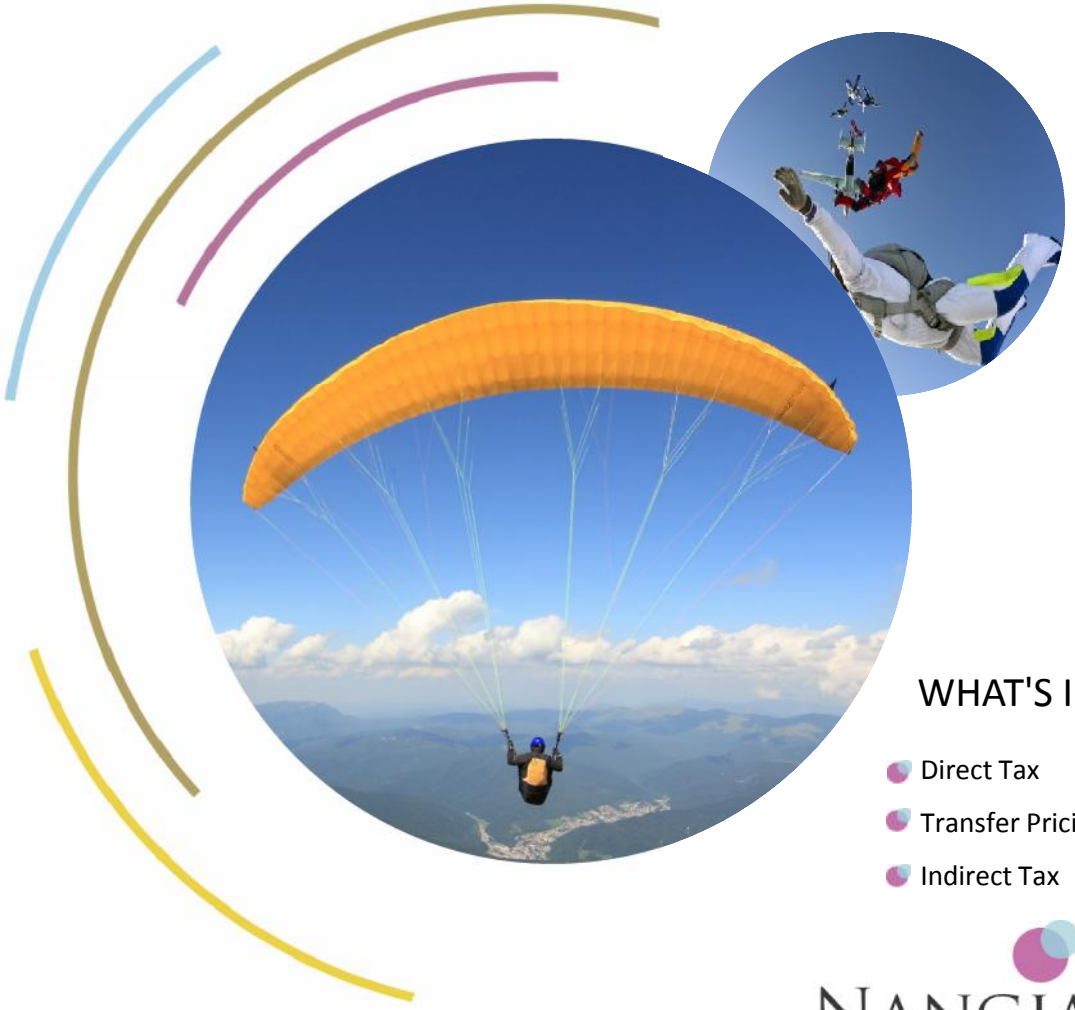
NEWS CRUNCH

January 16 - January 31



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NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. CBDT issues clarifications for implementation of GAAR

Income tax Act, 1961 contains anti-avoidance provisions in the form of General Anti-Avoidance Rules (GAAR) which provides wide powers to the Assessing Officer ('AO') to deal with impermissible tax avoidance arrangements. GAAR provisions under the Act are effective from tax year 2017-18. GAAR provisions are directed to be applied in accordance with such Guidelines, and subject to such conditions, as may be prescribed.

