NEWS CRUNCH

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NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. Capital gain not computable and hence not applicable when sale consideration is NIL – Mumbai ITAT

Aditya Birla Telecom Limited ('the assessee') demerged its telecom division to its holding company, without any consideration. The Scheme of Arrangement pertaining to the demerger ('the arrangement') was approved by Gujarat and Bombay High Court. The scheme also provided that, upon the same being effective, the assessee shall revalue the investments retained by it as it considers relevant and appropriate.

During the course of scrutiny, the assessing officer and CIT(A) held that the said demerger was slump sale and computed short term capital gains. The amount of revaluation of investment done by the assessee, pursuant to the arrangement, was considered to be the sale consideration while calculating capital gains.

Aggrieved the assessee filed an appeal before the Tribunal. The Tribunal ruled in favour of the assessee and observing as follows:

- Since no consideration accrues or is received by the assessee, no capital gains would arise in the hands of the assessee;
- Business Restructuring Reserve created in the books of the assessee

was merely an accounting entry passed on account of revaluation of its investment and could not be deemed value of sale consideration for calculating capital gain;

- Wherever considered appropriate, the legislature has inserted specific provisions for determination of sale consideration for transfer of assets in specified cases. For example, section 5OC provide for computation of sale consideration on transfer of land and building/ asset below stamp duty value and section 50D provides for transfer of assets where sale consideration is indeterminate or not ascertainable

Nangia's Take

This case law has upheld the cardinal principle of law that the charging section and the computation provisions together constitute an integrated code and when there is a case to which the computation provisions cannot apply at all, it would imply that such case was not intended to fall within the scope of charging section.

Source: [TS-608-ITAT-2016(Mum)]

2. India & Switzerland sign 'Joint Declaration' for implementation of automatic exchange of information (AEOI)

Pursuant to the signing of Joint Declaration, India can receive financial information of accounts held by Indian residents in Switzerland for 2018 and subsequent years, on an automatic basis, starting September 2019.

Government is gradually closing its griping on the black money hoarders from all the directions. With free flow of information from all the so called tax havens, government shall have the much needed teeth to kill the menace of blank money. The information flowing from Switzerland pursuant to the Joint Declaration shall be legally sourced and hence no bar on usage of such information to catch hold of the tax evaders, unlike the current scenario where government's hands were tied in view of the fact that the list of tax evaders has not been obtained from legal sources.

Nangia's Take

With Switzerland and other tax havens in the loop, demonetisation and revised Benami Act in place closing avenues for domestic black money, the tax evaders will have nowhere to go. It is evident that each move of the government is aimed at tightening its hold on the tax evaders and cleaning Indian economy of the black money. However, with automatic exchange of information kicking in from 2017, it is a little disappointing to see that information from Switzerland shall start flowing in from September 2019.

Source: CBDT Press Release dated November 22, 2016

3. CBDT prescribes guidelines on 'eligible fund manager' of offshore funds

CBDT amends Rule 10V by issuing guidelines in respect of fund manager of offshore funds in respect of section 9A of the Income-tax Act, 1961 ('the Act'). Section 9A(1) was introduced by Finance Act, 2015 to provide that fund management activity carried out through an eligible fund manager of offshore funds in India shall not constitute 'business connection' in India.

Further section 9A(4) provides that the eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfils the following conditions, namely:—

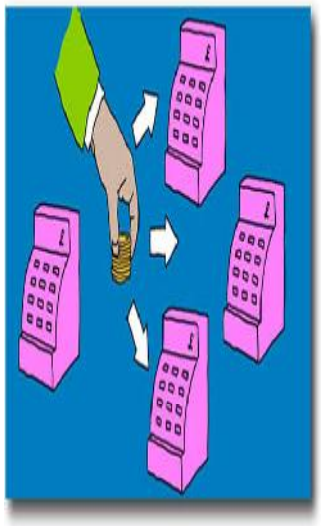
a) The person is not an employee of the eligible investment fund or a connected person of the fund;

b) The person is registered as a fund manager or an investment advisor in accordance with the specified regulations;

c) The person is acting in the ordinary course of his business as a fund manager;

d) The person along with his connected persons shall not be entitled, directly or indirectly, to more than twenty per cent of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through the fund manager.

