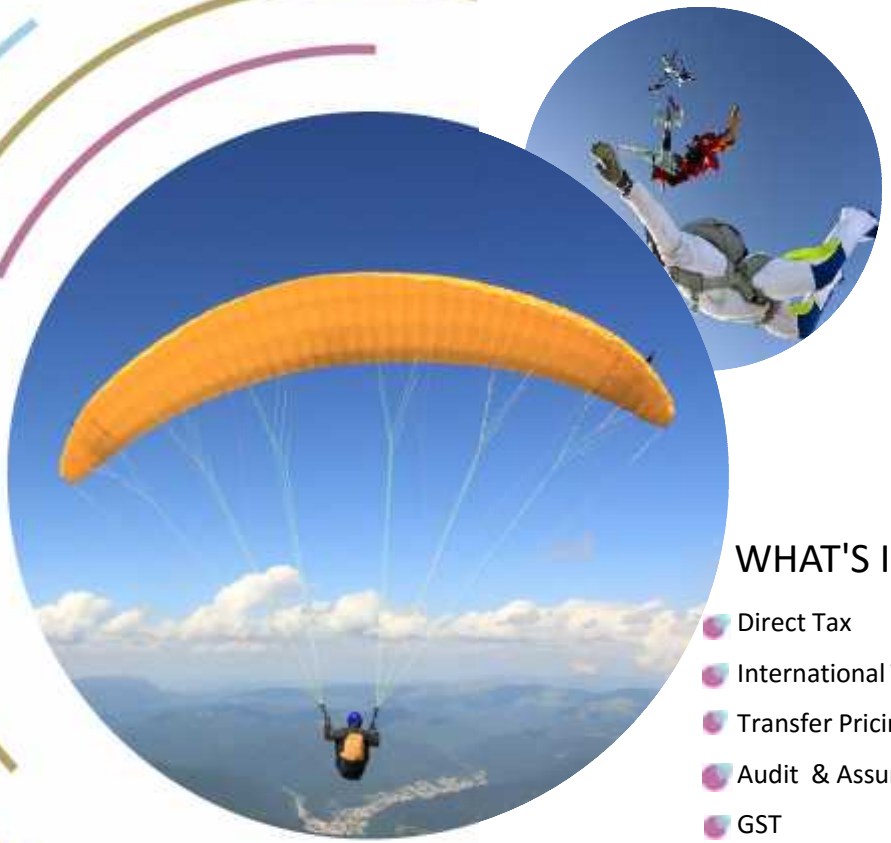
NEWS CRUNCH

January 01-31



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NANGIA & CO LLP
CHARTERED ACCOUNTANTS

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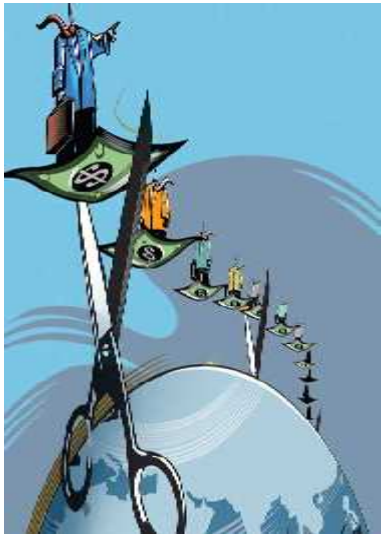
DIRECT TAX

1. AAR followed 'look at' approach to rule that offshore supply of equipment not taxable



Brief Facts of the Case:

- M/s Michelin Tamil Nadu Tyres Private Ltd. (MITTPL), the applicant, is a Chennai based resident company and M/s Manufacture Francaise des Pneumatiques Michelin (MFPM) is a company incorporated under the laws of France and is a tax resident of France.

- With a view to set up a plant for manufacture of tyres, the applicant entered into two agreements with MFPM

  - Umbrella Agreement as an "Equipment Purchase Contract" for design, engineering, manufacturing and supply of machinery and equipment from outside India and

- Services agreement, for supervision of installation services rendered by different external suppliers and to coordinate the start-up and ramp-up services rendered by those suppliers.

❖ MITTPL made an application to the Advance Ruling Authority (AAR) enquiring whether the amounts payable to MFPM under the Umbrella Agreement for offshore supply of machine were taxable in India.