Stakeholders and industry associations had requested for clarifications on implementation of GAAR provisions and a Working Group was constituted by Central Board of Direct Taxes (CBDT) in this regard.

CBDT on 27 January 2017 has issued a Circular providing 16 clarifications in Q&A format

Some of the key clarifications are:

(a) GAAR can co-exist with Specific Anti-Avoidance Rules (SAAR); GAAR provisions can also apply if the Limitation-of-Benefits (LOB) test in a double taxation avoidance agreement (DTAA) does not adequately address tax avoidance;

onsistency principle will be followed while applying GAAR provisions in different years if the facts and circumstances remain the same,

(c) GAAR cannot apply if Authority for Advance Rulings (AAR) has, in an advance ruling, considered an arrangement to be permissible or if an authority such as the Court or National Company Law Tribunal (NCLT) has examined the tax avoidance matters adequately while sanctioning an arrangement

(d) No corresponding adjustment across all taxpayers in an arrangement to be allowed as same militates against the deterrence of GAAR. The Circular also notes that adequate procedural safeguards are in place before GAAR can be invoked (such as, vetting by an Approving Panel) so that GAAR provisions are applied only in deserving cases. Other clarifications in the Circular deal with the scope of grandfathering to convertible securities, bonus issues etc.

The Press Release issued along with the circular also provides that the Government is committed to provide certainty and clarity in tax rules and that further clarifications, if any, on the doubts of stakeholders regarding GAAR implementation, will be provided in due course.

Nangia's Take

Clarifications issued by CBDT on GAAR which is set to be implemented starting April 1, 2017 answers most of the questions in the minds of the taxpayers. It has been clarified that Limitation of Benefit ('LOB') clause of the DTAA shall be duly considered before implementation of GAAR, which implies that GAAR shall not override the treaty, if the LOB clause of the treaty addresses the tax avoidance under play.

The recent clarification is giving a ray of hope to the FPI that GAAR shall apply only to abusive or highly aggressive arrangements and if the FPI has decided its jurisdiction based on a non-tax consideration, it is immaterial that such jurisdiction is tax efficient. It has been clarified that GAAR and SAAR shall co-exist, though procedural safeguards are in place, it remains to be seen whether practically the tax officers invoke GAAR in a fair and rational manner

Source: Circular No. 7 of 2017 dated 27 January 2017

2. Revisions proceedings under section 263 quashed involving over Rs 1000 Cr additions

In a recent ruling in the case of IBM India P Ltd., Bangalore ITAT ('the ITAT') quashes proceedings initiated under section 263 of the Income-tax Act, 1961 ('the Act') for AY 2007-08, observing that the issues raised by CIT were already examined by the Assessing Officer ('AO') and only after considering assessee's explanation, the AO had chosen not to make any additions, even if no reasons were given in the assessment order. Invoking the revisionary jurisdiction under section 263 of the Act, CIT directed the AO to make addition on varied issues including depreciation disallowance on assets under finance lease, software expense disallowance, expense disallowance under section

40(a)(ia) of the Act for TDS default, etc involving quantum of over Rs. 1000 cr.

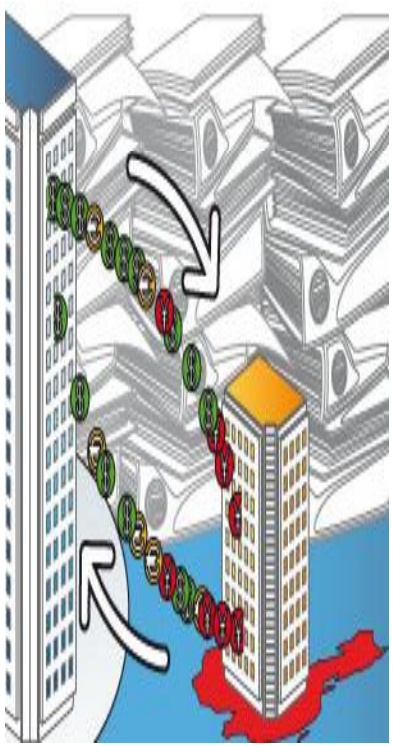
During the proceeding, the assessee established that all the issues raised by CIT were subject matter of inquiry by the AO and he had chosen not to make any addition after due application of mind. It was thus evident that the AO after making proper inquiry took a possible view and therefore, assessee contended that CIT was not justified in assuming jurisdiction under section 263 of the Act.

