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Direct Tax

1. Supreme Court holds the year of completion of substantial expansion within a new unit as a fresh "initial assessment year" for claiming 100% deduction of profits

Background

Supreme Court (SC) upheld the decision of Himachal Pradesh High Court (HC), in a group of cases, taking the case of Aarham Softronics (assessee) as the lead case. The assessee undertook substantial expansion of an industrial undertaking established in the specified area as mentioned under section 80-IC of the Income-tax Act, 1961 (Act), in the sixth year of its establishment and claimed deduction of profits @100% after having claimed 100% deduction of profits for the first five years from the year of set up of such new undertaking. The Assessing Officer (AO) disallowed the claim and held that assessee can have only one "initial assessment year" and deduction @100% cannot be claimed twice.

SC ruled in favor of the assessee and held that an assessee who sets up a new industry of a kind mentioned in section 80-IC of the Act and starts availing exemption of 100 percent tax, can start claiming exemption at same rate of 100 per cent beyond period of five years on ground that assessee has now carried out substantial expansion in its manufacturing unit. The said previous year in which substantial expansion is undertaken would become 'initial assessment year', and from that assessment year, assessee shall been entitled to 100 per cent deductions of profits and gains.

Brief facts of the case

- The assessee is engaged in the business of manufacturing of gears, axels and shafts. It had established new units in specified areas of Himachal Pradesh and Uttaranchal within the qualifying period. For such new unit, the assessee claimed 100% deduction for the first five years from the year of set up of new industrial units as per the provisions of section 80-IC of the Act

- Thereafter, in the sixth year, the assessee undertook substantial expansion of the existing unit and, considering the year of completion of substantial expansion of the said undertaking as 'initial assessment year', claimed a deduction of 100% of the profits of the unit for the next five years, commencing from the sixth year

- The AO disallowed the claim of the assessee and held that the assessee was entitled to only 25%/30% deduction from the sixth year to tenth year and cannot avail a fresh five-year tax holiday for 100% deduction on account of substantial expansion

- On appeal, Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal ruled in favor of the assessee and upheld AO's action of restricting deduction to 25% from sixth year onwards

- Aggrieved, the assessee filed an appeal before the Himachal Pradesh High Court (HP HC). The HP HC clubbed the assessee's case with that of many other taxpayers, who had completed "substantial expansion" during different time periods and ruled in favor of the assessee and permitted a fresh deduction of 100% from the year of substantial expansion for a maximum period of 10 years from the date of commencement of manufacture

- Aggrieved by the order of the HP HC, the revenue filed an appeal before the Hon'ble Supreme Court

Contentions of the Assessee

- It became entitled to a fresh deduction @100% for five years on account of substantial expansion

- Referred to the definition of "initial assessment year" as stated in section 80-IC of the Act and contended that there can be another "initial assessment year" on completion of substantial expansion of the existing unit

Contentions of the Revenue

- For the purpose of claiming benefits under section 80-IC of the Act, assessee can have only one "initial assessment year"

- Benefit of substantial expansion is available only to the existing units and not to the units that came into existence after introduction of the scheme

Supreme court's Judgement

The Hon'ble SC ruled in favor of the assessee by allowing the enhanced claim of deduction of 100% of profits from the year of completion of substantial expansion. While holding the same, it observed as under:

- The definition of "initial assessment year" stated in section 80-IB cannot be taken into account for the purpose of section 80-IC of the Act.

- Section 80-IC of the Act is materially different from section 80-IB, since section 80-IC of the Act is a special provision in respect of only those undertakings established in particular States viz., Sikkim, Himachal Pradesh, Uttaranchal or any of the North-Eastern States.

- The purpose for which section 80-IC of the Act was enacted was to encourage the undertakings or enterprises to establish and set up units in the aforesaid States in hilly areas to make them industrially advanced States as well.

- Having regard to the objective of the provision, 100% of profits and gains is allowed even when there is substantial expansion of the existing unit. As substantial expansion referred to in the provision would result in increase in production as also generation of more employment, the year in which substantial expansion is carried out is treated as "initial assessment year".