Contentions of the Revenue

❖ Since the applicant and the French group company were closely associated, the two agreements (offshore contract and onsite services) should be read as one and the entire income arising from the execution of this composite contract should be brought to tax in India.

❖ That local contractors and employees of MITTPL did not possess requisite skill for successful installation of machinery and hence the installation was done by MFPM.

❖ That the price of machinery included supervisory charges and hence services were rendered and utilised in India, thereby attracting tax.

❖ That MFPM had a business connection in India, in terms of Section 9(1)(i) of the Act, inviting taxability.

Contentions of the Applicant

❖ The scope of the Umbrella Agreement strictly excluded installation services, which were provided under a separate agreement, the scope of which was restricted to supervision. Installation work was primarily undertaken by the applicant through its own employees.

❖ All activities essential for supply of machinery took place outside India and MFPM had no Permanent Establishment (PE) in India, thus there cannot be any tax liability.

❖ The price of the machine did not include the terms "successful installation and implementation of equipment". Ambiguity, if any was clarified by a confirmation from MFPM

❖ The payment for import of equipment from MFPM was found at arm's length by the Transfer Pricing Officer (TPO)

That the local technicians had the required expertise and owing to the size of the project, it couldn't have been completed by the few technicians of MFPL.

Ruling of the AAR

- Both the agreements were entered into at different points of time, had independent scope of work, separate considerations, and the second followed only after the first one had been completed.

- The TPO's report was indicative of the fact the price paid was only for the equipment and not for installation.

- The overall transaction was not designed for tax avoidance, but for genuine business of setting up a plant, with the help of MFPM and other third parties who are genuine.

- There is no way that it can be contended that since MFPM had a role in the supervision of setting up the same, the transfer of the property extended beyond the shores of France such as to have income arisen or accrued in India.

- Sale of goods outside India would not give rise to any taxable income in India, even though the said goods are to be utilized within India.

- MFPM's income through provision of supervisory services was taxable in India, since MFPM is carrying on its supervisory activities through its personnel at the fixed place, that is the factory premises, and this income can be fastened to this PE.

NANGIA'S TAKE

Upholding the 'look at' approach in the instant case, the AAR distinguished Vodafone ruling and held that the overall transaction was not designed for tax avoidance. The Advance Ruling is in favour of the taxpayers incurring huge costs on purchase of Plant/ Machinery offshore. By not considering the two agreements as tax avoidance agreements, the AAR has opened a door to such transactions, which are entered into in good faith. This will help genuine business entities to flourish as they will not hesitate while entering into such contracts.

Source: TS-20-AAR-2018

2. Mere 66-day activity in India gives rise to a Belgian company's PE

Facts of the case

IJRecently the Authority for Advance Rulings (AAR) in the case of Production Resource Group (Applicant) dealt with the issue of taxation of income received from furnishing of lighting and searchlight services during the Commonwealth Games in India, under the India-Belgium Double Taxation Avoidance Agreement (DTAA)

The Applicant provided the services on a turnkey basis. The technical scope of work included installation, maintenance, dismantling and removal of the equipment. While the arrangement was entered into for a period of around 114 days, the Applicant's employees and equipment were present in India for a period of 66 days for preparatory, installation and dismantling of the equipment. For the above services, the Applicant was provided an office space and on-site space to store the equipment at the stadium where the Games were conducted.

Assessee's contention

- Invoking the MFN clause, the restricted scope of the make available condition under the India-Portgual DTAA can be applied in the present case. Since the make available condition was not met, the income did not qualify as FTS.
- No transfer of any IP or right to use any IP by the Applicant to the OCCG. Hence, the royalty definition was not triggered
- Applicant did not have a PE in India in the absence of any fixed place of business in India to which it could enter or make use as a matter of right
- Installation PE was not created since the activity was for less than six months
- Applicant's presence was only transient; it didn't satisfy the characteristics of a PE of continuity, regularity and stability

Revenue's contention

- Applicant had a fixed PE in India at the premises of the OCCG, since it had a comprehensive physical presence, through its key personnel on the ground, throughout the period of the Games

- the services were highly technical and sophisticated, amounting to FTS under the Indian Tax Laws (ITL), as well as under the DTAA

- Applicant's income also qualified as royalty for providing use or right to use of certain IP (like specific design, patent, plan, process which is not known to others) to the OCCG.

