s.14A.

- By relying on the jurisdictional HC rulings in the case of Cheminvest and Holcim ruling, the Tribunal held that no disallowance u/s 14A can be made in case of Nil exempt income.

- Several other HC rulings (rendered prior to Maxopp ruling) also support that if no exempt income is earned during a particular year, s.14A has no application. In other words, s.14A gets triggered only if some exempt income is actually earned.

- Being aggrieved by the Tribunal order, the Tax Authority preferred an appeal before the HC.

- Before the HC, the Tax Authority relied on the SC decisions in the case of Maxopp ruling and CIT v. Walfort Share & Stock Brokers Pvt Ltd (Walfort ruling) and contended that view expressed in Cheminvest (supra) and Holcim (supra) has been overruled or at least needs re-consideration after Maxopp ruling.

Delhi HC's ruling

Ruling in Taxpayer's favour, the HC dismissed the Tax Authority's appeal as not giving rise to substantial question of law. Further, the Delhi HC held that ratio of Cheminvest ruling that s. 14A does not trigger in absence of exempt income, is not impacted by SC ruling in Maxopp's case. The HC adopted following reasoning for its conclusion:

Scope of s.14A disallowance as explained by SC in Walfort and Maxopp rulings

- SC in Walfort ruling observed that expenses incurred can be allowed only to the extent they are relatable to earning of taxable income and held that s. 14A would apply when an income does not form part of total income. The SC in Walfort's case did not directly deal with the issue whether s. 14A disallowance can be made when taxpayer has not earned any exempt income during the year.

- SC in Maxopp ruling observed that if an expenditure has no causal connection with the exempt income, then the same shall be allowed as business expenditure. Only that expenditure which has been incurred in relation to exempt income needs to be disallowed.

Tax Authority had restricted disallowance in Maxopp ruling to the extent of exempt dividend income

- The HC noted that the Tax Authority, in Maxopp ruling, had itself restricted the disallowance to the extent of exempt income.

- The position becomes clear when reference is made to the case of State Bank of Patiala which was also decided by SC in Maxopp ruling. In State Bank of Patiala's case, the shares were held as stock in trade. The Tax Authority computed disallowance u/s 14A by applying Rule 8D but restricted the amount of disallowance to the amount of exempt income earned. While the CIT(A) enhanced and increased the disallowance as per Rule 8D, the Tribunal reversed the finding of the CIT(A). The SC held that CIT(A)'s view in that case disallowing expenditure beyond exempt income earned by the taxpayer by applying Rule 8D was clearly untenable and rightly rejected by the Tribunal.

- Since the Tax Authorities in Maxopp and State Bank of Patiala's cases had themselves restricted the disallowance to the extent of exempt income, the said ruling do not support Tax Authority's contention that s.14A disallowance can trigger even in absence of exempt income.

Reliance on past HC rulings (rendered prior to Maxopp ruling) which held that s. 14A does not apply in absence of exempt income

- Delhi HC in the case of Holcim had noted that three decisions of different HCs in the case of Lakhani Marketing, Corrtech Energy and Shivam Motors (supra) were directly on the proposition that if no dividend income was received during the year, s. 14A could not be invoked. The Holcim ruling was followed and elaborated in Cheminvest ruling.

- The Madras HC in the case of Chettinad (supra) also took similar view by following its earlier decision in Redington (India) Limited v. Addl. CIT and held as follows:-

a) By referring to the legislative background of s. 14A, the Madras HC rejected the Tax Authority's argument that s. 14A would be attracted even to exempt income "includable" in total income

b) The HC also rejected view expressed in CBDT Circular No. 5 of 2014 that s.14A was intended to cover even those situations where there is a possibility of exempt income being earned in future

c) S.14A is clearly relatable to earning of actual income and not notional or anticipated income. Application of Rule 8D in absence of exempt income will result in imposition of artificial method of computation on notional and assumed income

Source: PCIT v. McDonald's India Pvt. Ltd. [TS-680-HC-2018(Del)]

6. Jaipur Tribunal rules on apportionment of head office expense to tax holiday unit

Background and Facts

- Under the Indian Tax Laws (ITL), the Tax authority can re-open concluded assessments in cases, where the Tax Authority is of the opinion that certain income has escaped assessment. However, the Tax Authority cannot re-open assessment beyond four years from the end of year, subsequent to the relevant tax year if the original assessment was a scrutiny assessment and there is no failure on the part of the Taxpayer to disclose all the material facts.

- S. 80-IA of the ITL, inter-alia, provides profit linked tax holiday to a taxpayer undertaking the activity of generation or generation and distribution of power. The tax holiday operates for a period of 10 consecutive years at the option of the taxpayer, within a period of 15 or 20 years starting from the commencement of operation of the infrastructure facility. A taxpayer claiming benefit is also required to satisfy other conditions provided in the said provision.

