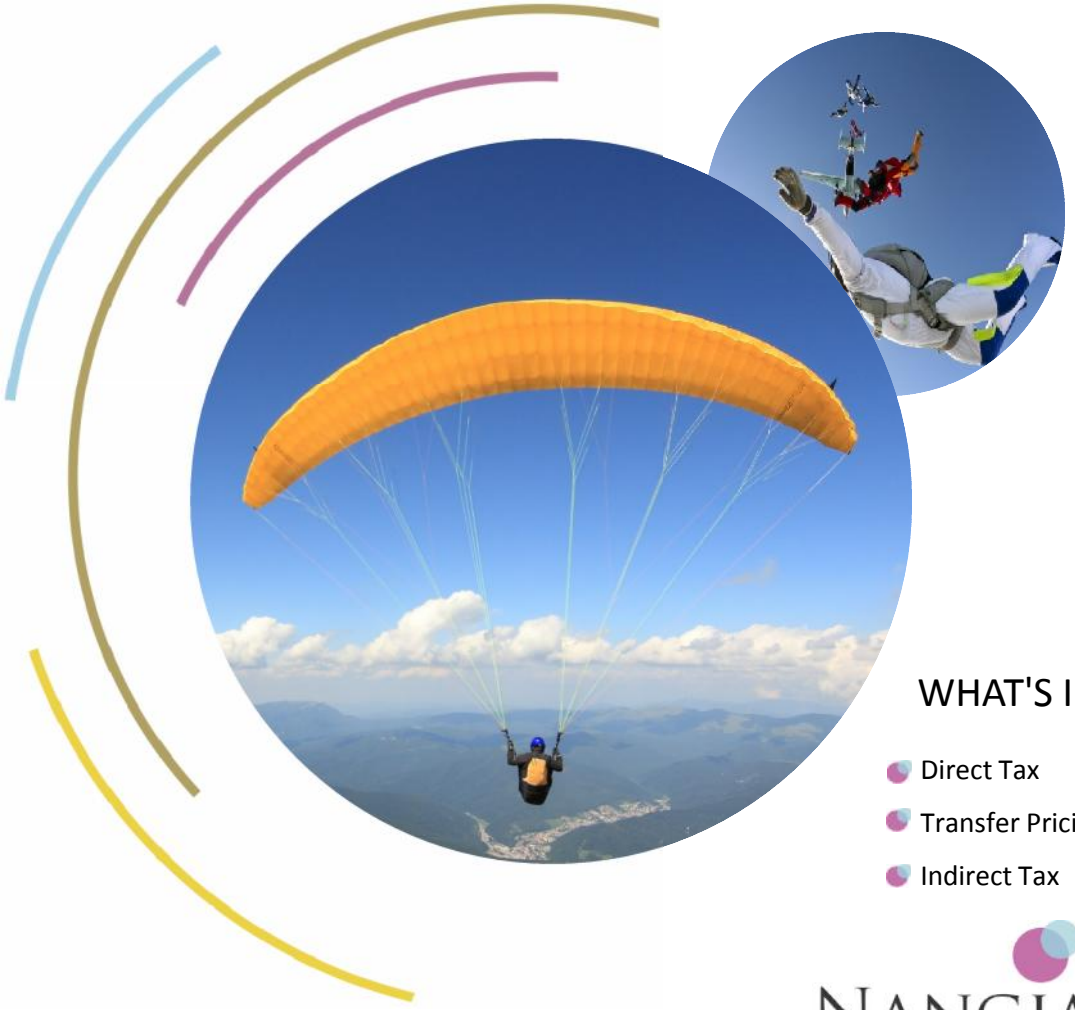
NEWS CRUNCH

March 16- March 31



WHAT'S INSIDE...

- Direct Tax
- Transfer Pricing
- Indirect Tax

NANGIA & CO
CHARTERED ACCOUNTANTS

What's inside . . .

