KNAV
PARTNERS BEYOND BOUNDARIES

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In this edition of our thought leadership publication, we have tracked the progress of some significant cases decided by the appellate forums across the country along with important notifications and press releases issued by the Central Board of Direct Taxes.

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Transfer Pricing

Case Law 1: M/s IDS Infotech Ltd Vs. M/s The Deputy CIT (ITA No. 130/CHD/2016)

Tested party taken by the assessee cannot be disregarded by the transfer pricing officer ('TPO') just because it is a foreign entity.

Facts of the case:

The assessee is engaged in the business of providing software solutions and IT enabled services in the areas of litigation support, publishing and content management, engineering services and healthcare support services. The TPO disregarded the arm's length price taken by the assessee in respect of market support services. The transfer pricing ('*TP*') study of the assessee had been rejected for the reason that the foreign associated enterprise ('*AE*') was taken as a tested party. The TPO rejected the foreign AE because he was of the view that the assessee had taken foreign comparables about which very little information had been provided and no reliable data in respect of foreign comparables was available. Therefore, the TPO considered the assessee as the tested party, searched for new comparables and completed the TP study at his end. On account of this, the TPO recomputed the arm's length price and made additions accordingly. The Hon'ble Commissioner of Income Tax (Appeals) ('*CIT(A)*') also upheld the order of the assessing officer ('*AO*').

Aggrieved by the order of the Hon'ble CIT(A), the assessee preferred an appeal with the Hon'ble Tribunal.

Decision of the Hon'ble Chandigarh Tribunal:

The Hon'ble Tribunal held that the AE which is the least complex party to the transaction, reliable data for comparison is available and which doesn't own valuable intangibles should be taken as the tested party. Therefore, the assessee was right in considering the foreign AE as tested party since the foreign entity was providing only marketing services and therefore, had the least complex functions. The assessee also pointed out that the entire process of selecting the comparables in relation to the foreign tested party and the data base used and all information pertaining to the comparables was duly disclosed in TP report. The Hon'ble Tribunal distinguished the order of the CIT(A) by relying on the decision rendered in the case of Ranbaxy Laboratories Ltd. Vs. Addl. CIT (2008) 299 ITR (AT) 175 (Del), General Motors India Pvt. Ltd. Vs. DCIT, (2013) 27 ITR (Trib) 373 (Ahd.) and Development Consultants Pvt. Ltd. Vs. DCIT, (2008) 115 TTJ 577 (Kol) wherein it was held that the assessee can take foreign entity as tested party provided the assessee ensures that relevant data for comparison is available in the public domain. In the assessee's case, all the conditions were fulfilled and reliable data was provided by the assessee in the TP report in respect of the foreign tested entity.

Therefore, the TPO cannot reject the test party merely because it is a foreign entity.

There were other grounds which were disposed off based on the facts of the case and relevant provisions.

KNAV comments:

Decision rendered by the Mumbai Tribunal in the case of Onward Technologies Ltd. Vs. DCIT 44 taxmann.com 295 [2014] wherein it was held that the tested party for the TP study report cannot be a foreign counterpart. The same was not considering while rendering the above decision. Therefore, the above decision cannot be relied upon completely since there are decisions against this principle as well.

International Tax

Case Law 1: Flughafen Zurich, AG Vs. DDIT (IT) [2017] 79 taxmann.com 199 (TBang)

In a case, wherein a foreign entity has seconded employees having expertise in field of management and the purpose of the said assignment for the Indian entity was to avail managerial services of those highly skilled personnel, reimbursement amount received by the foreign entity in respect of salary payments of such employees, to be considered as fees for technical services ('FTS').

Further, the nomenclature of the payment as 'reimbursement', doesn't negate the nature of the transaction.

Facts of the case:

The assessee company was a tax resident of Switzerland. It was engaged in providing operations and management services to airports.

The assessee entered into an agreement with Bangalore International Airport Ltd ('*BIAL*'), inter alia, Expatriate Remuneration Reimbursement Agreement for secondment of highly skilled personnel. The agreement was such that the assessee would pay salary to the seconded employees in foreign currency outside India, and in turn would be reimbursed for the same by BIAL.