Ruling of the AAR

- Applicant entered into various contracts for the purpose of its business in India, and was employing technical and other manpower for use at its site. The site was, thus, an extension of the foreign entity on Indian soil.

- In view of the overall facts and the terms of the Agreement,

the AAR held that the Applicant had a fixed permanent establishment (PE) in terms of the on-site space provided to store its equipment under a lock. Thus, exclusive access and control over such space lay with the Applicant Relying on the SC decision in the Formula One case[1], the duration for which the fixed place was at the disposal of the Applicant was sufficient for the business required. Furthermore, there was a continuous effort by the Applicant till the Games were over. Hence, the permanence test was satisfied.

NANGIA'S TAKE

The AAR ruling is welcome in so far as it accepted the Applicant's contention that its services did not 'make available' technical knowhow and hence did not amount to FTS. However, the reliance placed on Formula One case to hold that 'duration test' was irrelevant for determination of PE, is questionable. Fixed place PE determination is a fact driven exercise and should not be determined by placing reliance on another ruling. 'Disposal test' in the instant case was distinguishable from Formula one case.

Source: TS-626-AAR-2017

[1]TS-161-SC-2017

3. Google CEO Sundar Pichai Is Happy for the Company to Pay More Tax

- Google is willing to pay more tax globally, Sundar Pichai, the chief executive officer of the largest business unit of Alphabet Inc., said Wednesday at the World Economic Forum in Davos, Switzerland.

- "We are happy to pay more tax, whatever the world agrees to," Pichai said, noting that the company's current blended global tax rate is 20 percent. But he said the question was where Google should pay.

- Critics have accused large U.S. technology companies like Google of paying too little tax outside the U.S., despite deriving a large portion of their revenue from these other countries.

- Pichai said that as Google hired more engineers globally -- for instance, in France, where Google said this week that it would add more engineering and research staff -- it would equalize the distribution of its tax payments across different countries.

Source: https://www.bloomberg.com/news/articles /2018-01-24/google-ceo-pichai-is-happy-for-the-company-to-pay-more-tax

4. Barbados, Côte d'Ivoire, Jamaica, Malaysia, Panama, Tunisia sign multilateral treaty on tax avoidance

Officials from Barbados, Côte d'Ivoire, Jamaica, Malaysia, Panama, and Tunisia today signed a multilateral instrument designed to allow the countries to quickly strengthen their tax treaties with other countries, adding provisions to curtail tax avoidance and improve tax dispute resolution.

Today's signing brings to 78 the number of signatories to the instrument, the Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting or MLI. The MLI provisions reflect the outcome of the 2015 OECD/G20 base erosion profit shifting (BEPS) plan and include provisions on hybrid mismatch arrangements, tax treaty abuse. permanent establishments, and dispute resolution, including mandatory binding arbitration.

In addition to the countries signing today, Algeria, Kazakhstan, Oman, and Swaziland have expressed an intent to sign the MLI, the OECD said. The OECD also announced that four countries have thus far ratified the MLI — Austria, the Isle of Man, Jersey, and Poland.

If one more country ratifies the MLI and deposits its instrument of ratification with the OECD, the MLI will enter into force three months later.

Source: https://mnetax.com/barbados-cote-divoire-jamaica-malaysia-panama-tunisia-sign-multilateral-treaty-tax-avoidance-25775

5. As Singapore ages, low tax model creaks

Beneath its modern and glitzy exterior, Singapore is aging. For the first time in its short history, the Southeast Asian nation is expected to have as many people aged 65 and older as under 15 this year, a demographic crux that challenges the low-tax economic model that helped transform Singapore from port town to financial hub in a matter of decades. Top government officials have been signaling the need for higher taxes to support future social spending, and with the country forecasting a primary deficit in 2017 that would be the largest in at least 16 years, changes are expected as soon as the budget on Feb. 19. The city-state has some of the lowest tax rates in the world, with room to adjust parts without risking its competitiveness, but not even its citizens, who stand to be better supported by welfare changes, welcome higher taxes.