DIRECT TAX

1. ITAT Delhi affirmed interest paid by Indian PE to HO of the Assessee Bank on money lent not allowable as deduction in terms of Article of Indo–UK DTAA thereby distinguishing between Article 7(5), and 7(7) of the Indo–UK DTAA and Article 7(3) of the Indo-Japan DTAA
2. The date of pronouncement of the order by the ITAT should be considered as date of communication

TRANSFER PRICING

3. Reasons viz. taxpayer's intention of not avoiding taxes; or the absence of non-disclosure of its international transactions, cannot be considered as tool for not undertaking benchmarking analysis to justify the arm's length nature of the taxpayer's transactions with its associated enterprises
4. The Tribunal clarified that the interest rates along with a spread over and above thereon cannot be considered as 'same' for all types of international loans

INDIRECT TAX

5. GST laws passed by Lok Sabha

DIRECT TAX

1. ITAT Delhi affirmed interest paid by Indian PE to HO of the Assessee Bank on money lent not allowable as deduction in terms of Article of Indo–UK DTAA thereby distinguishing between Article 7(5), and 7(7) of the Indo–UK DTAA and Article 7(3) of the Indo-Japan DTAA

Facts of the case :

- Standard Chartered Grindlays Pty. Limited ("Assessee") is a banking company incorporated in United Kingdom ("UK") and considered as a tax resident of UK.
- It carried on business of banking and other related activities in accordance with the provisions of the Banking Regulation Act, 1949 through its network of branches in India.
- During the relevant assessment year , the Assessee's Indian PE made payment of interest for borrowing foreign currency loan from its head office at LIBOR amounting to Rs. 248,673,000.

- The said foreign currency loan was taken on account of payment to be made to National Housing Bank (a body corporate constituted under section 3 of the National Housing Bank Act, 1987, and a wholly owned subsidiary of the RBI) ("NHB") in respect of dispute for certain account payee cheques issued by NHB and credited to Mumbai based broker Harshad S.Mehta.

- In respect of the same, RBI issued a directive in terms of the banking Regulation Act, 1949 thereby directing the Assessee to make payment of the disputed amount to NHB , pursuant to which the Assessee deposited the sum of Rs.506,54,54,878/- with NHB.

Contention of Assessee :

- The Assessee contended that the interest payment was claimed as deduction in computation of business income, in accordance with Article 7(7) of the Indo-UK Double Taxation Avoidance Agreement ("Indo-UK DTAA").

- According to the Assessee, Article 7(7) of Indo-UK DTAA specifically permits the tax deductibility of interest paid by the PE of a banking company to its Head Office for money borrowed for the business of the PE in terms of the exception clause of the aforesaid article.

- Further, as per section 90(2) of the Act, as the Assessee can avail either treaty provisions or the domestic law to the extent they are more beneficial to the Assessee. Accordingly, the claim for the deduction of interest expense was made in accordance with the exception clause of the aforesaid article of Indo-UK DTAA .

- In this regard, the Assessee contended that the said issue is fully covered in favour of the Assessee by ABN Amro Bank Vs. DDIT reported in 343 ITR 81 (Kolkata HC) as well as Mumbai Tribunal ruling in case of Sumitomo Banking Corporation Vs. DDIT [2012] 16 ITR (Tribunal) 116 (Mum) [5 judges Special Bench Tribunal].

- It was also argued by the Assessee was that the interest paid to head office on account of making a foreign currency deposit in India with NHB squarely falls within the ambit of Section 10(15)(iv)(fa) of the Act and hence such interest is exempt from withholding tax.

- This was contended considering the funds placed by the Assessee with NHB were "deposit" as understood in banking laws .

Contention of Revenue:

- Under the domestic law , payment by a branch of to head office is in the nature of payment to self,which is neither taxable nor tax deductible in the hands of the Assessee as also affirmed by Special Bench of Tribunal in Sumitomo's Case (surpa).

- The aforesaid decision is not applicable in the said case as in the instant case, Indo-UK DTAA is involved whereas in the aforesaid case, Indo-Japan DTAA was involved. Furthermore, in the instant case, the interest paid by PE to HO is neither tax deductible under the Act nor under Artilce 7(5) read with Article 7(7) of Indo-UK DTAA .

- The Assessees's case is also not covered under Section 10(15)(iv)(fa) of the Act ,hence the claim for exemption from tax is not allowable and is subject to deduction of tax in India.

- The Revenue further distinguished the ABN Amro Bank's case(supra) contending that in that case the issue was as to whether interest paid by branch to its HO is subject to TDS whereas in the instant case, the issue involved is as to whether the interest paid by branch to HO is tax deductible *per se* or not.