- The Taxpayer was a government owned company and was engaged in the businesses of mining minerals and also generation of power through operation of windmills.

- Taxpayer had outsourced operation and maintenance of power generation business to a third party. Taxpayer claimed tax holiday benefit in respect of its income from the power generation undertaking.

- For tax year 2009-10, the Tax authority had concluded the original assessment proceedings vide order dated 27 February 2013, disallowing certain items of income on which the tax holiday was claimed. The disallowance was affirmed by the First Appellate Authority (FAA), but subsequently was reversed by the Tribunal, by holding that the Taxpayer was eligible for claiming the tax holiday benefit in respect of specified items of income.

- Subsequently, the Tax Authority re-opened the assessment for tax year 2009-10 vide notice dated 31 March 2017. The reason for re-opening the assessment given by the Tax Authority was that Taxpayer has claimed excessive tax holiday benefit by charging only direct operation and maintenance expenses while claiming tax holiday benefit and had not allocated cost of head office expenses incurred such as day-to-day management and supervision expenses, employee benefit, etc to power generation undertaking. The Tax authority also contended that the Taxpayer had failed to disclose truly and correctly all material facts to that effect.

- The Taxpayer objected to the re-opening of the assessment, by contending that re-opening of concluded assessments beyond a period of four years, from the end of the year subsequent to relevant tax year was bad in law as there was no failure on the part of the Taxpayer to disclose material facts in relation to taxpayer's claim for deduction in the original assessment and had appealed before the FAA against the re-opening of the assessment.

- The FAA, upheld the re-opening of the assessment by the Tax Authority,

- Aggrieved, the Taxpayer preferred an appeal before the Tribunal.

Taxpayer's Contentions

<u>On re-opening of concluded assessment</u>

- The Tax Authority cannot reopen the assessment unless any income chargeable to tax has escaped assessment by reason of failure on the part of the taxpayer to disclose fully and truly material facts necessary for assessment. This condition is not fulfilled in the present case.

- During the original assessment proceedings, the Taxpayer had filed detailed working of the tax holiday deduction duly supported by the audit report of a Chartered Accountant which was considered by the Tax authority in the original assessment proceedings and the Tax authority had made certain adjustments to the claim of tax holiday on certain items of income. Thus there was no failure on the part of the Taxpayer to disclose all material facts.

- The re-opening of assessment proceedings was initiated only due to a change of opinion on the existing facts on record which is not permissible under the law and hence the re-assessment proceedings should be quashed.

- Taxpayer relied on the several High Court and Supreme Court decisions, to support its claim against re-opening of assessment proceedings like ITO v. Techspan India Private Limited & ANR.

- Taxpayer distinguished Tax authority's reliance on Gujarat HC ruling in the case of Ajanta Private Limited v. ACIT which pertained to tax year 2007-08. Taxpayer contended that the said decision was superseded by a subsequent HC ruling in the case of same taxpayer (supra), pertaining to tax year 2010-11, where HC ruled that non-allocation of common expenses is not a sufficient ground to re-open the assessment proceedings.

<u>**On merit of claim for apportionment of common expenses**</u>

- The Taxpayer had duly considered all the expenditure related to the earning of the income from the business of power generation while working out the tax holiday claim.

- The head office/ common expenditure considered by the Tax Authority to be allocated against the income of the power generation units, could not be allocated against the income of the power generation units for the following reasons:

  - Some of these expenses were directly incurred in relation to the mining units and hence such expenditure had no nexus with power generation undertaking.

  - As regards other head office/corporate expenses incurred, no part of these expenses were for or allocable to power undertaking since entire operation and maintenance of the power generation units was outsourced to a third party.

  - In view of outsourcing of operation and management of power undertaking to third party, taxpayer had not required to undertake any strategic planning, marketing management, tendering, work allocation, contract awarding, control etc.

Tax Authority's Contentions

<u>**On re-opening of assessment proceedings**</u>

- There was failure on the part of Taxpayer, of not allocating proportionate amount of head office expenses towards eligible business and the same being a material fact for determining of profits from eligible business, re-opening of the assessment proceedings was valid.

<u>**On apportionment of common expenses**</u>

- The Taxpayer has only considered the direct operation and maintenance expenses to compute the profits from eligible business and has not apportioned the head office expenses between eligible and non-eligible business.

- FAA recorded a finding that the agreement with third party outsourcing the operational and management part revealed that Taxpayer retained certain functions of management, direction, supervision and control in relation to monitoring of operations of the undertaking. Therefore, the head office expenses should be apportioned towards eligible business.

Tribunal's Ruling

<u>**On re-opening of assessment**</u>

Tribunal held the issue against the Taxpayer, holding that re-opening of assessment proceedings beyond four years is valid for the following reasons:

- It is reasonable for the tax authority to hold a prima facie belief that head office expenses incurred at entity level should be allocated between eligible and non-eligible undertakings of the taxpayer.

