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NEWSLETTER

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What's Inside…

DIRECT TAX

- Grouting not 'construction', taxpayer constitutes Fixed Place PE
- Management services taxable as business profit in absence of FTS clause
- Delhi ITAT holds that CIT(A) can't impose Rule 11UA when taxpayer 'substantiated' higher valuation u/s. 56(2)(viib) before assessing Officer

INTERNATIONAL TAX

- Governments use receipt lotteries to boost tax compliance
- Ukraine ratifies MLI to amend tax treaties
- Switzerland Introduces New Tax Rule for Systemically Important Banks France tries to set trend with internet tax bill
- Australia embraces international co-operation to solve tax challenges posed by the digitalized economy
- Georgia ratifies tax instrument to tackle BEPS
- Taiwan Plans Extension of Tax Incentives for R&D Expenses

TRANSFER PRICING

- Application of Transfer Pricing provisions not against "non-discrimination" clause of DTAA; DCF valuation subsumes goodwill
- HC Accepts "headcount method" as a basis for apportionment of un-allocable cost
- Company cannot be rejected as a comparable merely on following different-FY wherein the data can be collated from the public domain relating to the year under consideration

REGULATORY

- Recent amendment in Companies (Incorporation) Rules
- Issue of Master Direction on External Commercial Borrowings and Trade Credits by RBI

1. Grouting not 'construction', taxpayer constitutes Fixed Place PE

Disagreeing with its earlier ruling, Delhi ITAT held that grouting services does not constitute construction activity and thus constitutes fixed place of business of the taxpayer in India

Background

M/s. ULO Systems LLC (assessee) contended that income earned from the "grouting activities" carried out in pursuance of contracts entered with Indian companies shall not be taxed in India in the absence of Permanent Establishment (PE) under Article 5 of India-UAE tax treaty (tax treaty). While denying the contention of the assessee and relying on Supreme Court's ruling in the case of Formula One, Delhi Income Tax Appellate Tribunal (ITAT) noted that the vessel of the main contractor in which assessee's equipment were placed and personnel were stationed formed a fixed place PE of the assessee and accordingly, income is liable to tax in India.
The judgment has been delivered in contradiction of its earlier ruling delivered in assessee's own case for the Assessment Year (AY) 2007-08 wherein it was held that rendition of grouting services would be assessed for constitution of construction PE. In the presence of specific clause, the same shall not be assessed under article 5(1) of the tax treaty to ascertain establishment as fixed place PE.

Facts of the case

- The assessee, a company incorporated in UAE, is engaged in the business of undertaking grouting work for companies in the oil and gas industry
- The assessee earned income from the grouting contracts entered into with certain companies in India. The assessee contended that it does not have a PE in India and therefore, the said income is not taxable in India
- The AO observed that income from grouting is taxable since it arises out of fixed place PE in terms of Article 5(1) of the tax treaty. Hence, income from grouting activities would be taxable in India as business profits @25%
- On appeal to the DRP, it concurred with the AO and held that income from aforementioned activities would be taxable due to the existence of PE of assessee in India. As regards the rate at which gross receipts of assessee were to be brought to tax in India, it opined that the said income shall be taxed @10%.
- Aggrieved, the assessee filed an appeal to the ITAT

Contentions of the assessee

- The assessee does not have fixed place of business in India available at its disposal for carrying on business in India and thus, no PE gets constituted under Article 5(1) of the tax treaty.
- The activities performed by the assessee in pursuance of the contracts fall under 'Construction' in Article 5(2)(h) of the tax treaty and since the duration test prescribed under Article 5(2)(h) i.e. 9 months is not satisfied, no PE is constituted
- By placing reliance on the ITAT ruling in assessee's own case for the AY 2007-08, it contended that the ITAT categorized activities carried on by the assessee as 'construction' applying the provisions of Article 5(2)(h) of the tax treaty

Contentions of the department

- Equipment used by the assessee to provide grouting services constituted its 'place of business' and therefore, 'Equipment PE' of the assessee gets constituted in India. Therefore, fixed place PE gets constituted in terms of Article 5(1) of the tax treaty

