NEWS CRUNCH

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NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. Interest on refund under 244A not taxable as per Indo-Italy DTAA

Facts of the case

Ansaldo Energia SPA ('Assesse') is a company incorporated under the laws of Italy. During the relevant assessment years, the Assessee received certain refund alongwith interest under section 244A of the Act. While making payment of the said interest, the Assessing Officer deducted tax at source ('TDS') at 42.024%. Aggrieved, the Assessee filed an appeal before the High Court.

The issue under consideration was whether interest paid on income tax refund is within the meaning of the term "interest" as per Article 12 of the India – Italy DTAA. Definition of interest under Article 12 of the India – Italy DTAA includes 'debt claim of every kind'. Further, the said DTAA specifies that interest will be exempted in a Contracting State where the payer of such interest is the Government of that Contracting State. Article 12(4) of the DTAA provides that the term "interest" as used in this Article means income from Government securities, bonds or debentures, and debt-claims of every kind as well as all other income assimilated to income from money lent by the taxation law of the State in which the income arises.

The department's main contention was that interest under section 244A is not in the nature of 'debt claim'. In this judgment, the High Court clarified that anything which is due and which a person is entitled to collect, is naturally in the nature of a debt claim and held interest on income tax refund to be exempt under Indo-Italy tax treaty.

Madras HC reversed ITAT order, holds that interest on income-tax refund arising to assessee (an Italy-based company) u/s 244A is not taxable in India under Article 12(3)(a) of India-Italy DTAA.

Nangia's Take

The tax department had relied on the decision of the Uttarakhand High Court in case of B.J. Services Company Middle East Limited wherein the High Court held that interest earned on income tax refund is taxable as business income as the same is effectively connected with permanent establishment in India. However, in case of B.J. Services Company Middle East Limited[1] the conditions laid in the India – UK DTAA was different than India – Italy DTAA. Accordingly, Madras High Court held that facts of the instant case are different and hence principle laid down in the case of B.J. Services Company Middle East Limited is not applicable.

[Source: Tax Case Appeal Nos 19 to 21 of 2016]

[1] 29 SOT 312

2. Indian subsidiary will not constitute a Permanent Establishment if it does not satisfy the conditions laid in Article 5

The Assessee, Adobe Systems Incorporated, is a tax resident of USA. The Assessee's Indian subsidiary provided software related research and development services to the Assessee. The Indian subsidiary use to charge the Assessee on cost plus basis (arm's length price) for the said services.

Further, the Assessee had not filed any returns in India as it did not have any taxable income other than interest, on which applicable taxes were deducted at source.

The Assessing Officer issued notice under section 148 of the Act stating that Assessee's Indian subsidiary constituted a permanent establishment ('PE') and Assessee's income from the said PE has escaped assessment. The Assessing Officer's contention was based on the following:

- The research and development carried by the Indian subsidiary were a part of the Assessee's core business activities and accordingly, the Indian subsidiary constitute the Assessee's PE
- Further, the Assessee was obliged to provide assistance, specifications and supervision to the Indian subsidiary and had a right to audit the facilities of the Indian subsidiary for maintenance of requisite standards.

Aggrieved by the notice under section 148, the Assessee filed petition under Article 226 and 227 of Constitution of India impugning the said notices.

The High Court set aside the notices issued by the Assessing Officer and held that the subsidiary is an independent tax entity and the fact that a holding company exercises certain control and management over a subsidiary would not render the subsidiary as a PE of the holding company. Further, the High Court held that even if the Indian subsidiary is considered to be the Assessee's PE, the entire income which could be brought in the net of tax in the hands of the Assessee has already been so taxed in the hand of the Indian subsidiary at arm's length price and accordingly, no income can be said to have escaped assessment.

Nangia's take

The High Court has reiterated the principle that an Indian Subsidiary does not constitute a PE merely because it provides services to its holding company. What needs to be examined is whether the conditions laid in the definition of PE under tax treaty are being satisfied.