4. Presence of director and affiliate company creates fixed place and agency PE



In a recent ruling of Chennai Income Tax Appellate Tribunal ("the ITAT") in the case of Carpi Tech SA ("the assessee") issue of trigger of agency and fixed place permanent establishment ("PE") of the assessee in India under the India-Swiss double tax avoidance agreement (DTAA) was dealt. The assessee had undertaken a project to provide geo membrane water proofing work for an Indian entity. In order to carry out the project work, an Indian director of the Indian entity was given work specific power of attorney (PoA) to undertake certain activities on behalf of the assessee and worked as the project co-ordinator.

Further, an Indian affiliate of the assessee was a representative of the assessee for the project undertaken in India and incurred all project related expenses in India which were later reimbursed by the assessee. The ITAT after considering the facts of the case held as under:

- The assessee had a fixed place PE in India at the residence-cum-office of the director which was used for all official purposes in India including correspondences with India customers, participation in bids, signing and execution of contracts etc.

- Further, given the nature of activities undertaken in India, the ITAT held that there was no significance of construction PE threshold as fixed place PE was created.

- Also, the director played a critical role in the Indian project of the assessee from the stage of signing the contract till its execution and he was a dependent agent working almost exclusively for the assessee during the relevant period of time. Hence, his activities also resulted in creation of agency PE.

- Further, since the Indian affiliate was the face of the Taxpayer in India and carried out various activities on behalf of the assessee, it created a PE of the assessee. Hence, it was held that the assessee had a PE in India through the director or Indian affiliate and the income from its Indian project is taxable in India.

Nangia's Take

India has been following broad based PE policies in line with OECD's BEPS Action 7 proposals on PE. Multinational companies may consider the impact of this ruling on their current business arrangements.

Source: TS-587-ITAT-2016(CHNY)

TRANSFER PRICING

5. The associated enterprise's low tax jurisdiction is irrelevant in determining arm's length price of intra-group services as the same does not result in tax base erosion

Facts of the case

Woco Motherson Advanced Rubber Technologies Limited ["the taxpayer"], engaged in manufacturing of high quality rubber parts, rubber plastic parts, rubber metal parts and liquid silicon rubber parts is a Joint Venture between Woco Franz Joseph Wolf Holding GmbH ["Woco Germany"] and Mothersons Sumi Systems Limited. During the years under review, the taxpayer paid technical service fees ["FTS"] to its associated enterprise ["AE"] viz. Woco Mothersons FZC, Sharjah ["Woco Sharjah"] in relation to know-how & technology licensed from Woco Germany. For benchmarking the same, the taxpayer applied Transactional Net Margin Method ["TNMM"] on entity wide basis.

During the course of assessment proceedings, the transfer pricing officer ["TPO"] determined the arm's length price ["ALP"] at *'Nil'* on the ground that the taxpayer had paid FTS to Woco Sharjah which is a tax heaven country where tax rates are low, whereas the manufacturing technology was owned by Woco Germany. The aggrieved taxpayer raised objections before the Dispute Resolution Panel ["DRP"], which was turned down by holding that the taxpayer has chosen this route simply to evade taxes for the Woco Group. Further, the DRP concluded its proceedings by applying internal Comparable Uncontrolled Price ("CUP") Method by considering the price of services paid by taxpayer to Woco Germany (i.e. without any consideration). Accordingly, the DRP confirmed the addition made by the TPO. Aggrieved by the same, the taxpayer filed an appeal before the Income Tax Appellant Tribunal ["the ITAT"/ "the Tribunal"].