The AO opined that the payment received by the assessee from BIAL in terms of secondment agreement was in the nature of FTS and accordingly chargeable to tax as per the provisions of section 9(1)(vii) of the Income Tax Act, 1961 ('*the Act*') as well as Article 12 of Indo-Swiss Double Tax Avoidance Agreement (*'DTAA'*).

The assessee claimed that the seconded personnel worked under the direct control and supervision of BIAL as it had the right to issue directions to the seconded employees. Therefore, the seconded employees satisfied the test of employer-employee relationship with BIAL and the payment of salary to those employees through the assessee could not be considered as FTS.

The AO did not accept the contention of the assessee and held the amount to be FTS. The Hon'ble Dispute Resolution Panel ('*DRP*') confirmed the order of AO.

Aggrieved, the assessee preferred appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal

The Hon'ble Tribunal held as under:

- There is no dispute that the secondees in this case at the time of agreement were under the employment of the assessee and therefore it was not an employment or recruitment by BIAL. It was also not in dispute that all the assignees/secondees were holding high managerial position as per the details given in the agreement;
- Since the secondees were holding the positions of CEO and CCO in the management, it clearly establishes the fact that they were not ordinary employees but were experts in the field of management and therefore the purpose of such assignment was to avail the services of these highly-qualified personnel;
- Reliance was placed on case of Intel Corporation Vs. Dy. DIT [2016] 76 taxmann.com 125 (TBang) wherein it was observed that considering the positions of the employees which had been seconded, one could say that in order to provide such technical services, the seconded employees had to draw from their technical knowledge, and thus the fees paid in that aspect falls within the ambit of the term FTS;
- On the contention of the assessee that the payment made was purely a reimbursement of expenses incurred by the assessee, the discussions in the case of AT & S India (P.) Ltd were taken into consideration, wherein it was opined that the fact that the overseas entity does not charge a mark-up over and above the costs of maintaining the seconded employees cannot negate the nature of the transaction itself. If the payment, being FTS or royalty, is made to the non-resident, then the concept of total income becomes irrelevant and the provisions of section 44D of the Act recognizes the gross payment chargeable to tax. Thus, all the payment made by the assessee to the non-resident on account of FTS or royalty is chargeable to tax irrespective of the inclusion of any profit element in the said payment or not;
- So far as the facts of the case as well as the terms and conditions of the expatriate agreement were concerned, there were no material variations in the terms and conditions of the secondment in the case of the assessee as compared to the cases which were considered;
- The definition of FTS as per the first limb as provided u/s 9(1)(vii) of the Act as well as Article 12(4) of DTAA means payment of any kind in consideration for rendering of any managerial, technical or consultancy services and to that extent, the definition of FTS under the Act as well as DTAA was identical; &
- In this case, when the payment is considered for managerial service then it becomes irrelevant to go into second aspect of provision of service by technical or other personnel as used in Article 12(4) of the DTAA.

Thus, in view of the above discussion as well as the facts and circumstances of the case, the Hon'ble Tribunal held that no distinguishing facts or circumstances in the case of the assessee were found, to take a different view as taken by the same Tribunal in the case of Intel Corporation (*supra*).

Hence, by following the earlier decision of the same Tribunal, the issue was decided against the assessee.

Case Law 2: Burt Hill Design (P) Ltd Vs. Deputy Director of Income tax (International Taxation), Ahmedabad [2017] 79 taxmann.com 459 (Ahmd)

Where the assessee has duly discharged its withholding obligations in respect of salary income paid to employees under a secondment agreement with its non-resident parent company, the assessee is not liable to withhold tax while making reimbursement to the parent company in respect of such payroll costs.

Facts of the case:

The assessee, engaged in the business of providing information technology enabled services, is subsidiary of a US company. During the relevant AYs, under a secondment agreement with the assessee, the parent company had seconded certain employees at the disposal, and control, of the assessee. The assessee has made remittances to the parent company, in respect of reimbursement of payroll costs, without any deductions on account of tax withholdings.

The AO was of the view that since the workforce was employed by the parent company, the payment was in fact in the nature of payment for services rendered by these employees. The AO proceeded to hold that the work done by these employees of parent company has resulted in creation of a service permanent establishment ('*PE*') under Article 5(2)(l) of India-US DTAA, and that the entire amount so paid to the parent company, being attributable to the PE, is taxable on gross basis, in the absence of details of expenditure of the PE, @ 40%. Accordingly, demands u/s 201 of the Act read with section 195 of the Act were raised. It was also held, that in any event, the amount so paid to the parent company was taxable as fees for included services ('*FIS*') under Article 12(4) of India-US DTAA as also u/s 9(1)(vii) of the Act.