[Source: Adobe Systems Inc vs. ADIT W.P.(C) 2384/2013 & CM 4515/2013]

3. Delhi High Court allows "non-discrimination" relief pre-Sec 40(a)(ia) insertion, for administrative fee payment under US treaty

Facts of the case

Herbalife International India Private Limited ['the assessee'], is the Indian subsidiary of Herbalife International Inc. USA ['HII'], which carries on business of trading and marketing of herbal products for use in weight management, to improve nutrition and enhance personal care. For AY 2001-02, the assessee claimed an expenditure of INR 5.83 crores as administrative fee paid to an Associated Enterprise.

The administrative fees paid were pertaining to the period of January 1, 2000 to March 31, 2001.

The Assessing officer disallowed the said administrative fees. The matter came before the High Court, in due course of appeal by the Revenue and the following questions were framed for adjudication –

- Whether the Tribunal was correct in law in allowing the sum of Rs. 5.83 crores being the administrative fee paid by the assessee to Herbalife International America Inc. and whether the ITAT was correct in holding that Section 40 (a) (i) of the Act is discriminatory and therefore, not applicable in the present case as per provisions of Article 26 (3) of the Indo-US DTAA?

- Whether the ITAT was justified in law in allowing the payment relating to the period for January 1, 2000 to March 31, 2000 to the assessee as deduction despite the fact that it was a prior period expense and liability to pay the same did not accrue during the year?

- Whether the ITAT was correct in law in allowing the expenditure on account of administrative fee relating to the period from January 1, 2001 to March 31, 2001 to the assessee as deduction despite the fact that the foreign company had not raised the bill for the same?

The High Court upheld the judgment of the ITAT, observing as under:

Fees pertaining to the period of April 2000 to December 2000

Under Section 40 (a) (i), as it then stood, the allowability of the deduction of the payment to a non-resident mandatorily required deduction of TDS at the time of payment. On the other hand, payments to residents were neither subject to the condition of deduction of TDS. The object of Article 26 (3) DTAA was to ensure non-discrimination in the condition of deductibility of the payment in the hands of the payer where the payee is either a resident or a non-resident. That object would get defeated as a result of the discrimination brought about qua non-resident by requiring the TDS to be deducted while making payment of FTS in terms of Section 40 (a) (i) of the Act.

Therefore, it was held that Section 40 (a)(i) of the Act was discriminatory and therefore, not applicable in terms of Article 26 (3) of the Indo-US DTAA.

Fees pertaining to the period January 2000 to March 2000

Expenses for the period January 1, 2000 to March 31, 2000 accrued as a liability to the assessee only during the previous year and that the said expenditure was rightly allowed as deduction during the AY in question. Reliance was placed on the decision in the case of Nonsuch Tea Estates Limited v. CIT where the Supreme Court held that liability towards royalty accrued only when the approval was granted by the Central Government for the appointment of the managing agent.

Fees pertaining to the period January 2001 to March 2001

Reliance was placed on the decision in the case of Bharat Earthmovers v. Commissioner of Income Tax wherein it was held that if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain in the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. Therefore, in respect of the fee paid for the period relating to the period January 1, 2001 to March 31, 2001, the liability should be held as accrued and arisen during the previous year relevant to the AY 2001-02 and was therefore rightly allowed by the Tribunal.

Source: [TS-257-HC-2016(DEL)]

4. CBDT clarifies that Taxpayers engaged in printing, publishing eligible for additional depreciation

CBDT clarifies that printing and publishing amounts to manufacturing activity and hence taxpayers engaged in printing/publishing are eligible for additional depreciation u/s 32(1)(iia) in addition to deprecation allowance u/s 32(1). CBDT accepts Kerala HC ruling in Mathrubhoomi Printing & Publishing co and Delhi HC ruling in Delhi Patra Prakashan Ltd wherein it was held that printing and publishing is a manufacturing activity and thus eligible for grant of additional depreciation.

Directing the revenue authorities, CBDT restricts filing of appeals on this ground by officers of the department and states that those appeals already filed in Courts Tribunals may be withdrawn/ not pressed upon.

Nangia's Take

CBDT seems to be on a spree to settle legal position on litigative issues, to reduce avoidable litigation causing undue hardship on the assessee. Reduction in litigation, saves time and energy of both the government and taxpayers at large. Printing and publication houses can take a sigh of relief that litigation on this aspect is over and those taking a conservative view of not claiming additional depreciation can now claim the same.