Ruling of the Tribunal:

- The difference pointed out by the ld. CIT (A) between the Indo-UK DTAA and Indo Japan Tax Treaty is that as per Article 7(3) of Indo Japan DTAA, deduction of expenses is allowable and there is no stipulation, as appearing in Indo-UK DTAA that these deductions shall be subject to limitation of domestic tax law and therefore limitation under domestic tax law of tax deductibility of interest paid by branch office to head office shall not apply, where Indo Japan DTAA is applicable.

- Article 7(7) of Indo–UK DTAA contains an exception, as per which Article 7(5) shall not apply to certain amount by PE to HO by way of royalties, fees and interest on moneys lent to PE by HO. However, there is an exception to this exception contained in Article 7(7) as per which in case of banking enterprises, interest paid by PE to HO on moneys lent to PE by the HO shall be subject to provisions of Article 7(5). Article 7(5) says that if certain expenses are not allowable under domestic tax laws, those shall not be allowed under DTAA also.

- Since it is not deductible under domestic tax laws, those shall not be allowed under DTAA also.

- In respect of applicability of sec. 10(15)(iv)(fa), the Tribunal highlighted two basic pre conditions viz. deposit in foreign currency and such deposit to be approved by RBI. In the instant case, none of the conditions met owing to the fact that the interest is paid by branch office to head office in respect of borrowing made by the branch from its head office which was in the nature of loan nor there was direction of RBI regarding the source from which the BO can raise funds.

NANGIA'S TAKE:

Delhi ITAT through the aforesaid ruling has categorically considered the allowability of deduction on account of interest paid by Indian PE to HO in case of banks on money lent thereby highlighting the difference between applicability of Article 7(5), and 7(7) of the Indo–UK DTAA and Article 7(3) of the Indo-Japan DTAA .

However, as far as domestic tax law is concerned , the Finance Act 2015 has taxed the same thereby inserting an explanation (a) to Section 9 (1)(v) in this regard whereby the same has been deemed to accrue or arise in India and shall be chargeable to tax in India in case of the non resident engaged in the business of banking.

By this, the non-resident banking companies will further face challenges being left with very restricted scope as regards allowability of such interest paid to HO wholly dependent upon the allowability in terms of the relevant articles of the respective treaties.

2. The date of pronouncement of the order by the ITAT should be considered as date of communication

Background

- While hearing a batch of appeals filed by the tax department before the High Court, the preliminary objection was raised by the counsel on behalf of the assessee, that the appeals were not maintainable as they were filed after the time limit of 120 days prescribed for filing an appeal under section 260A of the Income tax act, 1961 ("The Act")
- The controversy arose regarding the date from which the period of 120 days, as above, should be considered.
- It was contended by the tax department that on the very same issue, the divisional bench of the High court in case of *CIT v. Arvind Construction Co. (P) Ltd. (1992) 193 ITR 330* and *Commissioner of Income Tax v. Income Tax Appellate Tribunal (2000) 245 ITR 659 (Del)* has decided the issue in favour of the tax department. Whereas, to support its case the assessee placed reliance on the divisional bench of the High Court in the case of *CIT v. Sudhir Choudhrie (2005)278 ITR 490*.
- In this background, the issue was referred to the larger bench of the High court raising questions related to computation of prescribed time limit of 120 days, in case an appeal filed by the tax department under different situations.

Revenue's Contentions

- The Revenue contended that it is only the 'concerned' CIT or Principal Commissioner of Income Tax ("Pr CIT") who has the jurisdiction over the case, can be a 'party' to the appeal and not any and every CIT or Pr CIT. It was further pointed out that in the context of appeals by or against the Revenue, it is not that the Revenue as a whole that is the aggrieved party but only the concerned officer dealing with a case or having jurisdiction over the AO of the concerned case, who would be "the concerned party."
- Emphasis was also laid by the Revenue on the words "the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner". It was argued that the prefix 'the' in this context connotes that the particular CIT/Pr CIT has to take a decision about the filing of an appeal.