- Financial statements, audit report, tax computation and other submissions made during the original assessment proceedings did not suggest any disclosure or discussion on allocation of head office expenses in working out tax holiday deduction.

- If it is a case where the Taxpayer does not make a clear and complete factual disclosure and it is a case of failure on the part of the Taxpayer to disclose the material facts in relation to the claim made.

- Tribunal held that High Court ruling in the case of Ajanta Pvt. Ltd. relied upon by the tax authority supports the case of the tax authority. Further, tribunal distinguished the rulings referred by the Taxpayer by holding that the rulings were rendered in peculiar facts and hence are not relevant to the case of the Taxpayer for the following reasons:

- Techspan India Private Limited & ANR (Supra) - In this case, the issue of apportionment of common expenses between software development and human resource development divisions was duly contested and decided in the original assessment proceedings and the Tax Authority was aware of the facts. Hence the SC held that re-opening was not warranted as it involves mere change of opinion.

- Ajanta Private Limited (Supra) - In this case, claim for tax holiday was minutely examined by tax authority in the original assessment proceedings and in that context, it was held that mere non-maintenance of separate revenue account for two businesses, was not valid ground to re-open assessment.

- Hindustan Zinc Limited - In this case, there was complete disclosure of the claim by the Taxpayer in the original assessment proceedings. Therefore, re-opening of assessment was not invalid.

<u>On merits of the claim for apportionment of common expenses</u>

Tribunal held the matter against the Taxpayer and held that common head office expenses are to be allocated to both eligible and non-eligible business basis the turnover ratio and made following observations:

- Even if the activities have been outsourced to a third party, Taxpayer was responsible for overall supervision and management of the activities undertaken at the strategic and managerial level. Taxpayer was also to safeguard the interests of the shareholders. For all these reasons, the Taxpayer remains responsible for the activities of the third party at the operational level. Looked at from this perspective, it is not correct to suggest that Taxpayer had not incurred any expense in furtherance and support of these functions of the Taxpayer.

- Activities at strategic, managerial, regulatory and overall oversight level have nexus with the power generation business and the hence the expenses incurred on employees costs and other establishment expenses in this regard are to be allocated to the power generation business.

- Tribunal, however, held that expenditure on rates and taxes, land tax, insurance, interest on debenture, business promotion expenses and advertisement expenses did not have nexus with power undertaking and, hence, no allocation of these expenses are warranted.

- The Tribunal noted that there are certain discrepancies in the amount determined by the Tax Authority as head office expenses. The matter was therefore set aside to the tax authority to verify expense and re-calculate profits for the purpose of tax holiday.

Source: ITA No. 1944/Mum/2018 - TS-659-ITAT-2018(Mum)

7. India outlines the recommended approaches to deal with taxpayer specific rulings received spontaneously from other jurisdictions under BEPS Action 5

Background

- One of the three key pillars of OECD/G20's BEPS project is to improve tax transparency in cross border transactions while promoting increased certainty and predictability. In order to achieve such objective, BEPS Action 5 - "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance" targeted on improving transparency through a framework of mandatory spontaneous Exchange of Information (EOI) on certain taxpayer-specific rulings which, in the absence of such EOI, could give rise to BEPS concerns. Action 5 is a minimum standard under BEPS project and all participating countries in the BEPS project are committed to implement the recommendations through amendments in their domestic laws.

- According to the Action 5 Report, such EOI on tax rulings need to take place with specific countries in the form of a standard Template The tax authority of the receiving country could then determine whether to request for the ruling itself, which would then have to be exchanged. The exchange is intended to resolve the countries' concerns that, if countries have no knowledge or information on the tax treatment of a taxpayer in a specific country, the transactions or arrangements may affect a related taxpayer resident in their home country.

- The exchange of rulings framework covers six categories of rulings: (i) rulings related to preferential regimes; (ii) cross border unilateral advance pricing arrangements (APAs) or other unilateral transfer pricing (TP) rulings; (iii) rulings giving a downward adjustment to profits; (iv) permanent establishment (PE) rulings; (v) conduit rulings; and (vi) miscellaneous rulings which may be included at a later date by Forum of Harmful Tax Practices (FHTP).

- Action 5 report acknowledges that confidentiality of information is a legal right of both the countries exchanging the information as well as the taxpayers. The information exchange partners may suspend or limit the scope of exchange of information if appropriate safeguards are not in place or there is unsatisfactory resolution of breach of confidentiality. Further, the international provisions and instruments will prevail over provisions of domestic law if the latter allows for a broader use of the information.

The Instruction - Templates of rulings received in India and recommended approaches for tax authority in India

The Instruction gives a brief description of each type of ruling exchanged under Action 5, significance thereof and the approach recommended to deal with such rulings by the Indian Tax Authority in taxation of residents in India. Such residents could be either ultimate or immediate parent of the taxpayer receiving the ruling or a related party with the foreign taxpayer or ultimate beneficial owner of payments covered under conduit rulings.