Source : CBDT Circular 15 2016

5. Equalisation Levy comes into force and rules notified

Background

The global economy is undergoing a tremendous change with technology shaping the way that businesses operate, people work and customers consume, thus making Digital Economy an evolving and independent economy. India is also facing challenges in terms of characterization of income, and the lack of universal consensus on adopting the new nexus based significant economic presence, as well as the likely difficulties faced in attributing profits under existing rules.

'Equalisation Levy' introduced as a self-contained code to tax Digital Ecommerce transactions under Chapter VIII of Finance Act, is intended to serve as a way to tax a multi-national enterprise's significant economic presence in a country, which are able to avoid taxes completely in the source jurisdiction under the existing international taxation rules which require non-resident enterprises to have a Permanent Establishment in order to attract taxability.

Equalization Levy Rules, 2016

CBDT has notifies that Equalisation levy introduced by Chapter VIII under the Finance Act shall come into force from June 1, 2016[1] and has also notified Equalization Levy Rules, 2016 ('the Rules')[2] for carrying out the said provisions relating to Equalisation Levy.

[1]CBDT Notification 37/2016 dated May 27, 2016
[2]CBDT Notification 38/2016 dated May 27, 2016

The Rules provide for the following:

- **Rounding off**

  Consideration for specified services, equalisation levy, interest, penalty and refund payable, to be rounded off the nearest multiple of ten rupees

- **Payment of equalisation levy**

  Every assessee who is required to deduct and pay Equalisation Levy shall deposit the same to the account of the government by remitting the same to RBI or SBI or other authorized bank accompanied by an equalisation levy challan

- **Statement of Specified services**

  Statement of Specified services to be furnished in **Form 1** by June 30th following the financial year. The statement has to be filed and verified electronically using digital signature/electronic verification code. Principal Director General of Income-tax (Systems) shall lay down the data structure and standards for obtaining electronic verification code

- Where an assessee fails to furnish the statement of specified services, the Assessing Officer may issue notice calling for statement of specified services to be furnished within 30 days

- Where any levy, interest and penalty is payable under Chapter VIII, the Assessing Officer shall issue the notice of demand in Form 2

- Appeal to CIT(A) under section 174(1) shall be filed and verified electronically in Form 3 by the person who is authorized to verify the statement of specified services

- Appeal to ITAT under section 175(2) shall be filed and verified electronically in Form 4

Way Forward

With the rules in place, time has come to start taking action, since the statement of specified services procured starting June 1, 2016 has to be reported in the statement to be furnished by June 30, 2017. Further owing to the subjectivity attached to the interpretation of the term "Specified Services", it is advisable to review the nature of services obtained from foreign national to analyze if the same could fall in the meaning of "Specified Services" OR if advertising services are embedded in other services obtained from foreign national. It is pertinent to note here that the liability has been cast upon the payer to withhold and deposit the "Equalisation Levy" with the Government of India and failure to comply would lead to disallowance of such expense.

Source: CBDT Notification 37/2016 dated May 27, 2016 and CBDT Notification 38/2016 dated May 27, 2016

TRANSFER PRICING

6. Provisions enunciated in Section 115JB of Income-tax Act, 1961 is a self contained code and the Indian tax legislation, in any manner, doesn't allow Assessing Officer to consider the amount of TP-additions while computing the "book profits"

Facts of the Case

Owens Corning (India) Private Limited, ["the taxpayer'] is engaged in manufacturing and trading of glass fiber reinforcement products. While concluding the assessment proceedings for AY 2008-09, the Assessing Officer ["AO"] confirmed the upward adjustment of INR 1,30,72,762/- made by Transfer Pricing Officer ["TPO"] TP on account of rejection of few comparable companies. The aforesaid view of the TPO/ AO was also affirmed by the first level appellate authority. Aggrieved with the same, the taxpayer filed an appeal before Income Tax Appellant Tribunal ["the ITAT"/"the Tribunal"].

Tribunal's Ruling

1. ***Selection of Comparables***

The ITAT observed that there is no change in facts or business/ nature of international transactions of the taxpayer and the same comparables which were accepted in previous and succeeding assessment years by the tax authorities have been rejected during assessment year under consideration on the ground of dissimilar products. The Tribunal held that the TPO/ AO did not bring any robust reasons on record to show any change(s) in facts or nature of business activities or position of law in case of the taxpayer. In the light of the same, the ITAT set aside the action of TPO/ AO and ordered to delete the TP adjustment made in this regard.