ITAT remarks that "*Merely because the AO had failed to give reasons for accepting such claims, it cannot be said that there was no application of mind*". The ITAT relied on Punjab & Haryana HC ruling in the case of Hari Iron Trading Co. [TS-13-HC-2003(P & H)] and Bombay HC ruling in the case of Gabriel India Ltd [203 ITR 108]. Moreover, ITAT held that "*issues which are sought to be revised are not only covered by jurisdictional HC but came to be accepted by AO after due application of mind*."

Source: [TS-16-ITAT-2017(Bang)]

TRANSFER PRICING

3. Sharing of sponsorship cost by taxpayer with its associated enterprise is construed to be the promotion of brand owned by taxpayer's associated enterprise and accordingly, is subject to Indian TP provisions



Facts of the case

The Nike India Private Limited ["the taxpayer"] is engaged in the business of import and distribution of sports footwear, apparels, and accessory products in India under the brand name of Nike. For this purpose, it undertakes procurement and distribution from local parties. During assessment year under review, the taxpayer reported various international transactions including the share of sponsorship fee paid by its associated enterprise ["AE"] to the Board of Control for Cricket in India ["BCCI"]. During the course of transfer pricing ["TP"] proceedings, the TP Officer ["TPO"] viewed that the taxpayer's Advertisement, marketing & promotion ["AMP"] expenses (including the aforesaid share of sponsorship fee paid

to BCCI) indirectly servicing its AE in promoting the 'NIKE' brand, owned by the taxpayer's AE. To benchmark the same, the TPO applied Bright Line Test ["BLT"] approach on entire AMP spent of the taxpayer and made an upward adjustment of INR 63.50 Crores. The taxpayer challenged the action of the TPO before the DRP but could not succeed. Aggrieved by the same, the taxpayer filed appeal before the Income Tax Appellant Tribunal ["the ITAT"/ "the Tribunal"].

Taxpayer's Contentions

- AMP expenses had been incurred by the taxpayer for promoting its own products and not for promoting the brand of AE. Thus incidental benefits to the brand of the AE cannot be a ground for treating the said expenditure as an "international transaction" as per Indian TP provisions;

- The taxpayer is an entrepreneurial risk bearing distributor of its products in India and had obtained the license to use the trademark and exclusively distribute the Nike products in India from its AE. Further, the taxpayer purchased products from contract manufacturers and resold them through its network and retail outlets whereas there was no direct transaction of sale or purchase with AE; and

- Sharing of cost of AMP paid to BCCI by the AE cannot be construed as business arrangement for brand building but was only a temporary financial assistance provided by AE as taxpayer was in the initial stage of operations in India.

The ITAT Ruling

The Tribunal heavily relied on the findings in the case ***Essilor India Private Limited Vs. DCIT [IT(TP)A No. 29 & 227/Bang/2014)*** and observed the following:

- The taxpayer's AMP expense, to the extent of other than sponsorship fee paid to BCCI, cannot be considered as an independent international transaction;

- The sponsorship fee paid to BCCI cannot be construed as taxpayer's product specific promotion as the agreement between taxpayer's AE and BCCI provides the use of 'NIKE' logo on the cricket team's uniform and other accessories; and

- The agreement between the taxpayer and its AE for sharing of sponsorship fee clearly provides that the purpose has been duly acknowledged by both the entities that BCCI agreement will extend suitable benefit for promotion of 'NIKE' brand in India.

In the light of the above, the ITAT held that sharing of BBCI cost is a conscious understanding amongst the taxpayer and its AE to promote and enhance the 'NIKE' brand in India and the same constitutes as international transactions as per provisions of India TP regulations.