Details of rulings received and recommended approaches for India Tax Authority

Types of Rulings and its significance	Residents in India for whom the Template is relevant	CBDT recommended approach for utilisation of information templates by Indian Tax Authority
Rulings related to Preferential Regimes ▸ Geographically mobile business activities may be set up in a jurisdiction having a preferential regime for such activities, however, the substantial income generating activities may not be carried out in such jurisdictions. ▸ This may result in taxable profits of a geographical mobile activity	▸ Ultimate parent entity of foreign taxpayer ▸ Immediate parent entity of foreign taxpayer ▸ Related party with which foreign taxpayer has entered into a preferential treatment transaction	To utilize the information to identify and assess the extent of economic business activity actually reported in India and whether the income offered in India is commensurate to the same.

are artificially shifted away from the jurisdictions where value is actually created.		
Unilateral APAs and other cross-border rulings in respect of TP ‣ Unilateral APAs may bring about upward and downward adjustments to the profits of an entity. It may also provide a future TP methodology or a future pricing/profit apportionment structure. ‣ Absence of transparency in case of such unilateral APAs may lead to distortions and erosion of tax base for the other jurisdictions.	Ultimate parent entity of foreign taxpayer ‣ Immediate parent entity of foreign taxpayer ‣ Related party with which foreign taxpayer has entered into transaction covered by APA/the respective cross-border rulings	To ensure that there are no mismatches involved in the pricing of the transaction from the perspective of both the jurisdictions involved and no profits go untaxed resulting in base erosion and profit shifting.
Cross-border rulings providing for a downward adjustment of taxable profits ‣ A regime providing for negative adjustments to profits has a potential to result in no or low taxation and resultantly, provide an incentive to multi-national		

enterprises to shift profits. ‣ Where such adjustments are not reflected in enterprise's accounts or it is being made retrospectively, the corresponding affected country, may not be able to determine the existence of such adjustment resulting in revenue loss, if requisite rulings are not in its knowledge.		
PE rulings ‣ PE rulings focus on determination of existence or absence of PE or attribution of profit to PE.	‣ Ultimate parent entity of foreign taxpayer ‣ Immediate parent entity of foreign taxpayer ‣ Head office of foreign taxpayer	To assess the appropriate global profit of the Indian entity upon receipt of information of non-existence or attribution of profit to a PE in the foreign jurisdiction issuing the ruling
Related party conduit rulings: ‣ In the case of certain arrangements/ structuring in conduit rulings deduction is claimed by one party while the corresponding income remains un-taxed in the hands of the	‣ Ultimate parent entity of foreign taxpayer ‣ Immediate parent entity of foreign taxpayer ‣ Related party making payments to	To analyse such arrangement/ structuring to assess the appropriate profit of the Indian entity under such arrangement

transparent entity as well as its non-residents members	conduit ▸ Ultimate beneficial owner of payments made to conduit	

- The Instruction also indicates that further information can be obtained from the relevant foreign jurisdictions through the mechanism of EOI on request.
- The Instruction emphasizes that the any information received is subject to requirements of confidentiality under the tax treaties with the respective jurisdictions. Indian Tax authority is directed to strictly follow detailed guidelines on maintaining confidentiality provided in Manual of EOI issued by the CBDT in 2015.
- The Instruction comes into force with immediate effect.

Source: Instruction No. 6/2018 bearing F.No: SOO/141/2018-FT &TR-V

8. Mumbai ITAT rules on withholding requirement and deductibility of expenses incurred through an intermediary company

Background and facts

- The Taxpayer, an Indian company, was a subsidiary of a company incorporated in The Netherlands (Parent Company). The Taxpayer was engaged in business of certification of activities in respect of quantity, quality, pre-shipment inspections, surveys etc.

- During the relevant tax year, the Taxpayer made two type of payments to the Parent Company on which taxes were not withheld on the ground that the same amounted to reimbursement of expenses, viz.:

  i) Payment in respect of common expenses borne by the Parent Company for various group companies in respect of accounting services, legal and professional services, communication, R&D etc.

  These expenses were incurred by the Parent Company for and on behalf of the Taxpayer and other group companies and the same were recovered/allocated on the basis of arm's length principle by considering certain agreed parameters. As per the Auditor's Certificate, allocation of such expenses was done without any income element. (Common expenses).

  ii) Payments in respect of expenses for training services availed by the Taxpayer from independent third party and for which the payment was routed through the Parent Company.

  Such training services were arranged by the Parent Company which paid to the third party trainers and later on recovered the amount from the Taxpayer on actual basis. (Training expenses)

- The Tax authority was of the view that taxes were required to be withheld on both the above payments and in the absence of which, such payments/expenses were not allowed as deduction while computing taxable income of the Taxpayer under the ITL.