2. ***On considering the amount of TP adjustment while computing the amount of 'book profits' as per provisions of 115JB of the Income-tax Act, 1961 ("the Act")***

The ITAT observed that the AO had considered the amount of TP adjustment made by TPO while determining the *'book profits'* as contained in provisions of Section 115JB of the Act. In this connection, the ITAT obstreperously stated that provisions of Section 115JB of the Act is self contained code and only those adjustments as have been prescribed under aforesaid section are permissible. The TP adjustments as made by TPO, on the other hand is governed by altogether different set of provisions as contained in Chapter X of the Act. for the purpose of computing *'book profits'* under Section 115JB of the Act, the Indian tax legislation nowhere permits the AO to consider the amount of TP adjustment in the profit and loss account. The Supreme Court ruling in case of ***Apollo Tyres Limited Vs. CIT (255 ITR 273)*** was relied upon by the Tribunal. In the light of the same, the ITAT set aside the actions of the AO.

Nangia's Take

This is an indicative judgment wherein the ITAT highlighted the shifting of onus to the tax authority to confirm change in facts or business of the taxpayer during the current year vis-à-vis the previous year.

As far as the matter pertaining to the computation of book profits, this ruling clearly sends a message to the tax authorities to avoid the casual approach adopted by the revenue officers which tarnish the image of income-tax department which in turn discourage the voluntary compliance by the taxpayer.

Source: Owens Corning (India) P. Ltd. vs. DCIT [TS-248-ITAT-2016(DEL)-TP]

INDIRECT TAX

7. Processing of payments for Foreign Service recipient qualifies as export, not intermediary services

Facts of the Case

M/s Universal Services India Private Limited ['Applicant'] proposes to enter into a Services Agreement with Wild West Domains LLC ['WWD'], a foreign company located in USA. WWD is engaged in providing web services *viz* domain name registration, web hosting, designing etc to customers across the world. WWD intends to provide its services and products to customers located in India through its website. In respect of such services, the customers would make the payment to WWD online. In terms of the Service Agreement, Applicant would provide payment processing services to WWD, wherein Applicant would assist the customers of WWD, located in India, to pay for the services of WWD in INR.

Applicant would collect the payment from customers (directly to its account or through third party collection gateway provider) and would remit the same to WWD on actual basis. In consideration for such services, the Applicant would receive service fees in convertible foreign exchange from WWD. The main issues before the Authority for Advance Ruling were as under:

- Whether the place of provision of payment processing services by the Applicant to WWD is outside India, in terms of Rule 3 of the Place of Provision of Services Rules, 2012 ['PPS Rules'];

- Whether the services to be provided by the Applicant to WWD would qualify as export in terms of Rule 6A of the Service Tax Rules, 1994 ('ST Rules');

- Whether by providing payment processing services to WWD, the Applicant is providing any service to the customers of WWD in India.

The Authority for Advance Ruling observed and ruled as under –

- The main service provided by WWD to the customers in India is web related services. The Applicant is not at all concerned with the Indian customers of WWD, in respect of the said services. The Applicant is providing (on his own account) payment processing services to WWD, which is the main service, and charging a fee equal to operating costs incurred plus mark-up. It cannot be inferred that the Applicant would be providing payment processing services to the Indian customers, for the services rendered by WWD to such customers.

- The definition of 'intermediary' does not include a person who provides the main service on his own account.