Nangia's Take

The issue of incurrence of excessive AMP expenditure by taxpayer and thereby benefitting its overseas group entity in promoting its brand/ trademark is one concerning the fundamentals of economics and TP. After divergent views taken in various judgments by Indian Courts on AMP controversy, the matter now is pending before India's Apex Court and it is believed that the appeal filed before Supreme Court is without appreciating of principles laid down in Indian TP regulations and by setting aside the set precept of disregarding BLT approach by Indian Courts earlier.

Source: M/s Nike India Pvt. Ltd. Vs Deputy Commissioner Of Income Tax IT(TP)A Nos. 232 & 260/Bang/2014

4. The Tribunal has clarified that the controlling party, for invoking provisions of clause 'j' of Section 92A(2) of the Income-tax Act, 1961, has to be an "individual" and not a "partnership firm"

Facts of the case

Veer Gems ("the taxpayer"), a partnership firm, is engaged in the business of manufacture and sale of, domestic as well as exports, of the polished diamonds. During the assessment year ("AY") 2008-09, the taxpayer had entered into certain transactions with a Belgian entity, Blue Gems BVBA ("BGBVBA"). During the course of assessment proceedings, the Assessing Officer ("AO") considered BGBVBA as the Deemed Associated Enterprises ("AEs") under provisions of Section 92A(2)(j[1]) of the Income-tax Act, 1961 ("the Act") and referred the matter to Transfer Pricing Officer ("TPO"). The taxpayer objected to the above and stated in the preceding assessment year, the taxpayer and the BGBVBA were AEs by virtue of provisions of Section 92A(2)(h[2]) of the Act. However, such situation is not applicable for the assessment year under review.

The AO rejected the taxpayer's contentions on the premise that since the taxpayer had made substantial purchases from BGBVBA and the directors of BGBVBA were closely related to partners of the taxpayer, therefore, such scenario falls under provisions of Section 92A(2)(j) of the Act and thus, the instant was referred to the files of TPO. Subsequently, the TPO made an upward adjustment in case of the taxpayer which were deleted by taxpayer's appeal before the Commissioner of Income Tax (Appeals) ("CIT(A)"). CIT(A) further held that since the adjustment stands deleted on merits of the case, no discussion is to be made with respect to the relationship between the taxpayer and BGBVBA. Aggrieved with the same, Revenue as well as the taxpayer filed an appeal before the Income Tax Appellant Tribunal ("ITAT"/ "the Tribunal").

The Tribunal's Ruling

The ITAT found the findings of CIT(A) 'wholly unreasonable' and held that the first thing to be adjudicated upon is that whether the taxpayer and BGBVBA are AEs by virtue of Section 92A(2) of the Act.

The Tribunal observed that the basic rule for treating enterprises as AEs is set out in Section 92A(1) of the Act i.e. one enterprise, in relation to the other enterprise, participates, directly or indirectly, or through one or more intermediaries, in management, capital or control of the other enterprise. Sub-section 2 provides an exhaustive list of scenarios which can be considered as participation in management, capital or control of the other enterprise. The ITAT further stated that since the expression 'participation in the management, capital or control' is not a defined expression and to find its meaning one has to take recourse to Section 92A(2) of the Act. The Tribunal reiterated the principle that 'Section 92A(1) of the Act has to be read in conjunction with Section 92A(2) of the Act, as held in the cases of ***Page Industries Ltd Vs DCIT [(2016) 159 ITD 680 (Bang)]*** and ***Orchid Pharma Ltd Vs DCIT [(2016) 76 taxmann.com 63 (Chennai- Trib.)]***.

1 Where an entity A is controlled by an individual and entity B is also controlled individually or jointly with its relative by such individual then both the entities shall deemed as AEs for the purpose of Indian TP regulations.

2 90% of the consumable/ raw material required for manufacturing of goods is supplied by entity A to entity B along with the fact that the price and other pertinent conditions towards the aforesaid supply of consumables is also significantly influenced by entity A, then both the entities shall deemed as AEs for the purpose of Indian TP regulations.

Additionally, the Tribunal also observed that since the taxpayer is a partnership firm, accordingly, the same cannot be said to be controlled by "an individual", which is the starting point for Section 92A(2)(j), being invoked. The Tribunal stated that certain degree of control that may have been exercised by BGBVBA over the taxpayer, however, the same shall not be sufficient to hold the relationship between the two enterprises as AEs. Thus, the tribunal stated that since the two enterprises cannot be termed as AEs, therefore the adjustment on account of the same stands deleted.