- In purview of the provisions of section 80-IC of the Act, an undertaking or enterprise can have more than one "initial assessment year". Moreover, when substantial expansion takes place, a new "initial assessment year" is triggered. Therefore, the assessee is entitled to claim deduction @100% of the profits and gains.

NANGIA'S TAKE

The ruling is welcome relief which has been laid considering the intent of such beneficial provisions of section 80-IC of the Act to make the specified areas industrially advance and aid job creation. The Larger Bench of SC sets at rest a long-drawn controversy and provided sigh of relief to taxpayers by reversing the division bench ruling.

2. Mumbai ITAT held that the payments received by the foreign company for developing and transferring technical plan does not qualify as FTS in the absence of "make available" condition

Background

Buro Happold Limited (assessee) received payment for rendition of consulting engineering services in the nature of supply of design/ drawing and as cost recharge towards head office expenses. The Assessing Officer (AO) observed that the aforementioned payments fulfilled the criteria for being taxable as Fee for Technical Service (FTS) as the services rendered were development & transfer of technical plan/ design as mentioned under Article 13 of India-UK tax treaty (tax treaty). The Assessee contended that since it did not make available any technical knowledge or skill to BHEI, the said payments cannot be characterized as FTS. The matter was decided in the favor of the assessee and it was held that the said payments could not be held as FTS in the absence of satisfaction of "make available" condition. Moreover, the same cannot be brought to tax as business profits in the absence of Permanent Establishment (PE) of assessee in India.

Brief facts of the case

- The assessee, a tax resident of UK, is engaged in the business of providing engineering design and consultancy services
- During the year under consideration, the assessee received certain amounts from Buro Happold Engineers India Pvt. Ltd. (BHEI) in India for rendition of consulting engineering services and as cost recharge towards head office(HO) expenses
- The AO observed that as per the provisions of Article 13(4)(c) of the tax treaty, payments received for development and transfer of technical plan or technical design would be taxable as FTS in India. The AO observed that the words "make available" go with technical knowledge, experience, skill, knowhow, etc., but do not go with "the development and transfer of a technical plan or a technical design"
- Also, the AO held that cost recharge is ancillary to the provision of consulting engineering services which was held to be in the nature of FTS
- On appeal, Commissioner of Income Tax (Appeals) affirmed the order of the AO and held that the amount received towards consulting engineering services as FTS under the Income Tax Act, 1961 (Ac") as well as the tax treaty
- Aggrieved, the assessee filed an appeal before the Mumbai Income Tax Appellate Tribunal (ITAT)

Contentions of the Assessee

- The second limb of Article–13(4)(c) of the tax treaty should not be read separately but has to be read along with the first limb and therefore, unless the development and transfer of a technical plan or technical design makes available the technical knowledge, experience, skill, knowhow or processes to the service recipient, the amount received cannot be treated as FTS.
- The services provided by the assessee were project based and thus, could not be used subsequently for any other project. Thus, no technical knowledge or skill were made available to BHEI while providing engineering consultancy services
- Further, the amount received towards cost recharge at large can be treated as business profit. However, in the absence of PE of the assessee in India, such business income cannot be held taxable in India.

Contentions of the Revenue

- The assessee did not execute the project itself and has provided services to Indian parties enabling them to further apply and re–apply such technology in India
- The services include supply of design/drawing to BHEI and in each segment of advice and drawings BHEI and assessee participate together and they do not work in isolation BHEI makes designs and drawings only after understanding and incorporating the effect of designs and drawings and advisory provided by the assessee and thus, their work is interdependent. BHEI could not implement the project without the knowhow and experience of the assessee
- The technical services provided by the assessee are capable of being used in future
- The technical knowledge, experience, etc., are made available to the Indian company and the amount received by the assessee is in the nature of FTS under Article–13 of the tax treaty
- As regards the cost recharge, it contended that the cost recharge is ancillary to consulting engineering services and same shall be held taxable as FTS in India