- The First Appellate Authority upheld the action of the Tax Authority. Aggrieved by the above, the Taxpayer filed an appeal before the ITAT.

- Under the provisions of ITL, a payer is obligated to withhold taxes only if the payments are chargeable to tax in India under the provisions of the ITL. In the event of failure to withhold the taxes as specified, deduction of such payments would not be allowed for computation of taxable income of the payer under the ITL.

Ruling of the Mumbai Tribunal

On Common expenses

- Common expenses were incurred by the Parent Company for and on behalf of the Taxpayer and the same were recovered without any income element as certified by the Taxpayer's auditors. Such payments would amount to reimbursement of expenses which is not chargeable to tax in the hands of the Parent Company. Accordingly, there was no requirement to withhold taxes on such payments under the ITL.

- Disallowance of any expense in the hands of the Taxpayer can be made only if the amount paid is chargeable to tax in the hands of recipient and there is a failure in withholding tax on it. If the amount is not chargeable to tax, there is no question of disallowance of its deduction in the hands of the Taxpayer.

On Training expenses

- Training expenses were incurred in connection with training solely for the Taxpayer's employees by some trainers who were independent third party service provider. It is the Taxpayer which availed the services and payments for such services was made through the medium of the Parent Company.

- For payments to qualify as reimbursement of expenses, the expense should be first incurred by the intermediary in the first instance, which is subsequently recovered from another company. In the present case, the expense is incurred not by the Parent Company but by the Taxpayer itself for availing services of third party trainers and the payment to such trainers is routed through the Parent Company. Payments made the Parent Company in this regard cannot be termed as reimbursement of expense. It is only where the payment is ultimately stopping with the Parent Company that it can be considered as reimbursement and not otherwise.

- The remission of amount by the Taxpayer to the Parent company for finally making the payment to third party trainers is payment to the third party trainers. Accordingly, the provisions of withholding of taxes under the ITL will apply as if the Taxpayer has made the payment to such third party trainers de hors the routing of payment through the Parent Company. If routing of payments through an intermediary is treated as equivalent to reimbursement of expense, such treatment will make relevant provision of the ITL academic and will thwart the flow of law.

- Under the ITL, withholding requirement would arise only if such payments were chargeable to tax in the hands of the recipient under the provisions of the ITL as well as the relevant tax treaty. Thus, the matter was remanded back to the Tax Authority to ascertain taxability of such payments in the hands of the third party trainers.

Source: [ITA No.577/Mum/2011]

9. Supreme Court's Decision on deduction under Section 80IC

- In a group of cases, with the case of Classic Binding Industries (Taxpayer) as the lead matter, the common issue before the SC was whether a new industrial unit set up in specified areas on or after 7 January 2003 is entitled to a fresh five-year profit-linked incentive deduction of 100% under Section 80-IC (S.80-IC) of the Indian Tax Laws (ITL), if such a unit undertook "substantial expansion" on or before the sunset date of 31 March 2012.

- S.80-IC of the ITL grants a profit-linked tax holiday for two types of units:

  (a.) A new unit that commenced manufacture or production during a prescribed qualifying period in a specified area,

  (b.) An existing unit in a specified area that undertakes "substantial expansion" during the qualifying period. The tax holiday is 100% for the first five years and 25% (30% for companies) for the next five years, starting from the "initial assessment year" for units based in the states of Himachal Pradesh (HP) and Uttaranchal, with the qualifying period between 7 January 2003 and 31 March 2012, subject to the overall limit of 10 years. The "initial assessment year" is the year in which the unit commences manufacture or production or completes "substantial expansion", as the case may be.

- In this case, the Taxpayer set up a unit eligible for tax holiday in HP during the qualifying period and claimed 100% deduction for the first five years beginning from the assessment year corresponding to tax year 2005-06, being the "initial assessment year". Thereafter, the Taxpayer undertook "substantial expansion" of the same unit in tax year 2010-11 and sought to claim enhanced deduction of 100% from tax year 2011-12, being the seventh year of the claim. Such enhanced claim was denied by the lower authorities up to the Income Tax Appellate Tribunal (Tribunal). However, the HP High Court (HC) ruled in favor of the Taxpayer on the basis of a plain and literal interpretation of S.80-IC.

- The SC reversed the HP HC ruling and held that once the Taxpayer had started claiming deduction under S.80-IC and the "initial assessment year" had commenced, there cannot be another "initial assessment year" merely because the Taxpayer undertook "substantial expansion" within the aforesaid tax holiday period of 10 years. The SC held that Taxpayer is entitled to 100% deduction for the first five years and 25% deduction for the next five years, regardless of "substantial expansion" undertaken anytime during the qualifying period of 10 years.