Assessee's Contentions

- The assessee argued that, it is the date of pronouncement of the order which should be taken as the date on which that order is received for the purposes of Section 260A(2)(a) of the Act. This is because the order is pronounced in the open court and the date of pronouncement is duly notified by the ITAT in advance. Hence the tax department or its representative is aware of the date of pronouncement of orders by the ITAT.
- It was also argued that after the change of procedure where the orders of the ITAT are pronounced in the open court, it is incumbent on the Department through its DR or CIT (Judicial) to apply for a certified copy of the order. Thus, limitation would, therefore, begin to run from the date of pronouncement of the judgment (excluding the time taken in obtaining a copy thereof).

Proceedings before High Court

- The High court distinguished the decisions of divisional bench relied upon by the revenue on the basis that, they were rendered in the context of Section 256 (2) of the Act and there was no occasion to interpret Section 260A(2)(a) of the Act. Also, both decisions were given at a time when there was no practice of the ITAT 'pronouncing' orders in the open court.

High Court observed as under:

- As the period of limitation i.e. 120 days is considerably longer than the period of limitation (30, 60, maximum of 90 in routine cases), the High Court can condone the delay for as long there is sufficient cause for not filing the appeal within 120 days, thus, relaxation of the period of limitation in such cases has to be an exception and not the rule.

- Rule 34 of the ITAT rules, if read as a whole makes it mandatory for ITAT to pronounce orders at a hearing/sitting and obliges it to be made available to the parties. Also, one copy of the order is sent as a practice by the ITAT to the CIT (Judicial), apart from sending it to the jurisdictional CIT and while the actual filing of appeals before the High Court would remain the responsibility of the jurisdictional Pr. CIT/CIT, the CITs (Judicial) was made part of the Screening Committee and his office would provide secretarial assistance to the Screening Committee for engagement of standing counsels and prosecution counsels. The CIT (Judicial) was also responsible for assisting the Pr CIT/CIT in the work of reviewing and evaluating their performance.

- Person aggrieved is the entire tax department. It is not any individual officer of the Department who can be said to be aggrieved.

- It would be factually and legally incorrect to state that only that AO, CIT or Pr CIT within whose jurisdiction the Assessee's returns are scrutinized will be the aggrieved party and not any other officer of the Department.

- Thus, the pronouncement of the order by the ITAT has to be considered as the date of communication of the order and in case of a common order of the ITAT covering the several appeals, limitation would begin to run when a certified copy is received first by either the CIT (Judicial) or one of the officers of the Department (excluding the time taken for collection of the certified copy of order).

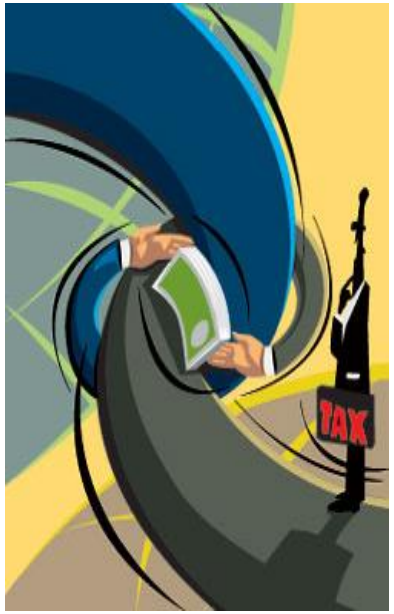
- It is up to the Department to devise the protocol to ensure that the decision to file the appeal and the steps to prepare and file such appeal are completed within the stipulated statutory period of 120 days from the date when the order was first received either by the DR or by the CIT (Judicial) or any other CIT. As long as the order to be appealed against is served on an officer of the Revenue, be it a DR or a CIT (Judicial), limitation will begin to run from that date.

NANGIA'S TAKE

The is a welcome ruling by the High court wherein the High Court have clarified that the period of limitation will commence from the date the impugned order is received by any commissioner (not the "concerned" Commissioner), removing the ambiguity, so far as, triggering date for filing of appeal by the tax department before the High court under section 260A of the Act is concerned. Also, the High Court has held that the date of pronouncement of the order by the ITAT should be considered as date of communication to the Commissioner (excluding the time taken for collection of the certified copy of order), which will henceforth remove the ambiguity so far as date of communication of order to the Commissioner is concerned.