ITAT's Judgement

While holding that the amount received by the assessee is not taxable as FTS, it noted as under:

- As per the rule of *ejusdem generis,* the words 'or consists of the development and transfer of a technical plan or technical design' appearing in the second limb of Article 13 of the tax treaty shall be read in conjunction with 'make available technical knowledge, experience, skill, knowhow or processes' and cannot be interpreted independently. Therefore, payment made shall be constituted as FTS once the make available condition is satisfied even while developing and transferring technical plan.
- The assessee did not make available technical knowledge, experience or skill to BHEI as the technical designs/ plans supplied by the assessee were project specific and could not be used in future
- Since cost recharge has been considered as incidental and ancillary consulting engineering services, the same would not be treated as FTS.

NANGIA'S TAKE

The ITAT has delivered a careful and through analysis of ambiguous provisions in the tax law. The judgement is an addition to the on-going 'make available' controversy with an exceptional argument of non-application of such condition on development and transfer of technical plan. Judgements like these instills the faith in judiciary as it deep dives into the intent of the law and clearly interprets any dubious provisions step-by-step.

3. Mumbai ITAT held that in the absence of fulfilment of make available condition as mentioned in the India-UK DTAA, no tax is required to be deducted by assessee on payments made to French company

Background

Entertainment network (India) Ltd. (assessee) remitted certain amounts (without deduction of tax at source) to M/s Phora Capital Advisor (PCA) in France towards rendition of certain services being in the nature of professional services. The assessing officer (AO) observed that said amount was taxable in India as Fee for Technical Services (FTS) and since no tax was deducted at source by the assessee, the same was disallowed under section 40(a)(i) of the Income Tax Act, 1961 (Act).
This ruling was delivered in favor of the assessee and it was held that basis the "make available condition" forming part of the India-France Double Taxation Avoidance Agreement (DTAA) by virtue of India-UK tax treaty, the advisory services rendered by French company to the assessee did not "make available" any technical knowledge or skill to the assessee company. Hence, no tax was deductible on the payment for such services.

Brief facts of the case

- The assessee engaged PCA in France to provide advisory services in relation to the review of strategic and M&A options
- The assessee remitted certain amount as fees to PCA for the said services without deduction of tax at source
- The AO observed that the aforementioned amount was taxable as FTS under Article 13 of India-France DTAA as the services rendered were specialized services requiring technical knowledge and since, no tax was deducted at source by assessee, the amount was disallowed under section 40(a)(i) of the Act
- On appeal, the Commissioner of Income Tax (Appeals) concurred with the AO and held that the amount received by PCA was FTS which was liable for deduction of tax at source
- Aggrieved, the assessee filed an appeal before the Mumbai Income Tax Appellate Tribunal (ITAT)

Contentions of the assessee

- That PCA had no Permanent Establishment (PE) in India and they have provided only professional services to the assessee. Furthermore, PCA is a French company and was not liable to tax in India. Therefore, no disallowance was required to be made under section 40(a)(i) of the Act
- "Make available" clause as provided under India-UK tax treaty has to be read as forming part of the India-France DTAA and therefore, the payment made should not be treated as FTS since no technical services were made available to the assessee.

Contentions of the Revenue

- The services rendered by PCA, in the nature of advisory services, were specialized services which required technical knowledge for which provisions of the India France DTAA would be applicable
- In view of Article 13 of the India-France DTAA, the assessee was required to withhold tax under the relevant provisions of Act.

ITAT's Judgement

While holding that make available conditions, as not specifically provided by India-France DTAA, has to be read as forming its part by virtue of India-UK DTAA, the ITAT observed as under:

- Referring the clause 7 of India-UK protocol and rulings such as Karnataka High Court ruling in ISRO Satellite Centre and Delhi High Court ruling in Steria (India) Ltd., ITAT noted that the definition of FTS under India-France DTAA has to be given a restrictive meaning similar to that of the expression FTS appearing in the India-UK DTAA

- Thus, since the advisory services rendered by French company to the assessee do not "make available" any technical knowledge or skill to the assessee company, the make-available condition is not satisfied and hence no tax is deductible on the payment for such services

NANGIA'S TAKE

Once again, the judiciary has established the fact that not all the services, even, technical in nature are taxable as FTS and 'make available' condition has to be satisfied for its taxation. Interestingly, this ruling seeks to provide benefit of 'make available clause' even in the absence of such a clause in the concerned tax treaty. Thus, while analyzing the taxation of any service rendered to a foreign company, not only the make available clause should be referred but also the protocol in the concerned tax treaty which may provide benefit other than those mentioned specifically in the tax treaty.