- Further, the assessee failed to provide details called for providing basis of computation of number of days of each project, their project duration, copies of invoices of each project etc. and also the assessee has not established that for how many days activities continued in Indian territories

ITAT's Judgement

While holding that the assessee has a fixed place PE in India for AY 2008-09 to 2012-13, it observed as under:

- While placing reliance on the definition of "building site or construction or installation project" as defined in Klaus Vogel book on double taxation conventions and OECD commentary, it held that such activities cannot be treated as 'construction work' so as to fall under construction or assembly project under Article 5(2)(h) of the tax treaty. The activities of grouting carried involves pipelines and cable crossing, pipeline and cable stabilization, anti-scour protection etc. The activities are of such nature that it cannot be construed as construction activity.

- The vessel of the contractor in which assessee's equipment were placed and personnel were stationed formed a fixed place through which assessee carried out its business in India. Moreover, the assessee had a fair amount of permanence through its personnel and equipment, within territorial limits of India

- Therefore, taking support of the OECD commentary and Klaus Vogel commentary on general principles as well as Hon'ble Supreme Court ruling in the case of Formula One World Championship, it held that the assessee had PE in the form of equipment as fixed place of business in India as per Article 5(1) of the tax treaty and income earned by the assessee from contracts are taxable in India

NANGIA'S TAKE

Unlike the ruling delivered in case of the assessee for the AY 2007-08, the ITAT pin-pointed a different angle for analyzing the tax liability of the assessee in the given period. With this ruling, ITAT has given an example of different interpretation of same facts. While in the earlier ruling, an important principle that

2. Management services taxable as business profit in absence of FTS clause

Background

Consideration received for rendering management services shall be taxed as business profit under tax treat in the absence of specific FTS clause.

Background

M/s. ABB Industries FZE (assessee) received payment for rendition of managerial/ technical services to M/s. ABB India Ltd (ABB India). The Assessing Officer (AO) observed that the aforementioned services fulfilled the criteria for being taxable as Fee for Technical Service (FTS) in view of the provisions of section 9 of The Income Tax Act, 1961 (Act). The assessee contended that in the absence of FTS clause in India-UAE tax treaty (tax treaty), the said payment is not taxable as FTS but as business profits under Article 7 of the tax treaty and in the absence of permanent establishment (PE) of the assessee in India, the same is not taxable. The Bengaluru Income Tax Appellate Tribunal (ITAT) ruled that payment received by assessee was not taxable as FTS in the absence of FTS clause in the tax treaty. Since, the assessee could not substantiate the non-constitution of PE in India for the purpose of taxation of payment as business profits, the matter was remitted back to the file of AO to examine whether there is any PE in India.

Brief facts of the case

- The assessee, a company incorporated in the UAE, was engaged in providing different management services including general management, strategic marketing and sales, etc.

- The assessee received certain payment from ABB India for rendering managerial/ technical services and claimed the same as exempt as per the tax treaty while filing its income-tax return in India

- During the course of assessment proceedings, the AO held that the services rendered by the assessee are in the nature of the managerial, technical, consultancy services. Hence, the said payment is taxable as FTS in accordance with the provisions of section 9 of the Act

- The assessee filed an appeal before the Dispute Resolution Panel (DRP), however, the case was decided in favor of the revenue. Aggrieved, the assessee filed an appeal to the ITAT

Contentions of the assessee

- Since, the tax treaty does not have a clause for FTS, the amount received towards rendition of managerial/ technical services shall not taxed in India as FTS

- In the absence of such clause in the tax treaty, the payment shall be classified as business profit under Article 7 of the tax treaty. Since, the assessee does not have any PE in India, no income shall be taxed

Contentions of the revenue

- The services rendered by the assessee are in the nature of managerial, technical, consultancy services and the payment thereof shall be taxable in India as per the provisions of section 9(1)(vii) of the Act

ITAT's Judgement

The ITAT upheld the contention of the assessee that consideration received by assessee for rendering managerial services shall not be taxed as FTS but as business profit in the absence of a specific clause in the tax treaty. While holding the same, it noted as follows:

- In the absence of FTS clause in Article 12 of the tax treaty, the consideration received by the assessee shall not be taxable as FTS in India and same shall be taxable as business profits under Article 7 of the tax treaty

- The assessee could not substantiate that there is no existence of PE in India. Therefore, the matter was remitted back to the file of AO to examine the constitution of PE in India

- It held that if it is proven with supporting evidence and documentation that there is no permanent establishment in India, then the assessee shall be granted the benefit of non-taxability

NANGIA'S TAKE

The ruling provides an insight that one cannot get out of the tax treaty to determine the taxability of a transaction on the basis of similar clause in the domestic law i.e. if FTS clause is missing in tax treaty, one cannot tax the amount as FTS in domestic law when income becomes taxable under any other clause of the tax treaty. The rule of "dominance of the specific provision" shall apply within the tax treaty and between the tax treaty & domestic tax law.

3. Delhi ITAT holds that CIT(A) can't impose Rule 11UA when taxpayer 'substantiated' higher valuation u/s. 56(2)(viib) before assessing Officer

Background

The issue of shares by India Today Online Pvt. Ltd. (assessee) @Rs. 30/share (including premium of Rs. 20) was sought to be taxed under section 56(2)(viib) of the Income Tax Act, 1961 (Act). The valuation of shares by the assessee was based on a report certified by independent chartered accountant. During the course of assessment proceedings, the assessing officer (AO), accepted such valuation report and made addition only to accommodate the difference observed in the actual stake held by the assessee in its subsidiary company and as reported in valuation report. However, the Commissioner of Income Tax (Appeals) [CIT(A)] disregarded the valuation report on several grounds and enhanced the addition made by the AO. Overruling the contentions of the CIT(A), Income Tax Appellate Tribunal, Delhi (ITAT) held that issue of shares at premium of Rs. 20 per share was justified as the assessee was able to substantiate to the satisfaction of the assessing officer, the method adopted for determination of value shares.

Facts of the case

- The assessee, an Indian company, is engaged in the business of development, design and maintenance of website and sale and purchase of shares
- It issued shares to M/s. Living Media India Ltd. (shareholder) @ Rs. 30 per share (of Face value Rs. 10) based on the valuation report certified by an independent Chartered Accountant. The share capital money was received over the period of three years i.e. Financial Year (FY) 2010-11, FY 2011-12 and FY 2012-13. The assessee allotted 2,40,83,333 shares in the FY 2012-13 against the share capital received during FY 2010-11 and FY 2011-12
- The AO required the assessee to justify the issue of shares at premium. While he accepted the method of valuation of shares, shares were revalued @ Rs. 27.75 for adjusting the difference observed in the actual stake held by the assessee in its subsidiary company and as reported in the valuation report. Consequently, an addition under section 56(2)(viib) of the Act for the difference of Rs. 2.25 per share on the share issued throughout the period of three years.
- Aggrieved by the above addition, the assessee filed an appeal before the CIT(A), who limited the said addition only to the shares issued during the FY 2012-13 for which consideration was received in the earlier two years. However, it enhanced the quantum of deduction on the ground that valuation report of the Chartered Accountant is incorrect on several grounds
- Aggrieved, the assessee filed an appeal before the ITAT

Contentions of the assessee

- The share value was determined on the basis of valuation of shares of Mail Today which was accepted by the AO in its assessment proceedings and therefore, such value cannot be rejected merely on the ground that losses were incurred by Mail today in such a year. A holistic view shall be taken rather than relying on a single fact.
- When the value of shares has been substantiated to the satisfaction of the AO, the CIT(A) cannot resort to the re-determination of share value based on methods prescribed under Rule 11U and Rule 11UA.
- NAV method adopted to value shares was as per section 56(2)(viib) of the Act

Contentions of the department

- The department strongly relied on the order of the CIT(A) and contended that issue of shares at premium of Rs. 20 is not be justified which should be taxed under section 56(2)(viib) of the Act

ITAT's Judgement

- The assessee adopted independent valuation report on the NAV method for ascertaining the share value. Further, it referred to the valuation of shares done by Mail Today (based on DCF method and accepted by the AO in Mail Todays' assessment proceedings) since assessee's shares derived value mainly from the shares of Mail Today.