Nangia's Take

Recent ITAT rulings have clarified the deemed AE provisions in an elaborative manner. In the light of the same, it becomes essential for the tax administrations to analyze not only the fact that the taxpayer's case falls within the scenarios covered in subsection 2 to Section 92A of the Act but also analyze the extent of its participation in the management, control and capital of other enterprise as per provisions of subsection 1.

Source: Veer Gems [TS-ITAT-2017(Ahm)-TP]

5. Completed assessments under section 143(3) of the Act cannot be interfered with by AO/ TPO in the absence of incriminating material during search and seizure operations

Facts of the case

Baba Global Limited ("the taxpayer") is engaged into manufacturing of flavored chewing tobacco, kiwan, scented elaichi and tulsi mix. During the assessment year 2011-12, a search and seizure operation was conducted under section 132 of Income Tax Act ("the Act") and consequently, the taxpayer was issued a notice to file return of income under section 153A of the Act. During the course of proceedings, it was observed that the taxpayer, during Financial Year 2004-05, has advanced interest free loan to its Associated Enterprises and the assessment proceedings under section 143(3) of the Act for the said year was already completed in October, 2007. In relation to the same, the Assessing Officer's reference ("AO"), referred the case to the Transfer Pricing Officer ("TPO") who made an upward adjustment on account of Arms Length Price ("ALP") by levying interest on aforesaid interest-free loans and made an upward adjustment of INR 2.32 crores.

Aggrieved the taxpayer filed its objections before Dispute Resolution Panel ("DRP"), which vide its order, upheld the actions of TPO. Consequently, the AO passed orders for six assessment years by making common additions on account of notional interest on the values of the loans lent to its AEs. Aggrieved with the same, the taxpayer filed an appeal before the Income Tax Appellant Tribunal ("the ITAT"/ "the Tribunal").

Proceedings before ITAT

1. Taxpayer's Contentions

- No incriminating material had come on board during the search and seizure conducted; and
- Appeals for the AYs 2006-07, 2007-08 and 2008-09 have already been decided by the Hon'ble High Court ("HC") in favour of the taxpayer by following another HC decision in case of ***CIT (Central) vs. Kabul Chawla 380 ITR 573 (Del.)***

2. Revenue's Contentions

- Reliance was placed on the case of ***Yash Jewellery P. Ltd. [TS-492-ITAT-2016(Mum)-TP]*** and was argued that taxpayer is barred from raising plea of non-availability of incriminating materials as taxpayer had not filed Form 3CEB during the first round of assessment proceedings; and
- The presence or absence of incriminating material was never raised before the DRP or AO.

3. The Tribunal's Ruling

- The Tribunal, while cited the HC decision in case of ***Kabul Chawla (supra)*** ruled out the following:
- No additions can be made in the absence of incriminating material;
- Non-furnishing of Form 3CEB is not tenable because details of income along with books of account and audited balance sheet had been filed by the taxpayer during the assessment proceedings completed under section 143(3) of the Act;
- The completed assessment u/s 153A is not tenable in the eyes of law as the disputed issue in relation to taxpayer's international transactions pertaining to advancement of interest free loan to its AEs had already been decided by the Hon'ble HC in favor of taxpayer for the AY 2006-07 and 2007-08; and
- The taxpayer has never suppressed its international transaction with its AEs during the assessment proceedings concluded u/s 143(3) of the Act.

Basis the above, the Tribunal held that the completed assessment under section 143(3) of the Act cannot be interfered with by AO/ TPO in the absence of incriminating material during search. Accordingly, the ITAT deleted the addition made under sections 143A/144C.

Nangia's Take

The instant ITAT ruling has clarified the search and seizure provisions in an elaborative manner by making it is essential for the tax administrations to analyze whether any incriminating material has been received by the tax authorities for the assessment years for which incomes have already been assessed.