INTERNATIONAL TAX

4. France sees global tax deal on digital giants in 2019: Minister

A planned revision to international tax rules for the digital era could be drawn up within 2019 after the United States and Ireland indicated that they wanted a deal, French Finance Minister Bruno Le Maire said on Thursday. Some 127 countries and territories agreed last month to tackle some of the most disputed issues of international taxation, such as where digital firms' cross-border income should be taxed.

https://www.reuters.com/article/us-france-tax/france-sees-global-tax-deal-on-digital-giants-in-2019-minister-idUSKCN1QH282

5. Governments use receipt lotteries to boost tax compliance

Governments around the world are encouraging consumers to ask for receipts by turning them into lottery tickets. Taiwan was an early experimenter, in 1951. The past decade has seen a flurry of such schemes: China, the Czech Republic, Lithuania, Portugal, Romania and Slovakia all now have them. Latvia will launch one later this year. The aim is to make it harder for retail businesses to evade taxes. Worldwide, 20-35% of government revenue comes from value-added taxes (VAT) or similar levies on consumption.

https://www.economist.com/finance-and-economics/2019/03/02/governments-use-receipt-lotteries-to-boost-tax-compliance

6. EU court issues landmark decision on Member State power to deny tax benefits

In a key decision issued February 26, the European Court of Justice (ECJ) has concluded an EU Member State does not need to adopt an anti-abuse provision into law to deny tax benefits granted under either the Parent-Subsidiary Directive or the Interest and Royalty Directive if fraud or abuse is involved. In joined cases T Danmark (C-116/16) and Y Denmark Aps (C-117/16), the ECJ addressed questions on the interpretation of the Parent-Subsidiary Directive.

https://mnetax.com/eu-court-issues-landmark-decision-on-member-states-power-to-deny-tax-benefits-32648

7. Turkey issues guidance on controversial digital tax

The Turkish government on 15 February published in the Official Gazette Communiqué No. 17 which provides further clarifications regarding withholding tax liabilities for cross-border online advertising services. Turkey has recently introduced a digital tax on cross-border online advertising services. Presidential Decree No. 476, published in the Official Gazette dated 19 December 2018, adds a withholding tax liability for payments made for cross-border online advertising services regardless of whether the payee is a resident or non-resident taxpayer.

https://mnetax.com/turkey-issues-guidance-on-controversial-digital-tax-32638

8. Accenture paid £150m to settle Lux Leaks tax dispute

The tax claims made against Accenture were prompted by the Lux Leaks scandal, according to those behind the investigation – the International Consortium of Investigative Journalists. In its quarterly report from March 2017, the company highlighted that it had been informed by the Swiss Federal Tax Administration (FTA) that it was under investigation. This was in regards to Accenture's tax treatment of an intercompany transfer of intellectual property in August 2010, on which the FTA asserted it had underpaid income and was therefore consequently withholding taxes.
https://economia.icaew.com/news/february-2019/accenture-pays-150m-in-lux-leaks-tax-dispute

9. France tries to set trend with internet tax bill

France will introduce a bill on Wednesday to tax internet and technology giants on their digital sales, and thus curb efforts to pay global levies in countries with lower tax rates. The bill is proposed by economy minister to have companies pay a tax of three percent on much of their digital sales in France.

https://timesofindia.indiatimes.com/world/europe/france-tries-to-set-trend-with-internet-tax-bill/articleshow/68280692.cms