Source: TS-474-SC-2018

10. Hong Kong India Income tax treaty comes into force

On 30 November 2018, the income tax treaty between Hong Kong and India (the Treaty), signed on 19 March 2018, entered into force. The Treaty will become effective for tax years beginning on or after 1 April 2019.

Various Articles of the treaty are summarised as follows:

- **Provisions of treaty Tie-breaker test for dual residency (Article 4)**

Pursuant to the Organisation for Economic Co-operation and Development (OECD)'s Model Treaty, residency status of a person other than an individual will be determined by the mutual agreement procedure (MAP), based on its place of effective management, place of incorporation or constitution, and any other relevant factors. This provision follows the OECD's Multilateral Instrument (MLI). In the absence of the MAP, dual residents are not entitled to any relief or exemption from tax under the Treaty, except as may be agreed by the competent authorities (CA).

- **Permanent establishment (PE) (Article 5)**

- In addition to a fixed place PE, the Treaty covers other forms of PE such as Construction PE, Service PE and Agency PE. These provisions are comparable to the United Nations (UN) Model Treaty.
- The Treaty provides a six-month threshold for a Construction PE that includes a building site, assembly or installation project or supervisory activities.
- A Service PE is created when services, including consultancy services, are furnished for the same or a connected project for an aggregate period of more than 183 days within any 12-month period.
- The Agency PE definition covers authority to conclude contracts (except preparatory or auxiliary activities), maintaining a stock of goods/merchandise for regular delivery and securing orders wholly or almost wholly for the principal or its associated enterprises. The provision does not incorporate the MLI-recommended provisions on Agency PE.
- The Treaty also states that where the activities of an agent are devoted wholly and almost wholly on behalf of the enterprise, the agent will not be considered as an independent agent. Unlike the UN Model Treaty, the additional condition of satisfying an arm's-length requirement for qualifying as an independent agent, is absent in the Treaty.
- Certain activities are listed as exempt from creating a PE such as storage, display, maintenance of stock for storage, display or processing, purchasing goods or merchandise or collecting information, and other preparatory or auxiliary activities.

Business income (Article 7)

Article 7 of the Treaty provides for source taxation of business profits to the extent attributable to a PE in the source country. The provision generally follows Article 7 of the UN Model Treaty but the force of attraction rule is absent in the Treaty. Further, unlike the UN Model Treaty, the Treaty does not restrict deductibility of expenses payable to a head office in the form of royalties, fees, commission, etc. The Treaty also contains the exclusion for purchasing activity. This provision is not present in the UN or the OECD model treaties.

Associated Enterprises (AEs) – Corresponding adjustment related to transfer pricing provision (Article 9)

The Treaty provides that a corresponding adjustment may be made in the profits of AE in the other Contracting State:

- Where an adjustment has been made by a country to the profits of a resident, based on an arm's-length condition and taxes are levied on such adjusted profits adjusted; and
- Such profits are also taxed in the hands of the AE in the other Contracting State.

This provision relieves double taxation in the other Contracting State and is in line with India's commitment made as part of Action 14 on dispute resolution mechanism of the OECD Base Erosion and Profit Shifting (BEPS) plan.

Taxation of dividends (Article 10), interest (Article 11), royalties (Article 12), and fees for technical services (FTS) (Article 13)

Passive streams of income like dividends, interest, royalties and FTS are generally taxable in the resident country. Such income may also be taxed in the source country at a tax rate of 5% on dividends and 10% on interest, royalties and FTS on a gross basis.2 If such income is effectively connected to a PE in the source country, Article 7 will govern the taxation on the net basis.

The beneficial tax rates will not be available, however, if the main purpose or one of the main purposes of any person concerned with the creation or assignment of shares or other rights or debt or royalty rights or performance of services is to take advantage of these articles by means of such arrangement. This is similar to the Principal Purpose Test (PPT) in the MLI. Definitions of royalty and FTS are similar to those in the UN and the OECD model treaties. However, the Treaty does not include a condition of "make available" with respect to FTS, accordingly, its scope is much broader compared to other treaties with such condition.

Capital Gains (Article 14)

- Capital gains arising from the sale of immovable property and from the sale of shares of a company which derives more than 50% of its asset value directly or indirectly from immovable property will be taxed in the country where the immovable property is situated.
- The source country where the company is a resident retains a taxing right on capital gains from sale of other shares in a company.
- Each country will determine taxability of any other property in accordance with the provisions of its domestic laws.

Similar to other passive income streams, benefits under this Article are also subject to the "main purpose or one of the main purposes" test.

Elimination of double taxation (Article 23)

To eliminate the double taxation on a person, both countries allow a foreign tax credit for the taxes paid in the other country.

MAP (Article 25)

The Treaty provides for MAP similar to the MLI provision. Among other things, it states that a taxpayer may present its case to a CA in its resident country within three years from the first notification of the action resulting in taxation.