TRANSFER PRICING

3. Reasons viz. taxpayer's intention of not avoiding taxes; or the absence of non-disclosure of its international transactions, cannot be considered as tool for not undertaking benchmarking analysis to justify the arm's length nature of the taxpayer's transactions with its associated enterprises



Facts of the case

Progressive Tools & components Pvt. Ltd. ("the taxpayer") is engaged in manufacturing of auto parts and components. During the previous year relevant to the assessment year under consideration the taxpayer, purchased materials worth INR 6.78 crore for the purpose of manufacturing auto parts from its Japanese associated enterprise ("AE"). In its detailed transfer pricing ("TP") documentation, the taxpayer, for the purpose of justifying the arm's length the aforesaid transaction, did not applied any TP method owing to the paucity of comparable companies/ data.

The TP Officer ("TPO"), during the assessment proceedings, set aside the TP documentation of the taxpayer and proceeded to determine the arm's length price ("ALP") of its international transaction by applying transactional Net Margin Method ("TNMM") on entity wide basis. However, while computing the amount of addition, the TPO confined the amount of addition to the value of international transaction. On appeal, the Commissioner of Income Tax (appeals) ["CIT(A)"] after taking the cognizance of several factors in the instant case, deleted the addition made by TPO. The aggrieved Revenue filed an appeal before the Income Tax Appellant Tribunal ("the ITAT"/ "the Tribunal").

The Tribunal's Verdict

1. On Benchmarking of international transaction

Over the issue of 'no benchmarking of the related party transaction of the taxpayer', the ITAT referred provision of Section 92D of the Income-tax Act 1961, read with Rule 10D of the Income-tax Rules, 1962 ("the Rules"), which provides the selection of most appropriate method wherein the controlled transaction needs to be justified from the arm's length perspective using comparable uncontrolled transaction. The Tribunal further emphasized that the provisions of Rule 10D of the Rules clearly outline the requirement of maintenance of records/ workings of the record of comparability analysis. Based thereon the Tribunal observed that simply circumventing benchmarking would mandatorily devoid the minimum information maintenance requirement of the Act and would be as good as having no TP analysis assumed by the taxpayer.

In the light of the above, the ITAT held the TPO justified in undertaking an analysis to determine the arm's length nature of the taxpayer's international transaction with its AE.

2. <u>On reasons given by the CIT(A) in deleting the TP additions</u>

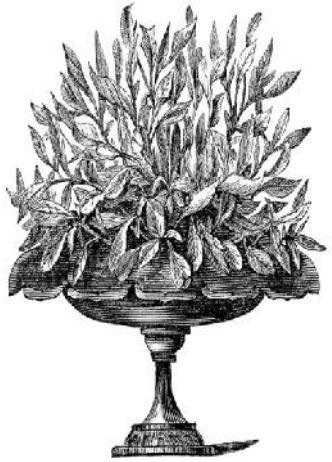
While deleting the TP additions in case of the taxpayers, the ITAT preclude the CIT(A)'s contention that *"there are neither any unrecorded transaction nor any undisclosed facts reflecting the taxpayer's intent to avoid tax"*. The Tribunal clearly stated that the Indian TP legislation does not provide that if there are no unrecorded transactions then no benchmarking should be done for international transactions of the taxpayer. The ITAT further held that the process of determining the ALP has to be carried out even in the case of unrecorded transaction or intent of avoidance of tax. Such excuses cannot be used as a tool to escape the benchmarking exercise. In this relation the ITAT categorically outlines that "*each and every international transaction has to pass through the hammer of TP analysis*".

<u>NANGIA'S TAKE</u>

The given ruling endorsed the significance of benchmarking as the critical part of any TP documentation file or policy which mainly used to test the arm's length nature of the related party transactions in preparing the prescribed detailed TP documentation. The emphasis, while compiling the TP documentation, has been given on undertaking a comprehensive analysis of potential comparables along with maintenance of detailed explanation/ workings in support of the same. The Indian TP legislation nowhere provides any situation (like absence of tax avoidance intentions or non disclosure of intra-group transactions etc.) which can be used as a tool for not undertaking the detailed benchmarking by the taxpayer.