Transfer Pricing

10. SC dismisses McKinsey India's SLP; HC upheld its research & information service characterization as KPO

Outcome: Dismisses taxpayer's SLP (Before High Court- in partly favour of Taxpayer)
Category: Characterisation of taxpayer as BPO vs KPO service provider and charging of interest on delayed receivables

Facts and Contentions

- M/s Mckinsey Knowledge Centre India Private Limited ("taxpayer") is a wholly owned subsidiary of Mckinsey Holdings Inc., USA. It operates in two business segments i.e. Research & Information Services Division and IT Support Services Division.
- During the Assessment Years ("AY") 2011-12 & AY 2012-2013, taxpayer has entered into certain international transactions with its associated enterprises ("AE") and for benchmarking such transactions Transactional Net Margin Method ("TNMM") was selected as the Most Appropriate Method ("MAM").
- During the assessment proceedings of relevant AYs, Transfer Pricing Officer ("TPO"/"revenue") has accepted TNMM as MAM. However, the TPO rejected certain comparables adopted by the taxpayer and included few new companies in his set of comparables. Accordingly, the TPO made an upward TP adjustment on account of differences in profit level indicators ("PLI") of comparables and taxpayer, while determining the Arm Length Price ("ALP") of the services provided under Research & Information Services Division and IT Support Services Division. Apart from above, TPO also made a TP adjustment on account of non-charging of interest on outstanding receivables from AEs.
- Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). The DRP upheld the taxpayers view partly. Aggrieved by the same, the taxpayer filed an appeal before Income Tax Appellant Tribunal ("ITAT"/ "the Tribunal").

Proceedings before ITAT

- The tribunal rejected four comparables from the list of comparables on account of dissimilarity. It observed that the services performed by the taxpayer were in the nature of KPO and not BPO as contended by the taxpayer. The ITAT ruled the following:

Dispute	Ruling
Nature of services- BPO vs KPO	✓ ITAT noted that taxpayer had to carry out research from internet based databases or other sources to compile data, which was then customized/processed in accordance with requirements before transmitting it outside India after organizing; and observed that taxpayer was not simply collecting data from databases; ✓ Accordingly, ITAT characterized the research and information services rendered by taxpayer to its AE as high-end knowledge-based research services (KPO) as it involved huge expertise and skills.
Charging of interest on outstanding receivables	✓ On the issue of interest of outstanding receivables, the Tribunal held that charging of interest on delayed receipt of receivables amounts to 'international transaction' and requires separate benchmarking.

- Aggrieved by the above ruling, taxpayer filed an appeal before Delhi HC on the ground that ITAT erred in concluding that nature of services provided by it under the Research & Information Services segment was in the nature of KPO services and the early or late realization of sale/ service proceeds was incidental to the transaction of sale/ service and contends that there can be no question to separate benchmark the interest.

HC's Ruling

Characterisation of taxpayer as BPO vs KPO service provider

- HC pursued the Master Service Agreement (Agreement) between taxpayer & its AE and based on the same it observed that taxpayer's functions included Knowledge management systems and infrastructure issues which would encompass infrastructure support, application support, application operations group and survey development centre.

- Based on the ITAT conclusion, HC opined that there was clearly a form of knowledge intensive analysis rendered by the taxpayer which was a more nuanced and involved service than that which is provided by a BPO.

- Further, HC relied on ***Maersk Global Centres (India) ruling*** and held that services rendered by taxpayer were specialized and required specific skill based analysis and research that was beyond the more rudimentary nature of services rendered by a BPO. Thus, HC concluded that "***it would be incorrect to slot the services provided by the taxpayer into that of a BPO, when it is more akin to a KPO.***"

Charging of interest on delayed receivables

- HC referred the ruling in case of ***BT e-Serv (India) Pvt. Ltd. V. ITO,*** wherein it was held that ***the receivable or any other debt arising during the course of the business is included in the definition of 'capital financing' as an 'international transaction' and imputing interest on such 'capital financing is natural corollary, if the interest is not charged at arm's length.***

- In view of the aforesaid ruling, HC held that if there is any delay in the realization of a trading debt arising from the sale of goods or services rendered in the course of carrying on the business, it is liable to be visited with transfer pricing adjustment on account of interest income short charged/uncharged and accordingly, rejected the contention of taxpayer against the ITAT order.