It was explained by the assessee that these are reimbursements plain and simple, and that these payments did not involve any profit element taxable in the hands of the parent company. It was also explained the payments were in the nature of salaries, and that the assesse had duly discharged his tax withholding obligations from these salaries to the extent the recipients were taxable in India. The details of tax payment by the seconded employees were also furnished.

The AO, however, rejected the contentions of the assessee.

Aggrieved, assessee carried the matter in appeal before the Hon'ble CIT(A). The Hon'ble CIT (A), in respect of certain AYs ruled in favour of the assesse, however, in respect of one of the AYs under consideration held that while the parent company cannot be said to have a service PE in India, the amounts so paid are required to be treated as FIS and accordingly the assessee should have withheld taxes, at the rates applicable for FIS.

The revenue as well as the assesse, not being satisfied by the stands so taken by the Hon'ble CIT(A), filed an appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

The Hon'ble Tribunal was of the view that the payment made to the parent company consists of income which is chargeable, and has been charged, to tax in India under the head 'income from salaries' and therefore whether the seconded employees continue to be in employment of the foreign entities or not is wholly irrelevant for this purpose. The income embedded in the impugned payments being in the nature of income chargeable to tax under the head 'income from salaries', the assessee cannot be said to have any tax withholding obligations u/s 195 of the Act and therefore, impugned tax withholding demands, u/s 201 of the Act r.w. section 195 of the Act, are wholly devoid of any legally sustainable merits.

Therefore, appeals filed by the assessee are allowed, and conversely appeals filed by the AO, are dismissed.

Case Law 3: Reebok India Company Vs. DCIT, New Delhi [2017] 79 taxmann.com 271 (TDel)

Use of trademark, trade name etc. in rendering of advertisement, publicity and sales promotion services is neither in the nature of royalty nor FTS.

Further, chargeability of income to tax in the hands of a non-resident is a condition precedent to deduction of tax at source on the payment made to the non-resident.

Facts of the case:

The assessee, under an agreement made payment of a certain amount to International Cricket Council ('*ICC*'), a resident of British Virgin Islands.

Per the agreement, ICC allowed assessee to associate with it as its official partner. The agreement granted the assessee a bundle of rights and listed the manner in which assessee was allowed to advertise/market its products during the ICC events for a consolidated consideration. The impugned payments were made by the assesse without deducting any tax at source.

The AO held the payment to be royalty/FTS and owing to non-deduction of tax at source, proposed disallowance u/s 40(a)(i) of the Act.

Aggrieved, the assesse appealed before the Hon'ble DRP. The Hon'ble DRP held that benefits availed by the assessee from ICC did not fall within the ambit of royalty or FTS and accordingly deleted the impugned disallowance.

Aggrieved, the revenue preferred appeal before the Hon'ble Tribunal.

Decision of the Hon'ble Tribunal:

In order to attract disallowance u/s 40(a)(i) of the Act, the payment made by the assesse must be in the nature of royalty or FTS in the hands of the non-resident and such payment should have been made without deduction of tax at source. Both the above conditions need to be satisfied cumulatively for attracting disallowance under the said section of the Act. Admittedly, the assessee did not deduct any tax at source. This manifests that if the payment made by the assessee to ICC gets covered within the scope of royalty or FTS, it will be chargeable to tax in India u/s 9 of the Act, thereby fixing liability on the assessee to deduct tax at source, failure of which would entail disallowance u/s 40(a)(i) of the Act. In order to analyse whether the payment by the assessee to ICC is in the nature of royalty or FTS, the Hon'ble Tribunal examined and evaluated the clauses of the agreement. A thorough analysis of the agreement brought to table the following observations/conclusions:

- ICC agreed to grant to the assessee certain promotional, advertising, marketing and other commercial rights on a worldwide basis in connection with the ICC events. Thus, it is apparent that the assesse acquired broadly two types of rights i.e. 'promotional and advertising' and 'marketing' rights;
- There are two types of payments, which the assessee is supposed to make under the agreement, namely, 'Rights fee' and 'Royalty', which have been defined in the agreement. Payment made for the sale of licensed products is 'Royalty' and payment made for grant of Rights is 'Rights fee'. The said 'Right fees' were in the nature of royalty as per the AO, and therefore were disallowed by the AO on account of non-deduction of tax at source;
- With regards to the definition of FTS given in the Act and having gone through the relevant clauses of the agreement, the Tribunal was of the view that ICC has not charged the assesse for rendering any managerial, technical or consultancy services, but instead has charged Rights fee for assigning certain rights;

- In that view of the abovementioned facts, the payment made by the assessee to ICC could not be considered as FTS;
- Further, Hon'ble Tribunal when evaluating whether the payment made was for use of any patent, invention, model, design or trademark or similar property etc or services in connection with the use of patent, invention, design etc thereby constituting royalty under the provisions of the Act, came to the conclusion that the 'Rights fee' is one composite payment for a package of 21 rights given to the assese without any bifurcation of consideration relatable to such rights individually. Apart from the payment of 'Rights fee', the agreement also requires payment of 'Royalty' which shows that there is a separate provision in the agreement for payment of royalty on the manufacture and sale of licensed products using the marks of ICC; &
- Thus, taking a holistic view of the agreement and relying on the decision rendered by the Delhi High Court in the case of DIT Vs. Sheraton International Inc [2009] 313 ITR 267/178 Taxman 84 (Delhi), the Hon'ble Tribunal held that payment for use of designations and marks etc. is on two counts, that is, for advertisement and promotion, which is dealt with by 'Rights fee' clause and for manufacture and sale of products, which is dealt with by 'Royalty' clause and it is only the latter, which is in the nature of royalty income in the hands of ICC.

Thus, the payment made by the assessee to ICC as 'Rights fee' is not in the nature of royalty or FTS and as such the assessee was not obliged to deduct tax at source on this payment and consequently the provisions of section 40(a)(i) of the Act are not attracted.

Domestic Tax

Case Law 1: Commissioner of Income Tax-1 Vs. M/s Gagandeep Infrastructure Pvt Ltd (ITA No. 1613/BOM/2014)

Section 68 of the Act cannot be invoked if the assessee fulfils the tests to prove the genuineness of the transaction.

Facts of the case:

The assessee company had increased its share capital to an exorbitantly high amount. The AO initiated the assessment proceedings and called upon the justification of such increase in share capital and charging high premium. In response, the assessee furnished the list of its shareholders, copy of the share application form, copy of share certificate and Form no.2 filed with the Registrar of Companies ('*ROC*'). The justification for charging share premium was on the basis of the future prospects of the business of the assessee. However, the AO did not accept this contention and invoked section 68 of the Act to treat the total credit to share capital as unexplained cash credit being chargeable to tax. The assessee preferred an appeal before the Hon'ble CIT(A) and filed his objections before the Hon'ble CIT(A).

The Hon'ble CIT(A) deleted the additions made by the AO since the AO had given no reason to conclude that the increase in the share capital and premium was not genuine. Further, he held that the appropriate valuation of the shares is for the subscriber/investor to decide and not a subject of enquiry by the revenue. He also relied upon the decision rendered by the Apex Court in the case of CIT Vs. Lovely Exports (P) Ltd 317 ITR 218 wherein it was held that if the amounts have been subscribed by bogus shareholders, it is for the revenue to proceed against such shareholders.

Aggrieved by the order of the Hon'ble CIT(A), the revenue preferred an appeal before the Hon'ble Bombay Tribunal.

The Hon'ble Bombay Tribunal upheld the decision of the Hon'ble CIT(A) since the assessee had furnished proper documents and proofs to prove the genuineness of transactions.

Aggrieved by the order of the Hon'ble Tribunal, the revenue department filed an appeal before the Hon'ble Bombay High Court.

Decision of the Hon'ble High Court

The Hon'ble Bombay High Court dismissed the appeal of the revenue holding that the assessee had fulfilled all the three tests namely the genuineness of the transaction, identity and capacity of the investor and the same was confirmed in the order of the Tribunal. Also, it upheld the reliance of the Hon'ble CIT(A) and the Hon'ble Tribunal on the decision of the Apex court in case of Lovely Exports (P) Ltd and concluded that the revenue is not entitled to add the amount credited to share capital to the total income of the assessee as unexplained cash credit if the shareholders are bogus. The officers have a right to reopen the assessment of the shareholders.