Source: Baba Global Limited [TS-1070-ITAT-2016(DEL)-TP]

6. Under no circumstance, the uncontrolled price/ margin can replace with controlled price/ margin for benchmarking taxpayer's transactions with its associated enterprises

Facts of the case

Sabic Innovative Plastics India Pvt. Ltd. ["the taxpayer"] is engaged in manufacturing and marketing of engineering thermoplastic granules. The taxpayer came into existence due to the demerger of plastic division of GE India Industrial Private Limited ["GEII"] on August 3, 2007. Being in nature of vertical demerger, the taxpayer's the significant business parameters remained parallel to the plastic division in GEII. The business of the taxpayer was carried out by GEII for the period of four months during the relevant previous year i.e. starting from April 1, 2007 to August 3, 2007. The taxpayer, for benchmarking the transactions with its associated enterprises ["AEs"] used Transactional Net Margin Method and identified five comparable companies. During course of assessment proceedings, the TP Officer ["TPO"] rejected all comparables adopted by the taxpayer and was of the view that the taxpayer's business was same as was carried on by GEII.

Basis the same, the TPO used Comparable Uncontrolled Price ["CUP"] Method and adopted operating margin (of 8.95%) shown by GEII's plastic division as a comparable for determining arm's length price ["ALP"] of the taxpayer's international transactions. Accordingly, the TPO made an addition to the taxpayer's income. The aggrieved taxpayer challenged the actions of the TPO before the Commissioner of Income Tax (Appeals) ["CIT(A)"] who upheld the actions of the TPO. Thereafter, the aggrieved taxpayer challenged the actions of CIT(A) before the Income Tax Appellate Tribunal ["the ITAT"/ "the Tribunal"].

Proceedings before the Tribunal

Taxpayer's contentions

Application of CUP Method is erroneous based on the following grounds:

- Instead of comparison of prices, the TPO compared the margins of the taxpayer with that of the GEII's plastic division; and
- The GEII's plastic division was having significant transactions with its AEs and thus, was considered to be as controlled in nature.

The Tribunal's Findings

The Tribunal, relying on provisions under Rule 10B of Income-tax Rules, 1962 for determination of ALP under section 92C of Income-tax Act, 1961, held that even in the case of CUP Method, the ALP to be adopted is the **price**, subject to admissible adjustments, at which the similar transactions are carried out between the taxpayer and an independent entity. Based on above rationale, the Tribunal rejected the TPO's approach of considering operating margin of GEII's plastic division for application of CUP Method.

Further, the Tribunal noted that the CIT(A) had relied on ruling in ***Bayer Material Science Pvt. Ltd. [TS-741-ITAT- 2011(Mum)]*** authored by Accountant Member ["AM"], in which controlled transactions were adopted as comparable, in absence of comparable uncontrolled transaction. However, the same learned Member, as a "Third Member" in the case of ***Technimount ICB Pvt. Ltd. [TS-557-ITAT- 2012(Mum)]***, in consonance with one of the bench members in a situation of divergence of opinion between the members constituting the division bench, discarded the aforesaid principle as espoused in case of ***Bayer Material (supra).*** In this regard, the Revenue argued that a judicial officer (i.e. learned member of the bench) cannot deviate from his own stand.

Relying on ITAT ruling in cases of ***DCIT Vs. Oman International Bank SAOG (100 ITD SB 285)***; and High Court ruling in ***P.C Puri Vs. CIT (584)***, the Tribunal was of the view that the third member ruling can override the decisions of division bench and had a greater biding force. The third member decision may be seen as overruling not only the dissenting views but also unanimous decisions of the division benches and even more so, held that a third member bench ruling has the same precedence value as that of a special bench ruling. The Tribunal further held that the hierarchical position of the forum at which the judicial officer is placed (i.e. as third member) is material rather than the judicial officer himself.

In the light of the above, the ITAT held that the TPO was not correct in adopting margin of GEII's plastic division as it had significant related party transactions. The Tribunal further noted that the CIT(A) had not considered merits of external comparables adopted by the taxpayer and remitted the matter back to the CIT(A) for fresh consideration.

