NEWS CRUNCH

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DIRECT TAX

1. Special purpose Mauritius company eligible to claim treaty benefit

Authority for Advance Ruling ("AAR") has recently in the case of Mahindra-BT Investment ("Applicant"), a company incorporated in Mauritius, held that transfer of shares of an Indian company to a USA company is not liable to tax in India under the beneficial provisions of India-Mauritius Treaty. In this ruling, the AAR has dealt with the issue of residential status of the Applicant, which is guided by place where the control and management of affairs of the applicant exists.

Treaty benefit is only available to a tax resident of the contracting states. In the present case, the Revenue Authorities argued that the control and management of the applicant was situated in India, since the sole purpose of existence of the Applicant was "transferring the shares of TML (i.e. the Indian Co.) to AT&T (i.e. the US Co.), the real transaction is between TML and AT&T and hence the control and management of the applicant should be treated as in India.

The Applicant argued that the board meeting wherein the business decisions were taken were held in Mauritius and hence the place of control and management of affairs of the applicant is situated in Mauritius.

AAR wan convinced with the arguments of the applicant and held that since the place of control and management of affairs of the applicant is situated in Mauritius, the applicant is resident of Mauritius, eligible to claim the beneficial provisions of Article 13(4) of the India-Mauritius Tax Treaty, granting exemption from capital gain tax.

Nangia's Take

Though an AAR is only binding on the applicant, persuasive value can be drawn from the same. Where a foreign company is able to establish that major business decisions, such as decisions on financial matters; approving of financial budgets and statements; decision on declaration of dividends; decision on buyback of shares; appointment of tax advisor, etc are taken outside India, its residential status shall remain outside India.

Further, interestingly, as per this ruling even a Special Purpose Vehicle ("SPV") merely earning Dividend and Interest income shall be construed as an entity having commercial purpose. Revenue authorities in this case argued that the Incorporation of the applicant was solely to hold the shares of TML to facilitate a tax neutral transfer. This ruling of AAR has laid a striking principal that a SPV which is established without any economic substance, shall be construed as having commercial purpose, where the future transfer of shares by the SPV is linked to the happening of a future event / business target etc.

Though the India-Mauritius Tax Treaty has been amended, by way of the 2016 Protocol permitting source taxation in respect of gains arising from transfer of shares of an Indian company, this ruling is relevant for grandfathered investments made before 1 April 2017.

Source: [TS-479-AAR-2016]

2. Grant of call option results in capital gain but not taxable under Singapore Treaty

Mumbai Income Tax Appellate Tribunal ("Mumbai ITAT") in the case of Praful Chandaria ("the assessee"), dealt with the issue of taxability of consideration received by the assessee pursuant to grant of call option in respect of shares of an Indian company. The assessee was holding more than 99% shareholding in an Indian company ('PHIL'), and vide the 'call option agreement', the Mauritian company was granted an option to call upon the assessee to sell his entire shareholding in Indian company, further such right in shares was given for a period of 150 years.

During assessment year (AY) 2002-03, the assessee received a sum of USD2.45m as a consideration for the call options, but claimed the same as non-taxable.

Mumbai ITAT has confirmed that under normal circumstances mere grant of call option does not result into transfer of actual asset, since no right in the shares is given by way of grant of "call option", except a right to buy the shares at a specified price within a fixed period of time. In view of peculiar facts of the case viz. strike price of $1, incredibly large period of option 150 years, irrevocable PoA in respect of Indian company's shares; a valuable and substantive right in the shares of the Indian Company, separate from shares, was transferred by the assessee and hence the same shall result in capital gains.

However, under the beneficial provisions of Article 13 of the erstwhile India-Singapore Tax Treaty, such gains shall not be liable to tax.

Nangia's Take

Bombay High Court in the case of Vodafone India Services Pvt Ltd [TS-621-HC-2015(BOM)-TP] had held that surrender of option rights is not a 'transfer' under the provisions of the Act. However, interestingly Mumbai ITAT in this ruling has upheld the principle of "substance over form" and considering the peculiarities of the facts of the case, held that since valuable and substantive rights have been transferred, gains arising on grant of option shall qualify as capital gains.

Under the erstwhile provisions of the India-Singapore Treaty applicable for the year under consideration, such gains were taxable only in Singapore, however, under the extant provisions of the Treaty, specific clause on taxation of transfer of shares in capital gains Article was deleted, and hence such gains if arising after 2005 shall be liable to tax in India.

Source: [TS-482-ITAT-2016(Mum)]

3. Offshore supplies taxable in India in case of composite contract for supply and services

AAR recently held that the entire contract revenue arising to the Singapore company ("the applicant") towards supply of goods and rendition of services was taxable in India. The contract under consideration was awarded to L&T, which in turn awarded the applicant a sub-contract for the entire external and internal façade, for the glazing and cladding systems for piers, fixed link bridges and nodes in connection with development of the airport terminal.