The CA would work together to resolve the case by a mutual agreement to be implemented notwithstanding any time limits in the domestic laws.

Anti-avoidance provisions (Article 28)

The provisions of the Treaty will not prevent a country from the application of its domestic law and measures concerning tax avoidance or evasion.
Treaty benefits will not be granted if the main purpose or one of the main purposes of any persons is non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements. This provision is comparable to the PPT rule as well as the language of the Preamble to the BEPS Action 6 in the MLI.
Cases of legal entities not having bona fide business activities will also be covered under the provisions.

11. Mumbai Tribunal: Tax includes surcharge & education cess for purposes of calculating MAT credit

Background and facts

- Explanation 2 to S. 115JB: the amount of income-tax shall include—

  (i) any tax on distributed profits under section 115-O or on distributed income under section 115R;

  (ii) any interest charged under this Act;

  (iii) surcharge, if any, as levied by the Central Acts from time to time;

  (iv) Education Cess on income-tax, if any, as levied by the Central Acts from time to time; and

  (v) Secondary and Higher Education Cess on income-tax, if any, as levied by the Central Acts from time to time.

- In the said case, two applications were moved u/s 154 of the Act for rectifying the mistakes of quantum of MAT credit (as the AO had granted lessor amount of MAT credit than claimed by the assessee). Since the applications were not disposed by the Assessing Officer (AO), two appeals had been moved regarding the quantum of MAT credit. In the appeal, the ACIT confirmed the order of AO in restricting the quantum of MAT credit.

- The issue before the Tribunal is whether MAT credit will include income tax, surcharge and education cess.

Tax Authority's contentions

DCIT in his order under section 154 said that section 115JAA stipulates that such book profit shall be deemed to be the total income of the assessee and tax payable by the assessee on such total income shall be the amount of income tax at specified rate of tax, which was 7.5% for Assessment Year 2006-07. Thus, section 115JAA does not talk about the income tax as increased by surcharge or education cess and it talks about only income tax.

Taxpayer's contentions

- Assessee contended that tax includes surcharge, cess so far as S. 115JB and 115JAA are concerned and placed reliance upon decision in M/s Eastern Jewels Pvt. Ltd. vs ACIT and CIT vs K. Srinivasan 83 ITR 346 (SC).

- As per facts of case in **M/s Eastern Jewels Pvt. Ltd. vs ACIT**, assessee has claimed a MAT credit u/s 115JAA which included surcharge and education cess. The AO held in the said case that MAT credit so calculated by the assessee includes surcharge and cess, which is not to be included for calculating MAT credit as only tax is allowed to be carried forward as MAT credit and not surcharge and cess. The CIT(A) confirmed the action of AO in restricting the MAT credit to tax only. Hence appeal was filed before the Tribunal against the said order.

- In the said appeal, it was submitted that the Supreme Court (SC) in case of CIT vs. K. Srinivasan has held that the words "income-tax" would include surcharge and additional surcharge. Therefore, the tax paid and tax payable as per section 115JAA(2A) would include both surcharge and education cess and the MAT credit claimed by the assessee company is correct.

- It is accordingly submitted that the assessee has rightly claimed the MAT credit well within the four corners of provisions of section 115JAA.

- In this regard the explanation 2 of S. 115JB is referred and in the result, the appeal of the assessee is allowed in the abovementioned case.

Tribunal's decision

- Tribunal relied on the decision in case of CIT vs K. Srinivasan (1972) 83 ITR 346 (SC) in which it was held that the surcharge is part of income tax.

- Hence, basis the decision in case M/s Eastern Jewels Pvt. Ltd. vs ACIT and having regard to explanation 2 to Section 1115JB, the ground raised by the assessee, as to whether income tax will include surcharge and education cess so far as S. 115JB and 115JAA are concerned, is allowed.

Source: TS-711-ITAT-2018(Mum)

12. Delhi Tribunal: Only markup under manpower supply agreement subject to TDS, not salary reimbursement

Background and facts:

- An appeal had been preferred by the AO against the order of CIT(A).

- The appeal primarily involved 3 issues in respect of which disallowance made by AO had been deleted by CIT(A). The issues under dispute are as follows:

a. Disallowance of project management expenses on ground of non deduction of TDS u/s 195.
b. Disallowance of interest expenses on the ground that it pertains to Capital Work in Progress (CWIP)
c. Capitalisation of software expenses

i. Project management expenses

The assessee made a payment to a Cyprus based entity ("foreign entity") for supply of manpower as per a Manpower supply agreement. The said expenses were claimed u/h "Project Management Expenses" and the payment was made after deducting TDS on 5% mark-up. However, on the actual cost component, which was in the nature of reimbursement of salaries, no TDS was deducted by the assessee but TDS was deducted by foreign entity u/s 192 of the Act. The AO made disallowance of the said expense on the ground of non deduction of TDS u/s 195 of the Act [40(a)(i)]. The CIT(A) deleted the disallowance.

ii. Disallowance of interest expenses

The assessing officer considered the disallowance of interest by holding that interest attributable to Capital Work in Progress (CWIP) is not allowable as revenue expense. The CIT(A) deleted the disallowance.

iii. Capitalisation of software expenses

The assessing officer was of the view that Software expense incurred by the assessee is of capital nature and same was required to be clubbed with Computer and other peripherals. Accordingly, the assessing officer made disallowance after allowing depreciation @ 60%. The CIT(A) deleted the disallowance.