<u>Progressive Tools & Components Pvt. Ltd. Vs. ACIT [TS-200-ITAT-2017(DEL)-TP]</u>

4. The Tribunal clarified that the interest rates along with a spread over and above thereon cannot be considered as 'same' for all types of international loans



<u>Facts of the case</u>

Devgen Seeds & Crop Technology Pvt. Ltd. ["the taxpayer"] is engaged in the business of agricultural operations i.e. cultivation of land, sowing, irrigation, production and sale of seeds grown. With respect to its international transactions pertaining to payment of interest to its associated enterprises ("AEs") on Fully Convertible Debentures ["FCDs"] and External Commercial Borrowings ["ECBs"], the Transfer Pricing Officer ["TPO"] made the following observations:

A. Interest Paid on FCDs

The taxpayer paid an interest of 4% during the year under consideration and for benchmarking the transaction, the taxpayer, based on independent search analysis, arrived at the average interest of 8.8%. On the contrary, the TPO considered prevailing one year SIBOR[1] as the comparable rate (ranging from 0.78% to 0.94% with an average of 0.86%) which was much less than the interest paid by the taxpayer. Based thereon, TPO made the upward adjustment of INR 1.94mn by considering SIBOR plus 200 basis points as the arm's length rate of interest on FCDs.

[1] Singapore Interbank Offered Rate

B. Interest paid on ECBs

The taxpayer paid fixed interest of 5.94% per annum which was determined at 3 months SIBOR plus 500 basis points at the date of disbursement of loan. The taxpayer was of the view that for its ECBs, the taxpayer falls under the automatic approval route prescribed under ECB/FCCB guidelines and its ECB's have been permitted by Reserve Bank of India ("RBI") as well. However, the TPO considered the taxpayer's rate of interest of 5.94% higher than the 3 months' SIBOR rate. On the lines of FCDs, the TPO considered 200 basis points as an appropriate spread over and above three months' SIBOR. Based thereon, the TPO made the upward adjustment of INR 5.17mn.

The aggrieved taxpayer filed its objections before Dispute Resolution Panel ("DRP"), which vide its order, deleted the interest adjustment on FCD by holding that interest rate of 4% is much less than the interest charged by independent bank in respect of working capital as well as interest adjustment on ECB by considering that interest of 5.94% as reasonable in comparison to the interest paid to bank at 11.7%.

The aggrieved Revenue department filed an appeal before the Income Tax Appellant Tribunal ("the ITAT"/ "the Tribunal").

Proceedings before ITAT

The Tribunal made out the following observations:

- For the purpose of benchmarking interest on FCDs and ECBs, the use of prevailing international rates (to be considered as external CUP) is reasonable for benchmarking should be done keeping in mind internal as well as external "CUP" which is based on the rates available in the international market and ITAT observed that LIBOR plus 500 bps (i.e. 5.24%) is higher than 4% charged to the taxpayer;

- As far as considering an appropriate spread over and above the prevailing international rates (i.e. SIBOR/ LIBOR[2]), the ITAT clarified that the spread of 200 bps cannot be considered as a universal rate for all types of loans. In deciding a reasonable spread for long term/ short term loans, the banks generally considered various commercial factors viz. security, net worth, credit ratings, term of loans and intensity of risks involved etc;

- The RBI in its norms has given windows for the pricing of interest and the spread according to which the term of loan up to 5 years, can have spread of 300 bps and beyond 5 years can be 500 bps;

Basis the above, the Tribunal, taking a cue from the RBI Guidelines, held that the taxpayer has properly allowed its AEs to adopt the spread of 500 bps and upheld the order of DRP.

NANGIA'S TAKE

There are plethora of rulings which corroborates the use of prevailing international interest rates as appropriate for benchmarking foreign currency loans. However, for the first time, the ITAT, in the instant case, has taken reference of RBI guidelines in clarifying the reasonability of spread over the international interest rates. The Tribunal clamorously held that interest rates along with spread thereon cannot be the same for all types of international loans irrespective of their terms risks etc.