- Aggrieved by the above ruling, taxpayer filed a Special Leave Petitions ("SLP") before Supreme Court, wherein after hearing both the sides Supreme Court stated that it was not inclined to entertain the SLP and accordingly dismissed it.

NANGIA'S TAKE

The verdict in the instant case clearly defined that the line of difference between BPO & KPO Services is very thin, and it may be difficult to classify services strictly as falling under the category of either a BPO or a KPO due to significant overlap in their activities. This ruling emphasizes the importance of intercompany agreements entered between enterprises under common ownership or control that complete business transactions with each other. These legal written contracts cover the actual functions undertaken, risks borne and assets employed by the parties and ultimately, it set forth the factual substance that will affect the determination of the arm's length conditions and specific pricing. Further, imputation of interest on delayed realisation of receivables with AE has been a contentious issue in India. In the aforesaid ruling it is clearly stated that if there is any delay in the realization of a trading debt, the interest should be charged on such delayed realization. It may be noted that in other cases like case of Kusum Health Care Private Limited, the High Court had clearly approves the principle of working capital adjustments to factor in the effect of outstanding receivables on pricing/ profitability. Since conflicting views are evolving between these two rulings (this case and the case of Kusum Health Care Private Limited), it seems this issue is yet to reach finality in terms of judicial analysis.

Source: Mckinsey Knowledge Centre India Private Limited [TS-49-SC-2019-TP]

11. ITAT rules BLT's inability to provide valid ground for AMP adjustment subsequent to high court's ruling in prior period; Rejects BEPS actions 8-10 applicability

Outcome: In favour of taxpayer
Category: Marketing Intangibles; AMP adjustment
Facts of the Case

Whirlpool of India Ltd ("the taxpayer") a subsidiary of Whirlpool USA, engaged in production, sale and distribution of Whirlpool Appliances. During Assessment years ("AYs") 2010-11, 2011-12 and 2012-13, the taxpayer entered into certain international transactions with its Associated Enterprises ("AE's") and since value of the international transactions exceeded more than 15 crores, the Assessing Officer ("AO") made reference to the Transfer Pricing Officer ("TPO") for determining the arm's length price ("ALP") of the international transactions under section 92CA of the Income Tax Act, 1961 ("the Act").

The TPO after going through the documentations filed by the taxpayer under rule 10D, and after calling for requisite details and submissions from the taxpayer held that the AMP expenses incurred by the taxpayer for AY 2010-11 is an international transaction. Consequently, in order to compute arm's length price ("ALP") of the said international transaction, TPO applied Bright Line Test ("BLT") and adjusted the taxpayer's income by INR 243.85 crores. Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). The DRP also upheld the TPO's view and confirmed the upward adjustment made by him and directed the TPO to examine the nature of salary and remuneration spent by the taxpayer.

Aggrieved by the same, the taxpayer filed an appeal before Delhi Income Tax Appellant Tribunal ("ITAT"/ "the Tribunal").

ITAT's Ruling

ITAT made the following observations:

- Ld. TPO as well as DRP treated AMP expenses as international transaction by applying ratio laid down by special bench decision of the Tribunal in case of the ***LG Electronics India Pvt. Ltd. vs. ACIT***[1] which, has been overruled by the Decision of the Hon'ble Delhi High court ("HC") in case of ***Sony Ericsson India Pvt. Ltd. vs. CIT***[2] by considering that BLT is not an appropriate yardstick for determining existence of international transaction, and thus accordingly for calculating the ALP.

- The Hon'ble HC while deciding the question of law raised by the taxpayer for AY 2008-09 held that the AMP expenses incurred by the taxpayer cannot be treated as international transaction between taxpayer and Whirpool USA. Further, HC held that since there is no existence of international transaction, accordingly, the question of determining the ALP does not arise.