Source :https://www.reuters.com/article/us-singapore-taxes-analysis/as-singapore-ages-low-tax-model-creaks-idUSKBN1FC0TP

6. UAE hails EU step on tax rules

The Ministry of Finance has welcomed the European Union's decision to remove the UAE from its list of uncooperative tax havens, in recognition of the transparent procedures the State has been adhering to, and will continue to do so, locally and internationally.

Younis Haji Al Khoori, Under-Secretary of the Ministry of Finance, said, "The European Union's decision reaffirms the UAE's full and solid commitment to transparency in tax procedures, and reflects the meticulous local and international efforts made by all stakeholders in the Emirates since the beginning of 2017 to cooperate with our European counterparts and adhere to the EU's standards and requirements regarding the exchange of tax information.

Source: http://gulftoday.ae/portal/60d7c5c8-e07d-4cb2-a942-9f2be91dc998.aspx

TRANSFER PRICING

7. ITAT remits directors remuneration transaction back to AO on account of domestic TP omission by Finance Act, 2017

Brief Facts of the Case:

- Textport Overseas Private Limited ("the taxpayer") has entered into a Specific Domestic Transaction ("SDTs") in the nature of payment of remuneration to its directors as covered under Section 92BA of the Income Tax Act, 1961 ("the Act") during the Assessment Year ("AY") 2013-14. Since the aforesaid transaction exceeded the prescribed monetary threshold, the Assessing Officer ("AO") made a reference to Transfer Pricing Officer ("TPO") under Section 92CA of the Act for determination of the Arm's Length Price ("ALP").

DRP, however, enhanced the disallowance on the remuneration paid by the taxpayer to its directors and disposed of the objections with certain findings/directions. Aggrieved, the taxpayer filed appeal before Bangalore Income Tax Appellate Tribunal ("ITAT") for the deletion of the disallowance of expenditure in relation to director's remuneration, owing to an amendment in Section 92BA of the Act by the Finance Act, 2017, whereby clause (i) of the said Section was omitted.

Proceedings before ITAT

ITAT's Rulings

During the course of hearing, ITAT admitted additional grounds raised by the taxpayer questioning the validity of disallowance on remuneration paid to the directors owing to omission of Section 92BA(i) by the Finance Act, 2017, while the admission of additional grounds was strongly objected by Department Representative ("DR") on the fact that these grounds were never raised before the DRP nor were they raised in original grounds of appeal. ITAT opined that *"once a particular provision of section is omitted from the statute by subsequent amendment, it shall be deemed to be omitted from its inception*

unless and until there is some saving clause or provision to make it clear that amendment regarding observed that the action taken or proceeding initiated under that provision or section would continue and would not be left on account of omission". Therefore, the proceeding initiated or action taken under Section 92BA(i) of the Act would not survive at all. ITAT referred to Supreme Court ("SC") judgements in the case of ***Kolhapur Canesugar Works Ltd. Vs. Union of India in Appeal (Civil) 2132 of 1994*** and ***General Finance Co. Vs. Assistant Commissioner of Income Tax [257 ITR 338 (SC)]*** as well as jurisdictional High Court ("HC") ruling in the case of ***CIT Vs. GE Thermometrics India Pvt. Ltd., [TS-820-HC-2014 (KAR)]***, wherein it was stated that Section 6 of General Clauses Act, 1897 saves the right to initiate proceedings for liabilities incurred during the currency of the Act will not apply to omission of a provision, but rather only to repeals.

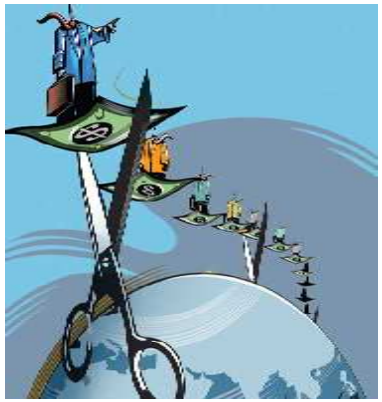
Accordingly, ITAT quashes reference made by AO to TPO under Section 92CA of the Act as well as the consequential order passed by TPO/DRP and directs AO to re-adjudicate the issue of claim of expenditure incurred which could not be done on account of provisions of Section 92BA(i) of the Act.