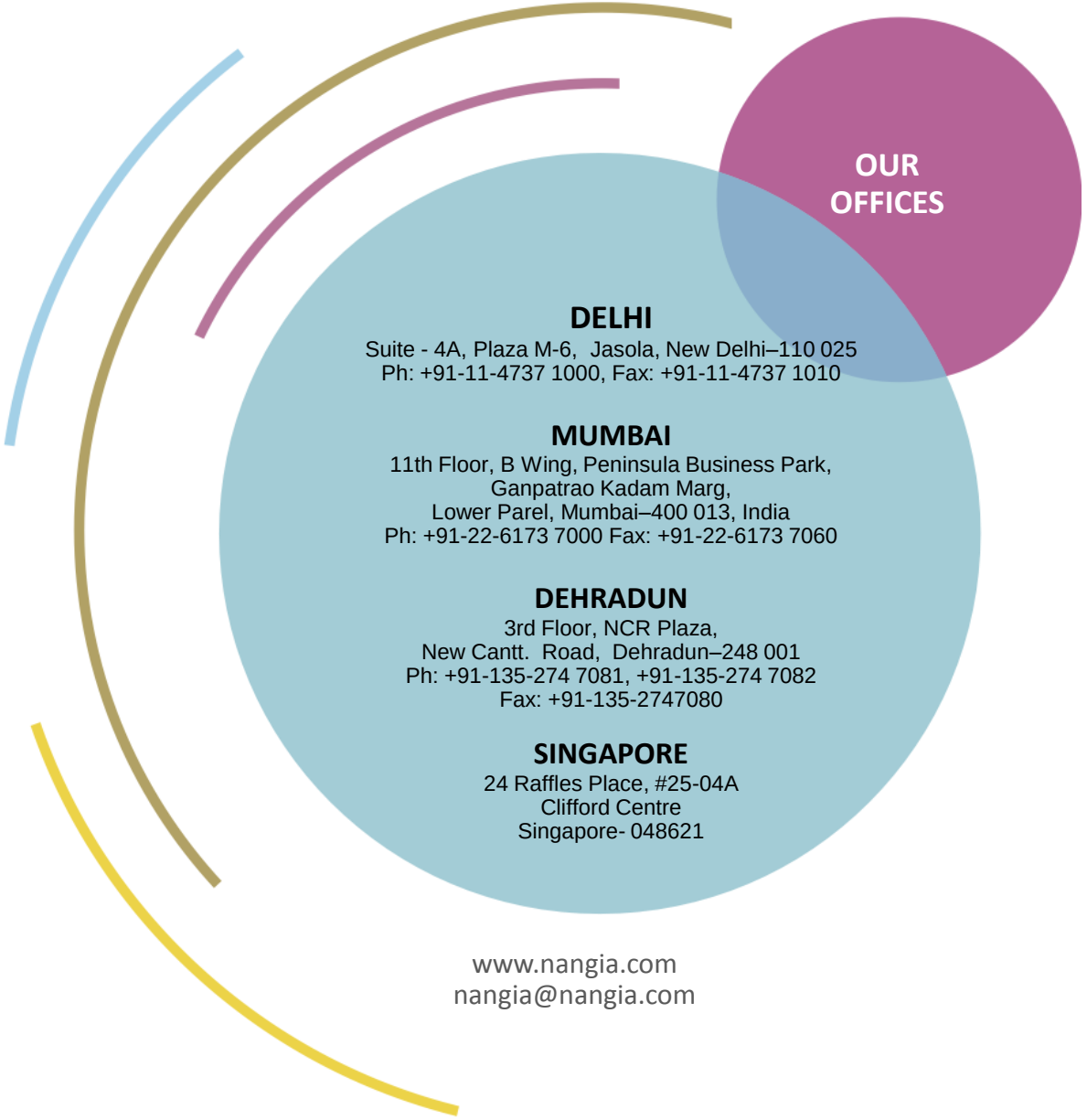
As the Applicant is providing main services i.e. 'Business Support Services' to WWD US, on his own account, the Applicant is not a intermediary. Accordingly, place of provision of services provided by the Applicant would be outside India, in terms of Rule 3 of the PPS Rules.

- The services provided by the Applicant would qualify as 'export' in terms of Rule 6A of the ST Rules and therefore no service tax would be payable on services provided by the Applicant to WWD.

Nangia's Take

The Ruling brings in much awaited clarity on concept of 'intermediary', under which lower level Authorities are trying to tax almost all transactions involving three parties. The Ruling would also be useful for placing reliance in cases (may be of persuasive value) where recipient based services (i.e. covered Rule 3 of PPS Rules) performed in India are alleged to be provided in India by the Authorities, by application of other PPS Rules.

[Source: Universal Services India Private Limited Vs. The Commissioner of Service Tax, Pune-I in Application No. AAR/44/ST/14/2014 and Ruling No. AAR/ST/07/2016]



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