- Revenue highlighted that there is a mutual agreement between taxpayer and its AE for discharge of function of marketing and market development in addition to agreement/arrangement for sale and distribution of goods purchased from its AE, for which the cost has been borne by the AE. In light of the same, Revenue by keeping reliance on the BEPS Guidelines, provided for Transfer Pricing of intangibles, under Action Plan 8-10 of GE 29/OECD BEPS project contended that the taxpayer has been working for the benefit of foreign AE and therefore deserves suitable remuneration.

- The ITAT, keeping the aforementioned Delhi HC's conclusion as its base, opined that since the basis on which adjustment shall be made being BLT, has been rejected in the taxpayer's own case for AY 2008-09 due to inability of the Revenue to demonstrate some tangible material to provide for AMP expenses as international transaction, no further interference can be called for.

[1] [TS-11-ITAT-2013(DEL)-TP]
[2] [TS-96-HC-2015(DEL)-TP]

- Further, ITAT rejects Revenue's reliance on BEPS guidelines and holds that Action Plan 8-10 cannot be applied as the same is yet to be implemented. However, appreciating the concern raised by the Revenue, ITAT set aside this issue to Ld. AO/TPO to pass fresh order after considering decision of Hon'ble Supreme Court.

NANGIA'S TAKE

The issue in relation to 'marketing intangible' is recognized as an extremely challenging and complex issue especially considering that India is one of the largest consumption markets which has the potential to significantly enhance the brand value of consumer goods manufacturers.

In the instant ruling, the lower tax authorities differentiate the current case from the earlier rulings in a way that there exists a mutual agreement between taxpayer and its AE for discharge of function of marketing and market development in addition to agreement/arrangement for sale and distribution of goods purchased from its AE. Further, it can be seen that on one side, in the rulings such as PesiCo India Holdings Pvt Ltd, the higher tax authorities are putting reliance on BEPS Action Plan 8-10 for addressing the issue of AMP expenses and on the other side, abovementioned ruling states that the reliance cannot be put on BEPS Action Plan 8-10, as the same is yet to be implemented.

In view of the above, it can be clearly seen that there are different views of tax authorities on the same matter, therefore, only relief or hope of ray for the taxpayers facing the said issue, would be an outcome from the Supreme Court on this contentious issue.

Further, as the matter relating to AMP expenses is pending for adjudication before the Supreme Court, the taxpayers entering into such kind of transactions, are advised to re-look at their inter-company transactions/arrangements to mitigate any risk arising on account of same.

Source: Whirlpool of India Ltd [TS-25-ITAT-2019(DEL)-TP]

12. The HC Upholds ITAT-order treatment of additional interest on AE's margin-money

Outcome: In favour of taxpayer
Category: Provision of investment advisory services/ Interest
Facts of the Case

- JP Morgan India Pvt. Ltd. ("the taxpayer") is engaged in merchant banking, stock broking and providing related financial and advisory services.

- During assessment year 2006-07 ("the year under consideration"), taxpayer provided broking services for future and option trade to its Associated enterprise ("AE"). The taxpayer benchmarked the said international transaction using Transactional Net Margin Method ("TNMM") as the Most Appropriate Method ("MAM") for determination of Arm's length price ("ALP").

TPO Arguments

- During the course of assessment proceedings, the transfer pricing officer ("TPO") benchmarked the aforementioned international transactions using Comparable uncontrolled price ("CUP") as the Most Appropriate Method ("MAM").

- As per the taxpayer, suitable adjustments should be allowed for the difference between the functions performed and risks assumed in respect of broking services related parties vis-à-vis unrelated parties. TPO accepted the taxpayer's contention and according to him, to account for such difference, the additional cost incurred in transactions with unrelated parties vis-à-vis related party would need to be reduced from the brokerage charged to unrelated parties to arrive at adjusted comparable brokerage rate i.e. internal CUP data.