NANGIA'S TAKE

The instant case is an example of the possible effect of the amendment carried out by way of omissions of provisions vide Finance Act. Such rulings/observations by the Appellate authorities is a welcome step towards avoid incessant litigation for the taxpayers.

Source: Texport Overseas Private Limited [TS-1032-ITAT-2017(Bang)-TP]

8. Changes in Foreign Direct Investment (FDI) Policy



❖ Recent global developments have demonstrated that India's strong fundamentals and robust domestic consumption levels make it a resilient economy that can withstand global economic slowdown and declining consumption levels.

Further Government of India, in continuity with its maxim of captivate foreign investment and Ease of Doing Business in India, has made changes to the Foreign Direct Investment (FDI) Policy across sectors. The key changes made are briefly summarized below:

1. Single brand Retail Trading

Foreign Investment in Single Brand retail was permitted under the automatic route up to 49%. Investments beyond 49% required Government approval. Going forward, 100% FDI under the automatic route will be permitted for Single Brand retail.

For the initial five years, incremental sourcing by overseas companies, including their group companies for the specific brand will count towards the mandatory 30% local sourcing commitment. The requirement of license agreement between brand owner and investor has been removed.

2. Civil aviation

Foreign airlines are now permitted to invest upto 49% in Air India with prior government approval, subject to the condition that substantial ownership and effective control continue to vest with Indian National.

3. Real Estate Broking

It is clarified that real estate broking services do not amount to real estate business. Hence, they will be eligible for 100% FDI under automatic route.

4. Investing companies and core investment companies

Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies/ LLP and in Core Investing Companies is presently allowed upto 100% with prior Government approval.

It has now been decided to align FDI policy on these sectors with FDI policy provisions on Other Financial Services. Going forward, if the above activities are regulated by any financial sector regulator, then foreign investment upto 100% under automatic route shall be allowed. On the other hand, if they are not regulated by any financial sector regulator or where only part is regulated or where there is doubt regarding the regulatory oversight, foreign investment up to 100% will be allowed under Government approval route, subject to conditions including minimum capitalization requirement, as may be decided by the Government.

5. Pharmaceuticals

The definition of medical devices will be amended in the FDI policy and its reference to Drugs and Cosmetics Act has been removed.

6. Power Exchanges

Foreign Institutional Investors (FIIs) / Foreign Portfolio Investors (FPIs) were allowed to invest in Power Exchanges only by purchases in the secondary market. This restriction has been removed, and FIIs/FPIs will be able to invest in Power Exchanges through the primary market as well, within the overall cap of 49% in power exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.

7. Issue of shares for non- cash consideration

Issue of shares against non-cash considerations, such as against pre-incorporation expenses, import of machinery is now permitted under automatic route provided the sector is under the automatic route.

8. Competent Authority for examining FDI proposals from Countries of Concern

In case of investment in the automatic route sector from Countries of Concern, the administrative ministry has been changed from the Ministry of Home Affairs to the Department of Industrial Policy & Promotion.

9. Prohibition of restrictive conditions regarding audit firms

Whenever the foreign investor wishes to specify a particular auditor/ audit firm with an international network, for the Indian investee company, the audit of such investee companies should be carried out as a joint audit, wherein one of the auditors should not be part of the same network.

9. Applicability of Standard on Auditing (SA) 701, Communicating Key Audit Matters in the Independent Auditor's Report.

What are 'Key audit matters'

'Key audit matters' are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

The purpose of communicating key audit matters in the audit report is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

Effective Date of Applicability

This SA applies to audits of complete sets of general purpose financial statements **of listed entities** and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This SA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2018 (Financial year 2018-2019).

NANGIA'S TAKE

We believe that the proposed implementation of Key audit matters is one the biggest change to auditing standards. The platform for change is to provide insights to shareholders on the conduct of the audit, till now only viewed by those in the board room. We have seen that Globally, the most common key audit matters relate to carrying value assessments or impairments of goodwill, intangibles and other significant judgement matters. We suggest that the Companies on which it is applicable should start reviewing and engaging with their auditors the possible key audit matters which can be included in the section.