Assessing officer's contentions

i. Project Management expenses

- It is submitted that as per the manpower supply agreement entered into with foreign entity, the foreign entity is the service provider and since the services are rendered in India, the payment received by the foreign entity was accrued and earned in India and hence, TDS u/s 195 was to be deducted by the assessee company.

- It was contended that the amount reimbursed to foreign entity was in the nature of Fee for Technical Services (FTS) and as such the assessee was required to deduct TDS on entire amount

ii. Disallowance of interest expenses

- It is argued that the CIT(A) has erred in deleting the addition relating to disallowance of interest expenses without appreciating the fact that the statement of the assessee regarding capitalisation plant and machinery is contradictory.

iii. Capitalisation of software expenses

- AO has contended that the software expenses are of enduring nature and are to be taken as a part of computers and need to be capitalized. It argued on the ground that expenses towards Annual Maintenance Contract (AMC), License Fee etc are of enduring nature.

CIT(A)'s contentions

i. Project Management expenses

- It is contended that the assessee has rightly deducted TDS on the mark up value only and further, there was no need to deduct TDS on the actual cost which is merely in the nature of reimbursement.

- The CIT(A) also submitted that the actual payment made to the foreign entity has been further disbursed to respective employees after deduction of TDS u/s 192 of the Act and as such there is no default in complying with the withholding tax provisions.

- On the issue of nature of manpower supply service vis-a-vis FTS, the CIT(A) submitted that the agreement is merely for supply of manpower and employees so seconded are under full supervision of the assessee and as such the payment is not in the nature of FTS.

ii. Disallowance of interest expenses

- It is submitted that assessee is a real estate developer and CWIP is in fact current work in progress in the form of consumables which are used at different sites.

- It is argued that the assessee company has sufficient own funds and that the assessing officer has failed to prove any nexus between the borrowed funds and CWIP.

- The issue is also covered by the assessment order for AY 2011-12 wherein the assessing officer has not made any similar disallowance of interest.

iii. Capitalisation of software expenses

- It is submitted that the expenses towards AMC, consumables and license fee are incurred on year to year basis and cannot be considered to be of enduring nature.

- It is further submitted that in AY 2011-12, the assessing officer himself has accepted the claim of AMC as revenue expenditure.

Tribunal's decision

i. Project Management expenses

- It is settled law that before thrusting liability to deduct TDS, the following pre-conditions must be satisfied:
  i. There must be income element in the hands of the recipient

  ii. The income must be earned/derived in India

  iii. In case the payment is made to a non-resident, satisfaction of conditions mentioned in the relevant Article of the Double Taxation Avoidance Agreement (DTAA), if any, is to be seen.

- In the present case, on examination of the manpower supply agreement, it is evident that the foreign entity has only supplied employees to the assessee on secondment basis and the invoice raised shows a clear bifurcation of the amount of reimbursement of actual cost and mark up of 5% on which TDS has been deducted by the assessee. The reimbursement of actual manpower expense has no element of any income in the case of foreign entity in terms of S. 195 of the Act.

- Held, assessee was not required to deduct TDS on the actual cost component which is in the nature of reimbursement.

ii. Disallowance of interest expense

- Observed that the assessing officer has not given any basis for estimating the interest disallowance @12% on the monthly balance of CWIP. Also, the assessing officer has failed to even prove slightest of nexus between the borrowed funds and the amount reflected under the head 'CWIP'.

- It is found that the capitalization and the consequential disallowance of interest has been made on an arbitrary basis without even appreciating the fact of availability of own funds and without establishing any nexus between the interest expense, which is apparently related to business activities, and the borrowed funds.

- Moreover, the assessing officer has accepted the claim of interest in AY 2011-12 wherein, on identical facts, no such disallowance was made. Hence the deletion of disallowance by CIT(A) is held to be valid.

iii. Capitalisation of software expenses

- The expenses claimed under the head software expense include AMC, consumables and license fee. These expenses are a regular feature in organizations which are obliged to incur these expenses every year.

- Moreover, no new asset has come into existence by incurring of such expenses and even the assessing officer has accepted the claim with regard to AMC expenses in AY 2011-12.

- Thus, it is held that software expenses are of revenue nature.

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