- Further, TPO identified another element to be factored i.e. interest earned on account of high volume trade of related parties. In relation to the same, TPO calculated interest earned in related and unrelated parties as percentage of turnover i.e. 0.0348% and 0.0212% respectively. As a consequence, additional interest earned in volume of related party trade was calculated as 0.0136% and accordingly proposed an addition of INR 4.3 Crores.

- Aggrieved by the same, taxpayer filed an objection before the Dispute Resolution Panel ("DRP"). In the DRP directions, DRP upheld the addition proposed by TPO.

Aggrieved, the taxpayer filed an appeal before the Income Tax Appellant Tribunal ("ITAT").

ITAT Ruling

- ITAT noted the taxpayer's plea that additional interest earned on account of high volume of related party trade cannot be computed as percentage of turnover since interest has no connection with turnover rather interest earned is based on margin money placed by related and unrelated parties.

- Further, ITAT elucidated that the methodology proposed by the taxpayer is more appropriate than the manner in which the adjustment for the difference on account of interest earned in the respective segments of related and unrelated parties has been allowed by the TPO.

- Accordingly, ITAT remitted the issue to Assessing Officer ("AO") with direction to verify the working of additional interest earned and therefore to factor-in such difference in internal CUP data for purposes of benchmarking the international transaction of provision of broking services for Futures and options Trade.

- Aggrieved, the Revenue filed an appeal before the High Court ("HC").

HC Ruling

- The HC after going through with the merits of the case held that ITAT's view to be reasonable one being directly linked to the interest on the margin money deposited by the AEs and unrelated parties while engaging the services of the taxpayer as a broker in future and option trade and hence upheld the ITAT order, accordingly restored the issue to the AO to determine the ALP.

NANGIA'S TAKE

The instant ruling by High Court is one of a distinctive judgment in relation to the benchmarking of the financial transaction. The above ruling focused on the adjustment in internal CUP data with regards to computation of interest earned by the taxpayer i.e. broker in future and options trade. In context thereof, HC and ITAT analysed the mechanics for adjustment and concluded that interest earned by a broker while providing broking services is directly related to the margin money deposited by the related and unrelated parties and therefore cannot be computed as percentage of turnover since interest earned has no connection with the turnover as computed by TPO.

Thus the verdict in the instant case reiterate the stringent applicability along with parameters for application of internal CUP method for benchmarking purposes. The ruling again highlighted the requirement of adjustment under internal CUP method for utmost functional equality between the transactions with related parties and unrelated parties for the purpose of determination of ALP.

Source: J P Morgan India Pvt Ltd [TS-24-HC-2019(BOM)-TP]

ABOUT US

Nangia Advisors LLP is a premier professional services organization offering a diverse range of Taxation, Transaction Advisory and Business Consulting services. Nangia Advisors LLP has presence currently in Noida, Delhi, Gurugram, Mumbai, Dehradun, Bengaluru and Pune. Nangia Advisors LLP has been in existence for more than 38 years and has been consistently rated as one of the best advisory firms in India for entry strategy, taxation, accounting & compliances over the past many years. Nangia Advisors LLP had announced a strategic collaboration agreement with Andersen Global last year in May. Andersen Global is an international association of legally separate, independent member firms comprised of tax and legal professionals around the world. Established in 2013 by US member firm Andersen Tax LLC, Andersen Global now has over 4,000 professionals worldwide and a presence in over 129 locations through its member and collaborating firms.

Quality of our people is the cornerstone of our ability to serve our clients. For this reason, we invest tremendous resources in identifying exceptional people, developing their skills, and creating an environment that fosters their growth as leaders. From our newest staff members through senior partners, exceptional client service represents a dedication to going above and beyond expectations in every working relationship.

We strive to develop a detailed understanding of our clients' business and industry sector to offer insights on market developments and assist our clients develop effective strategies and business models. We have the resources and experience necessary to anticipate and competently serve our clients on issues pertaining to all facets of Tax and Transaction Advisory. We take pride in our ability to provide definite advice to our clients with the shortest turnaround time. The business and tax landscapes have changed dramatically, and the pace and complexity of change continues to increase. We can assist you navigate this shifting landscape.

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