Source: Devgen Seeds & Crop Technology Pvt. Ltd. [TS-222-ITAT-2017(HYD)-TP]

[2]London Interbank Offered Rate

INDIRECT TAX

5. GST laws passed by Lok Sabha

- GST Council in its 12th meeting approved the final draft of the remaining two bills: State Goods and Service Tax Bill ("SGST") and Union Territory Goods and Service Tax Bill ("UTGST"). Central Goods and Service Tax Bill ("CGST") & Integrated Goods and Service Tax Bill ("IGST") were already approved at the 11th meeting of GST Council.
- CGST, IGST, UTGST & Compensation cess passed by Lok Sabha as Money Bill. Rajya Sabha can only make recommendations on the proposed laws within 14 days of the bills being sent to the upper house. The government may be able to push through these bills in Parliament before the end of the ongoing budget session on 12 April.

Highlights:

- Our Hon'ble Finance Minister Arun Jaitley introduced the CGST, IGST, UTGST & Compensation cess as "money bills" in Lok Sabha on 27th March 2017 which ensures their passage as Rajya Sabha cannot reject money bills.
- SGST laws will be taken up by the state cabinets and the respective state assemblies for passage in their state legislature.
- GST Council has already approved five sets of rules and regulations relating to registration, payments, refund, invoice and returns, which will now be tweaked according to new legislations in place. The government would soon come up with four others rules namely composition rules, valuation rules, input tax credit rules and transition rules.
- After March 31, GST Council will take up the exercise of the fitment of various commodities in pre-decided GST tax slabs - 5 per cent, 12 per cent, 15 per cent and 28 per cent.
- CBEC is being renamed as the Central Board of Indirect Taxes and Customs ("CBIC"). The proposed CBIC shall, inter alia, supervise the work of all its field formations and directorates and assist the government in policy making in relation to GST and continue to perform all Central Excise Duty & Customs functions. [press note dated 25th March 2017 (Release ID: 159936) by Ministry of Finance]
- CBIC will have 21 zones, 101 GST taxpayer services commissionerates comprising 15 sub-commissionerates, 768 divisions, 3969 ranges, 49 audit commissionerates and 50 appeals commissionerates.
- GST Working Groups has been constituted to address concerns of the Trade & Industry. The Working Group will suggest ways & means to overcome the key concerns. The emphasis of the Groups would be on procedural simplification & possible rate structure. [Order (F.NO. 349/36/2017- GST) dated March 24, 2017 issued by Ministry of Finance]
- Cabinet has approved amendments to the Customs & Excise Law, relating to the abolition of cesses & surcharges on various goods & services to facilitate implementation of GST regime. [Press release dated 22nd March 2017 (Release ID: 159760) by Ministry of Finance]

Key changes in GST Bills, 2017 introduced in Lok Sabha:

- GST Law shall apply to the whole of India except the State of Jammu and Kashmir.
- The CGST rate cap has been increased from 14% to 20%. The IGST rate cap has been increased from 28% to 40%.
- In the case of non-payment to the supplier of goods or services or both within 180 days from the date of issue of invoice, an amount equal to input tax credit ("ITC") availed by the recipient shall be added to his output tax liability, along with interest.
- The following shall be treated neither as a supply of goods nor as a supply of services.
- Sale of land & constructed building (where entire consideration is received after issuance of completion certificate) Actionable claims, other than lottery, betting, and gambling.
- A registered person procuring taxable goods or services from an unregistered person will be required to pay tax under reverse charge basis.
- Composition Tax rates under Central GST Law would be as follows:
  - For Manufacturers: 1% of turnover
  - For Traders: 0.50% of turnover
  - For Restaurant sector: 2.5% of turnover

NANGIA'S TAKE

Passing of GST bills in Lok Sabha is an ultimate signal from government to all the stakeholders that government is ready for July 1, 2017 GST implementation.

GST implementation would repose faith in worlds largest democracy with over 1.3 billion living in a sovereign nation. Today our gvoernement proved that a reform which was under discussion for more than 10 years, would become a reality with mutual discussions and agreements, this is the best example set forth by cooperative federalism by any country in last few decades.

Now the next marathon for government is fitting of various goods and services into the four slabs--5%, 12%, 18% and 28%. Let's see the time that our worthy tax officers may take to complete such mammoth task. We belive GST would lay a strong foundation of tax compliance in India, and as country we would be a stronger and far more comlliant nation as we used to be. We hope with this we scale new hights in might Ease of doing business Index.