The applicant was required to design the curtain wall and façade, supply all materials, erect, install, inspect, test and commission the entire subcontract works. The applicant was of the view that scope of work could be broadly divided into

- Offshore supply of goods, and
- Installation and other work to be executed in the airport

AAR, held that the consideration received for the entire contract was taxable in India, based on the following observations:

- The contract was a composite one and there was no evident division in the contract whatsoever for supply and services in terms of scope of work, payment terms, responsibility, risk, etc.

- The offshore supply of goods by the applicant to the contractor, and

then by the contractor to its ultimate customer (the airport company) on high seas was contentious as, even though the applicant was not a party to the goods supplied by the contractor to the airport company, it was responsible for delivery of materials to the project site in India, and acted as an agent of the airport company, like paying customs duty in India.

- The applicant's PE (i.e., the project office in India) had come into existence long before the design of materials and equipment for offshore supply started and was responsible for custom clearance and payment of custom duty, hence PE was actively involved in supply of goods in India

- Further, insurance in the name of the applicant instead of the contractor until it reached the site in India was clear proof that risk did not pass to the customer until the goods were used for the works as per the contract

- Payments under the contract were not in relation to sale of goods, and were linked to different stages of work, which further the point that the contract was a composite one

Nangia's Take

This ruling shall impact the foreign companies executing EPC contract in India. The observation of AAR shall act as a guiding factor for those planning to enter into an EPC contract in India. Though an AAR is only binding on the applicant and that too for the specific case, but persuasive value shall be drawn by the Revenue Authorities to examine the cases involving offshore supplies, followed by onshore services.

Source: AAR No. 981 of 2010

TRANSFER PRICING

4. Transaction amongst taxpayer and Indian permanent establishment of its overseas group entity does not fall within the ambit of "international transaction" and thus, is not subject to Indian Transfer Pricing provisions

Facts of the case

IJM (India) Infrastructure Ltd ("the taxpayer") is a subsidiary Company of IJMII (Mauritius) Ltd which in turn is a wholly owned subsidiary of IJM Corporation Berhad, Malaysia (IJM Malaysia). During the assessment year under review, the taxpayer has entered the certain transactions with its associated enterprises ("AEs") viz. Delhi based project office [permanent establishment ("PO")] of IJM Malaysia; Delhi based joint-venture ("JV") namely "IJM-IJMII JV" between taxpayer and IJM Malaysia; the Indian PE, located in Delhi, of Road Builder (M) SDN Bhd, an another group entity/ AE of the taxpayer; and RBM Pati JV (based out of Delhi, India).

The Assessing Officer ("AO") was of the contention that the taxpayer's transactions with its aforesaid AEs (all India based) fall under the domain of "international transactions" under section 92B of Income Tax Act ("the Act") as their management and control is based outside India and consequently are subject to the determination of arm's length price.

Based thereon, the AO made reference to the Transfer Pricing Officer ("TPO") who made an upward adjustment of INR 33.04 crore. During the course of proceedings before Dispute Resolution Panel ("DRP"), the DRP followed the taxpayer's own case relating to previous assessment year to categorically held that the transactions between the taxpayer and it's the project office/ PE of its AEs (including the taxpayer's JVs) cannot be treated as international transaction do not fall under provisions of section 92B(2) of the Act. Aggrieved by the same, the Revenue filed an appeal before Income Tax Appellant Tribunal ["ITAT"/"the Tribunal"]

Tribunal's Ruling

The Tribunal relied on taxpayer own case relating to the AY 2008-09 and ***Swarnandhra IJMII Integrated Township Development Co. Ltd. Vs. DCIT*** wherein it was held that the transactions between the taxpayer and the Indian PE of its AEs (i.e. IJM Malaysia & Road Builder (M) SDN Bhd.) along with Delhi based taxpayer's JVs (i.e. IJM-IJMII JV and IJM-NBCC-VRM JV) do not fall within the definition of international transactions. While adjudicating so, the ITAT considered the provisions of sections 92A(1) and 92A(2) of the Act the along with observation drawn by the DRP in the instant case. The Tribunal held that to qualify a transaction as international transaction, at least one among the AEs must be non-resident. Since in the present case both the taxpayer and other parties are the residents for the purpose of Indian Taxation, any transaction between them will not constitute an international transaction.

Nangia's Take

For the taxation purposes, the Indian PE of an overseas entity is considered to be non-resident. However, the ITAT, in instant case, has given due weightage to the merits of the case and considered a contrary view from the TP perspective. The given ITAT ruling provides clarity to all other Indian taxpayers who are facing similar issues while dealing with its overseas group entities' Indian PE.

Source: IJM (India) Infrastructure Ltd.Vs. DCIT [TS-671-ITAT-2016(Hyd)-TP]

5. The Tribunal dismissed the appeal and cross-appeal of Revenue Authorities and the Taxpayer respectively as the matter in dispute was resolved in MAP proceedings

Facts of the case

Northern Operating Services Private Limited ["the taxpayer"] is an Information Technology Enabled Services provider. For assessment year 2010-11, appeal and cross appeal were filed by the Revenue and the taxpayer respectively against the order of the Assessing Officer ["AO"] before Income-tax Appellate Tribunal ("the Tribunal").