The ITAT's Adjudication

1. On inter-company transaction pertaining to payment for FTS

1.1 Application of CUP Method by the DRP

The ITAT negated the benchmarking methodology adopted by the DRP of comparing the services rendered by Woco Germany to the taxpayer with the services rendered by Woco Sharjah. The Tribunal ruled out that the same is unsustainable in law as the Indian TP Provisions clearly provides that the controlled related party transactions can only be compared with transactions with unrelated third party under uncontrolled conditions.

1.2 On Agreements with Woco Germany and Woco Sharjah

The ITAT rejected the TPO's contention of considering procurement of services by the taxpayer from Woco Sharjah as a ploy to transfer the profits to a tax haven on the ground that nature of services provided in taxpayer's agreement with Woco Germany and Woco Sharjah are distinct from the perspective that services agreement between the taxpayer & Woco Sharjah is for achieving technical assistance towards use of technology, whereas agreement with Woco Germany encompasses the right to use know-how for development/ manufacturing of licensed products. Based thereon, the Tribunal observed that lower authorities failed to appreciate that ownership of technology to be used in the manufacturing process by a service provider is not a pre-requisite for provision of technical assistance in relation to the use of aforementioned technology.

1.3 On arm's length price determination of FTS

In relation to the revenue authorities' stand on fulfilment of need test, duplicity test, service rendition test and the benefit test by the taxpayer in order to justify the remuneration paid for the aforementioned services from arm's length perspective, the ITAT held that the taxpayer duly justifies all the above tests. Based thereon, the ITAT held that the TP adjustment can be made only in the event when price of transaction intercompany under review does not meet the arm's length scenario. Further, on setting aside lower tax authority's contention that the taxpayer has adopted a tax evasion strategy by making lower payments to Woco Sharjah (which is a tax haven country instead of Woco Germany), the ITAT ruled out that ALP determination involves examination of the arm's length price irrespective of whether or not the person entering into transaction is in a high tax jurisdiction or low tax jurisdiction.

In light of the above, the ITAT deleted the TP adjustments.

Nangia's Take

The Tribunal in the instant ruling categorically emphasized that while evaluating the ALP of intra-group service, the real question which needs to be analyzed by lower tax authority is whether the price of services is what an independent enterprise would have charged in an independent economic scenario. The ITAT, reiterated that questioning business and commercial expediency of the taxpayer is unwarranted while determining the ALP of intra-group services.

Source: Woco Motherson Advanced Rubber Technologies Limited vs DCIT [I.T.A. Nos.: 89 and 3208/Ahd/11, 2637/Ahd/12, 474/Ahd/14, 63 and 593/RJT/2015]

INDIRECT TAX

6. GST Council Meet: Nearly 80 items to form part of GST exemption list

- GST council has achieved the biggest milestone in the journey of GST by finalizing the tax rate structure under GST. Now, Centre is preparing the item-wise list for GST rates. However, exemption list has not been finalised yet.
- About 80 items would form part of exemption list i.e. GST would not be applicable on it.

Faltering exemptions under GST:

- Government has recently decided the slabs structure for GST rates i.e. 5%, 12%, 18% and 28%, as well as a cess on sin and luxury goods such as tobacco, big cars and aerated drinks.
- According to a report, exemption list would include grains, green coconut, poha, unprocessed green tea leaves, and non-mineral water.
- It is proposed that negative list of services, exempted from levy, will be reduced to include only essential services such as health and education. We would have a small number of essential services out of the GST net.

- Some common items exempted by centre and state include bread, eggs, milk, vegetables, cereals, books and salt. These would continue to be exempted.

- According to the Constitutional 101st (Amendment) Act, petroleum products would come zero rate till the time of GST council decides to bring them under GST rates. Therefore, states will continue to impose VAT and Centre excise duty on such items .

- It is noted that zero rated is different from exemption as input credit is given in case an item is zero rated.

Nangia's Take

Since slabs structure is finalised by council is almost similar to what was proposed earlier. It is also difficult to put local items of certain states in the exemption list. Government should exempt food, pharmaceutical, book & mineral item etc. Goods and services which would be exempt from payment, to the extent possible, the list of exemptions should be uniform across India. However, Centre is looking to minimize the exemptions under GST regime.

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