Therefore, section 68 of the Act cannot be invoked if the assessee fulfils the tests to prove the genuineness of the transaction.

Case Law 2: M/s Fidelity Business Services India Pvt Ltd Vs. Asst. Commissioner of Income Tax (IT(TP}A. No.416/Bang/2016)

Any payment on account of purchase of its own shares by the company prior to June 01, 2013 cannot be termed as dividend distribution per section 2(22) r.w. section 115QA of the Act.

Summary of the case:

The assessee is incorporated in India and 99.99% of its shares are held by M/s FIS Holding Mauritian Ltd which is incorporated in Mauritius. The assessee had bought back its own shares from its holding company to the extent of 2933 shares at a price of INR 285,108 per share having face value of INR 10 per share. The AO contended that the route to transfer reserves and surplus to the holding company was chosen as buyback of shares over dividend distribution only to avoid dividend distribution tax ('*DDT*'). Therefore, he held that the buyback of shares is just a colourable instrument to transfer the accumulated profit without having tax impact in India in the hands of the recipient.

However, the AO on directions from the DRP still treated the payment made to holding company on buyback of shares as dividend u/s 2(22)(d) of the Act and levied DDT on the difference between the face value of the shares and amount paid for the buyback of shares.

Aggrieved by this decision, the assessee filed an appeal to the Hon'ble Bangalore Tribunal.

Decision of the Hon'ble Bangalore Tribunal:

The Hon'ble Bangalore Tribunal distinguished the order of the AO stated that the exclusion clause (iv) of section 2(22) of the Act has specifically excluded the transaction of buyback of shares from the definition of dividend u/s 2(22) of the Act. The Hon'ble Tribunal disregarded the view taken by the AO and concluded that under no circumstances, the transaction of buyback can be brought into the definition of dividend u/s 2(22)(d) of the Act. Also, the transaction was entered by the assessee before the introduction of section 115QA of the Act, therefore the same would not apply. Prior to the amendment/introduction of section 115QA of the Act, the recipient of consideration on account of buyback of shares was liable to capital gains tax as per section 46A of the Act. Also the assessee relied on the decision rendered by the Hon'ble Tribunal in case of Goldman Sachs India Pvt Ltd Vs. ITO (International Taxation) 70 Taxmann.com 46 wherein it was contended that the transaction of buyback was not a colourable device or distribution of dividend. In this case, since the recipient was based out of Mauritius the Articles of the Indo-Mauritius DTAA had been considered by Hon'ble the Tribunal. The Hon'ble Tribunal upheld the view taken by the AO wherein the AO had accepted that the capital gain in the hands of the holding company is not chargeable to tax as per the provisions of Article 13(4) of Indo-Mauritius DTAA.

Therefore, merely there were no tax liabilities in the current case due to the benefit available in the Indo-Mauritius DTAA, the AO cannot classify the transaction of buyback of securities as deemed dividend to bring it in the purview of income tax laws.

Recent important notifications and press releases issued by the central board of direct taxes ('*CBDT*')

1. Notification No. 18/2017 and Press release dated March 23, 2017 - Third protocol amending India-Singapore DTAA comes into force and Notification No. 18/2017

A link for the same is provided herewith:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/605/Third-Protocol-Amending-India-Singapore-DTAA-Comes-Force-23-3-2017.pdf

http://www.incometaxindia.gov.in/communications/notification/notification18_2017.pdf

2. Draft Notification and Press release dated April 3, 2017 - CBDT requests for stakeholder's comments on draft Notification to be issued u/s 10(38) of the Act.

The Finance Act, 2017 amended the provisions of section 10 (38) to provide that exemption under this section for income arising on transfer of equity share acquired or on after October 01, 2004 shall be available only if the acquisition of share is chargeable to Securities Transaction Tax (*'STT'*). However, to protect the exemption for genuine cases where the STT could not have been paid like acquisition of share in IPO, FPO, bonus or rights issue by a listed company, acquisition by non-resident in accordance with FDI policy of the Government etc., the Central Government has come out with a draft notification to state the acquisitions for which the condition of chargeability to STT shall not apply.