Nangia's Take

The instant ruling perspicuously clarified that under no circumstances, the uncontrolled price/ margin can be substituted by a controlled price/ margin for benchmarking transactions of the taxpayer with its AEs. The taxpayers can also take a cue from this ruling that an appellate authority's decision does not necessarily become a law or a ground of reference for adjudicating similar cases without appropriately considering the relevant legal provisions.

Source: Sabic Innovative Plastic India Pvt Ltd [TS-178-ITAT-2013(Ahd)-TP]

INDIRECT TAX

7. Appropriate state for levy and collection of CST is the state from where the movement of goods commenced – Bombay High Court(HC)

Petitioners M/s BrahMos Aerospace Private Limited (Hyderabad) & M/s. BrahMos Aerospace Private Limited (Nagpur) is a joint venture company established by Defence Research and Development Organisation and NPO Mashinostroeniya – a State Unitary Enterprise incorporated and registered under the Russian Federation's Legislation. The petitioner has been established for the purpose of design, development, production and sale of Brahmos Cruise Missile weapon system.

Pursuant to the sale agreement with President of India, missiles assembled in Hyderabad unit, located in Andhra Pradesh (AP) were dispatched to Nagpur branch, located in Maharashtra by the petitioner for warhead integration and were subsequently dispatched out of the State of Maharashtra to Indian armed forces.

The assessing officer (AO) in the State of Maharashtra demanded CST on the ground that since fully finished missiles were dispatched from Nagpur to the customers, the petitioner was liable to pay CST in Maharashtra.

The petitioner filed a Writ petition before the High Court of Bombay against the above order. In this regard petitioner has made following submissions-

- Petitioner contended that the impugned assessment order is contrary to law. The missiles are to be used by Indian Armed Forces (IAF) for the safety and security of the country. As the order is placed by Government of India, the transaction cannot be treated as a normal sale and not marketable.

- Petitioner submits that the assembly and production of Brahmos Missiles takes place at the Hyderabad facility. Some of the parts of missiles in a SKD condition are transferred to Nagpur for storage purpose.

- All parts other than warheads are re-transferred to Hyderabad for assembling the missiles. Warheads at all times remained at Nagpur only. The petitioner explained the process of dispatch of missiles and stated that the missiles complete in all respects had been dispatched to Nagpur unit for warhead integration due to the peculiarity and sensitivity of goods involved.

- The sale of all missiles is effected from Hyderabad Unit. Clear instructions were given to Nagpur unit to dispatch the said missiles after warhead Integration to IAF. Till such time, Nagpur unit would have no knowledge to whom the missile is to be sent. Thus, Nagpur branch cannot by itself cause the movement of missiles which is an essential ingredient of an inter-state sale.

- The Petitioner submits that sale means transfer of general property in goods. In the present case, the property in goods has already been vested in the Government of India. The Petitioner has acted in the capacity of agent for the purpose of assembly of missiles and warheads.

Hon'ble High Court of Bombay observed and ruled as under-

- HC noted that as per CST Act, the tax levied on sale of goods in course of inter-state trade or commerce shall be collected by the Government in the state from which the movement of goods commenced.
- HC is of the opinion that there is a fundamental error in the understanding of assessing officer of the provisions of CST Act 1956.
- The understanding of the AO that it is the movement of finished goods, which would be the determining and conclusive factor is legally flawed. It is clear that it is the establishment at Hyderabad, where the components are assembled, which makes the missiles.
- HC observed that in the present case, the movement of goods from Hyderabad has been made pursuant to supply agreement with the President of India
- Further, there is no dispute as to whether this is an inter-State or intra-State sale. It is only a question of the authority of the agent to collect the tax on behalf of the Central Government. Hence, no justification in law is seen for the distinction made by the AO about the goods being brought in semi-finished or finished status.
- HC distinguished the Bharat Electronics Limited's case relied by respondent on facts and concluded that the transaction was an inter-state sale commencing from AP and CST was payable in the State of AP

[Source: M/s BrahMos Aerospace Private Limited (Hyderabad) & M/s. BrahMos Aerospace Private Limited (Nagpur) Vs The State of Maharashtra & State of Andhra Pradesh & State of Telangana & Others- Writ Petition No. 11393 of 2015]

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