- While deleting the enhancement made by CIT(A), the ITAT held that as the assessee was able to substantiate the value of shares to the satisfaction of the AO as per the option provided by the Act, therefore, the CIT(A) cannot acquire jurisdiction to tinker with such valuation or valuation method. Thus, issue of shares at premium of Rs. 20 per share was justified.

- ITAT analyzed various contentions made by CIT(A) for disregarding the valuation of shares done on the basis of independent valuation report of a Chartered Accountant and invalidated each of them by observing as under:

  a) At the time of allotment of shares, neither provisions of section 56(2)(viib) of the Act were in statute, nor the methods stipulated under Rule 11U and 11UA were notified. Therefore, the substantiation of the value of shares cannot be doubted on the argument that such valuation report of independent valuer did not follow method prescribed under the aforesaid rules.

  b) Further, report by Chartered Accountant would be valid as the valuation has not been done as per the aforesaid rules, therefore, his competency cannot be challenged

  c) Also, it would be inappropriate to disregard the reliance on the valuation of shares of Mail Today, merely on the ground that Mail Today was running into losses

- Determination of value of shares on the basis of financial statement or book value does not have much relevance under DCF method as it is based on expected growth and fair expected cash flow.

- DCF is not exact science and can never be done with arithmetic precision. Therefore, the valuation by a valuer has to be accepted unless specific discrepancy in the figures and factors taken are found

NANGIA'S TAKE

The ruling provides an insight that when the Act itself provides options to determine the value of shares, assessee cannot be forced to follow a particular method. CIT(A) does not have the power to interfere in such a decision which has been substantiated to the satisfaction of the AO. The income-tax department cannot go beyond what has been already accepted by it in the assessment order. Identification the degree of estimation involved in applying DCF method may further strengthen the genuine cases but may make certain cases more complex and litigious.

4. Governments use receipt lotteries to boost tax compliance

People pay taxes because governments say they must and society says they should. But what if tax compliance became fun? 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.
https://www.economist.com/finance-and-economics/2019/02/28/governments-use-receipt-lotteries-to-boost-tax-compliance

5. Ukraine ratifies MLI to amend tax treaties

On March 1 Ukraine's Verkhovna Rada adopted the President's bill concerning the ratification of Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting (MLI).
https://mnetax.com/ukraine-ratifies-mli-to-amend-tax-treaties-32698

6. Switzerland Introduces New Tax Rule for Systemically Important Banks

The Swiss Federal Council has announced that legislation setting the rules for a participation deduction for systemically important banks will enter into force retroactively, with effect from January 1. Switzerland's Too Big To Fail (TBTF) regime requires systemically important banks to have sufficient capital so that taxpayers do not have to bail them out in the event of a crisis. This obligation can result in them issuing TBTF instruments such as bail-in bonds, write-off bonds, and contingent convertible bonds.
https://www.taxnews.com/news/Switzerland_Introduces_New_Tax_Rule_For_Systemically_Important_Banks____97046.html

7. Australia embraces international co-operation to solve tax challenges posed by the digitalized economy

The Government recently confirmed that it would take a step back from pursuing a unilateral interim tax on digitalized services and refocus on a more co-operative approach to updating the international tax framework. In doing so, Australia has proven that it is willing to engage with its trading partners and take a principled approach rather than resorting to populist stop-gap measures.
https://www.theaustralian.com.au/business/tax-solutions-for-a-digitalworld/newsstory/0999cbff0dfe781c0a91917107388878

8. Georgia ratifies tax instrument to tackle BEPS

Georgia on March 29 deposited with the OECD the Instrument of Ratification for the Multilateral Convention to implement tax treaty-related measures to prevent base erosion and profit shifting (BEPS MLI). The BEPS MLI, negotiated by over 100 countries and jurisdictions, updates the existing network of tax treaties and reduces opportunities for MNE tax avoidance.
https://transferpricingnews.com/georgia-ratifies-tax-instrument-to-tackle-beps/