A link for the same is provided herewith:

http://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/156/draft-notofication-10-38-for-web-manager-03-04-2017.pdf

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/608/PressRelease-Sec10-38-3-04-2017.pdf

3. Notification No. 28/2017 dated April 5, 2017 Non-applicability of provisions of section 269ST of the Act

The Central Government has notified that the provision of section 269ST of the Act shall not apply to receipt by any person from any banking company, post office savings bank or co-operative bank.

A link for the same is provided herewith:

http://www.incometaxindia.gov.in/communications/notification/notification28_2017.pdf

4. Press release dated April 5, 2017 – Mandatory quoting of Aadhaar for PAN applications & filing return of income

Section 139AA of the Act as introduced by the Finance Act, 2017 provides for mandatory quoting of Aadhaar/Enrolment ID of Aadhaar application form, for filing of return of income and for making an application for allotment of Permanent Account Number ('*PAN*') with effect from July 01, 2017.

A link for the same is provided herewith:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/611/Press-Release-Aadhaar-5-04-2017.pdf

5. Press release dated April 5, 2017 – Budget 2017 takes steps to discourage cash transactions & curb black money

The said press release summaries various legislative steps that have been taken by the Finance Act, 2017 to curb black money by discouraging cash transaction and by promoting digital economy.

A link for the same is provided herewith:

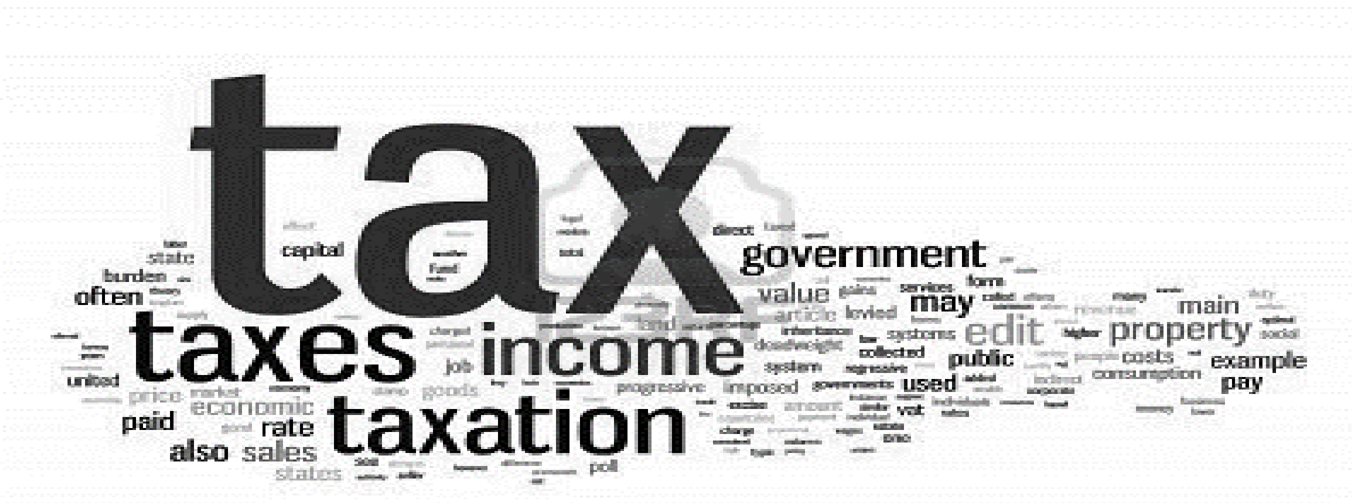
http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/610/Press-Release-on-promoting-Digital-Economy-5-4-2017.pdf

6. Press release dated April 11, 2017 – CBDT Issues PAN and TAN within 1 day to improve ease of doing business

In order to improve the ease of doing business for newly incorporated corporates, CBDT has tied up with Ministry of Corporate Affairs (‘*MCA*’) to issue PAN and Tax Deduction Account Number (‘*TAN*’) in 1 day.

A link for the same is provided herewith:

http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/613/CBDT-issues-PAN-TAN-within-1-day-improve-Ease-Doing-Business-11-4-2017.pdf



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