10. Whether Indian Accounting Standards (Ind-AS) are applicable on Branch offices/ Project offices of Foreign Companies.

Facts

Recently, In response to a question on the applicability of Ind-AS on Branch offices of a foreign Company, ITFG noted that As per the roadmap issued by the MCA on implementation of Ind-AS, "company" as defined in clause (20) of section 2 of the Companies Act, 2013 is required to comply with Ind AS.

Section 2(20) of the Act defines company as follows:

- "company" means a company incorporated under this Act or under any previous company law;

- Since, the branch office of a foreign company established in India is not incorporated under the Act. It is only an establishment of a foreign company in India. The Branch office is just an extension of the foreign company in India.

- Further, as per Rule 6 of the Companies (Indian Accounting Standards) Rules, 2015, "Indian company which is a subsidiary, associate, joint venture and other similar entities of a foreign company shall prepare its financial statements in accordance with the Indian Accounting Standards (Ind AS) if it meets the criteria as specified in sub-rule (1)."

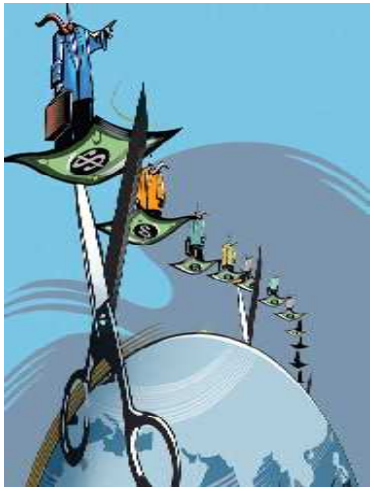
- In accordance with the above, ITFG noted that Branch office of a foreign company is not covered under Rule 6 as mentioned above. Accordingly, the branch office is not required to comply with Ind AS.

NANGIA'S TAKE

This is a welcome clarification issued by ITFG to avoid any confusion on the applicability of Ind-AS on branch offices. We also believe that the similar assessment can be applied on the applicability of Ind- AS on project offices as well.

GST

11. 25th GST council meeting cuts tax rates on Goods & Services



The GST Council in its 25th meeting held at New Delhi on 18th January, 2018 took key decisions to revise rates of 29 goods and 53 services and introduced measures aimed to curb tax evasion. The Council also debated on simplifying the return filing process but Council has not arrived on a final decision in this regard.

Highlights:

Rate Changes

- To reduce GST rate on construction of metro and monorail projects (construction, erection, commissioning or installation of original works) from 18% to 12%
- To reduce GST rate from 28% to 18% [for medium and large cars and SUVs] & from 28% to 12% [for other than medium and large cars and SUVs] on sale of old and used motor vehicles on the margin of the supplier. Provided the supplier has not taken any ITC of taxes paid on purchase of such vehicle

Policy Changes

- To reduce the late fees for failure to furnish returns (GSTR 1, GSTR 5, GSTR 5A) within due date from 200 rupees to 50 rupees (25 rupees each under CGST & SGST) per day & to 20 rupees (10 rupees each under CGST & SGST) per day for NIL returns
- To permit the taxable persons (obtained registration on voluntary basis) to apply for cancellation of registration even before the expiry of one year from the effective date of registration
- To extend the last date for filing FORM GST REG-29 for cancellation of registration (for migrated taxpayers) to 31st March, 2018

Other Changes

- To exempt service by way of transportation of goods from India to a place outside India by air
- To reduce GST rate on transportation of petroleum crude and petroleum products (MS, HSD, ATF) from 18% to 5% without ITC and 12% with ITC

Clarifications

- Leasing or rental service, with or without operator, of goods, attracts same GST as supply of like goods involving transfer of title in the said goods
- Services provided by senior doctors/consultants/technicians hired by the hospitals, whether employees or not, are healthcare services and are exempt under GST

NANGIA'S TAKE

GST Council in its 25th meeting, headed by FM decided to reduce tax rate on several goods and services which is a step in the right direction.

As taxpayers were facing numerous technical glitches on the common portal reduction in late fees provided relief to the taxpayers. All eyes are on next meeting of GST Council wherein final discussion on simplifying the return filing process would be taken.