Following grounds were raised by the Revenue before the Tribunal:

- *That the Dispute Resolution Panel ("DRP") erred in rejecting certain comparable companies citing that size and turnover of any company are reliable factors for treating it as an appropriate comparable; and*
- *That the DRP erred in excluding companies on the basis of turnover being more than 200 crores.*

The taxpayer, on the other side filed a cross-appeal against the order of the Revenue and raised the following objections:

- *That the lower tax authorities erred in objecting the application of upper limit of the turnover filter while selecting comparable companies without providing any empirical analysis; and*

That the DRP erred in not excluding a comparable company based on functionally dissimilar function.

Ruling of the Tribunal

Whilst the course of hearings before the Tribunal, the taxpayer submitted it had filed a Mutual Agreement Procedure ["MAP"] Application pursuant to the provisions of Indo-US DTAA with respect to its transfer pricing ["TP"] adjustments made by Indian tax authorities. It was also submitted that the matter covered in MAP Application is the subject matter of the appeal before by the Tribunal. I the light of the same, the Tribunal held that since the taxpayer agreed to the order passed by the Joint Commissioner Of Income Tax giving effect of the MAP order (passed based on the mutually agreed between the competent authorities of India and US), the grounds raised by the taxpayer as well as the Revenue before the Tribunal are infructuous and accordingly, dismissed.

Source:
Appeal: DCIT Vs M/s Northern Operating Services Private Limited [ITA (TP)A No. 112/Bang/2015]

Cross Appeal: M/s Northern Operating Services Private Limited Vs DCIT [IT(TP)A No. 210/Bang/2015 & Co. No.106/Bang/2015]

6. Tribunal upholds taxpayer's contention of exclusion of indirect expenses for margin computation; verify data before considering a company as a comparable

Facts of the case

Swarovski India Pvt. Ltd. ("the taxpayer") is a wholly owned subsidiary of Swarovski International Holdings AG (FIH) which is globally famous for its Crystal and related products. The taxpayer is operating as a 100% EOU in Pune and engaged in job work coating raw material beads and polishing the sale to its associated enterprises ("AEs") and domestic unit operating in New Delhi carried out import and sale of crystal and related products.

During the year under consideration, the taxpayer, being the sole distributer of the products of its AEs in India, sold goods manufactured by its AEs to the customers. For benchmarking its international transaction pertaining to *"purchase of consumables and job work charges received"*, the taxpayer selected Cost Plus Method ("CPM") and computed gross mark-up at 120.94% which was re-computed by the transfer pricing officer ("TPO") by including certain other indirect expenses in the cost base. The TPO also excluded two comparables out of 19 comparables selected by the taxpayer due to unavailability of data. Based thereon, the TPO made an upward adjustment of INR 1.50 crores. Aggrieved with the same, the taxpayer filed an before the CIT(A) who set aside the additions made by TPO and grated relief to the taxpayer. Aggrieved by the same, the Revenue appealed before the Income Tax Appellate Tribunal ("the Tribunal").

Tribunal's Ruling

On treating the expenses not directly attributable

The Tribunal confirmed the findings of CIT(A)'s exclusion of certain expenses (i.e. depreciation, repairs and maintenance, electricity and insurance) which could not be directly linked with the taxpayer's distribution activity while computing the gross profit mark-up for applying CPM. For the sake of the same, the Tribunal relied on the provisions of Rule 10B of the Income Tax Rules, 1962.

Nangia's Take

The given ruling clearly provides to consider the expenses (especially while computing the gross profit) which can have a direct nexus with or can be directly attributable to the taxpayer's business activities of production and distribution. The expenses like clearing charges, for-ex fluctuation etc. cannot be considered to have a nexus with cost production while computing the gross profit margin.

Source: Swarovski India Pvt Ltd Vs. DCIT [TS-705-ITAT-2016(Del)-TP]

INDIRECT TAX

7. GST Council now in action

GST Constitutional Bill, 2016 was passed by Lok Sabha on 8th August 2016 and received the assent from president on 8th September 2016 and has become the Law. After receiving the assent from president, Cabinet approved the creation of GST council and its secretariat on 12th September 2016 and president has also given his ascent for the formation of same.

GST council will meet on 22 September and 23 September. Determining the tax rates will be one of the biggest issues facing the council as it will have to strike a balance between protecting its tax revenues while arriving at a rate that does not hurt the common man. Besides the rates, dual administration or dual control will be one of the most contentious issues.

As per Article 279A of the amended Constitution, the GST Council will be a joint forum of the Centre and the States. This Council shall consist of the following members namely: -

- Union Finance Minister… Chairperson
- The Union Minister of State, in-charge of Revenue of finance… Member
- The Minister In-charge of finance or taxation or any other Minister nominated by each State Government… Members

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