9. Taiwan Plans Extension of Tax Incentives for R&D Expenses

Rules governing crediting the funds invested in research and development against income tax will be extended by 10 years after current expiration date, cabinet spokeswoman Kolas Yotaka said March 21. Cabinet at weekly meeting approves the regulation changes, pending regulatory approval.

https://news.bloombergtax.com/daily-tax-report-international/taiwan-plans-extension-of-taxincentives-for-r-d-expenses

10. Application of Transfer Pricing provisions not against "non-discrimination" clause of DTAA; DCF valuation subsumes goodwill

Outcome: Partly in favour of taxpayer
Category: Sale of Shares; Share Valuation; Goodwill Adjustment

Facts of the Case

- Technip Italy S.P.A. {"the taxpayer"} is a company incorporated under the laws of Italy, engaged in the business of construction, design and engineering and implementation services to Oil & Gas, Power, Pharmaceuticals and Infrastructure industries. Technip India Ltd. was incorporated as a Joint Venture ("JV") between Southern Petrochemical Industries Corporation Ltd. and the taxpayer. Technip India became wholly owned subsidiary of the taxpayer, post-acquisition stake in SPIC in Technip India. In relation to the same, the taxpayer entered into Share Purchase Agreement (SPA") with its Associated Enterprise ("AE"), Technip France SA. The agreed price for the share transfer was INR 396.42 per share. The sale consideration was determined on fair valuation of shares undertaken by independent valuer using Discounted Cash Flow ("DCF") methodology.

- During the course of assessment proceedings, the Transfer Pricing Officer ("TPO") rejected the taxpayer's share valuation report and proposed TP adjustments of INR 81.56 Cr.

- The TPO rejected the share valuation report furnished by the taxpayer and proposed upward adjustment of INR 81,56,35,772 on account of difference in discounting factor, Goodwill adjustment and difference in exchange rate.

- 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.

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

ITAT''s Ruling
ITAT on "Non-Discrimination Clause"

- The taxpayer placed reliance on the Article 25 of India- Italy DTAA, which contains non-discrimination clause and contended that TP provisions should not be applicable on the transaction entered into by the taxpayer. The ITAT, keeping article 25(1) of the India-Italy DTAA, stated that even if an Indian national (Legal person), enters into an international transaction with its AEs, will also be subjected to TP provisions and accordingly the taxpayer shall be subjected to TP Proceedings. Therefore, the TP proceedings in the taxpayer's case is not at all discriminating and accordingly do not fall within the purview of article 25.

Substituting Actual consideration with notional consideration

- The taxpayer contended that the TPO substituted the original consideration with notional consideration after upward adjustment on account of ALP determination. ITAT held that no substitution (of full value) of actual consideration with notional consideration was made. However, adjustments as per Section 92C(4) of the Act were made to the total income of the taxpayer by the AO as per the provisions of Section 92C(3) on in compliance with the directions issued by the DRP.

SHARE VALUATION

- The Valuation Report: The ITAT observed that the valuation report furnished by the taxpayer was supported by the valuation report of two independent valuers whereas the share valuation report furnished by the TPO was not furnished by any independent valuer. Here, the ITAT highlighted that the TPO has failed to comply with the requirement, that conditions similar to those applicable on the taxpayer, as directed by the instruction issued by the CBDT[1].

- In the present case, the share valuation as per the taxpayer is INR 396.42 whereas that of TPO is INR 463.19. The reason for difference between share valuation shall be discussed in the following points.

- Ill-Liquidity Discount: The ITAT highlighted that the shares being transferred are highly ill-liquid and the independent valuers have accordingly allowed ill-liquidity discount@ 15% which has not been considered by the TPO in its valuation report.

- Different Financial Year: The ITAT highlighted that the TPO considered financial data on financial year basis whereas the taxpayer's accounting year was calendar year.

- Market Risk Premium: The ITAT observed that the market risk premium of performance of SENSEX has been considered by the independent valuers' for over 32 years (1979-2011), whereas the TPO has considered it from the year of incorporation (1998). The ITAT states that market risk premium is generally computed as return on market index, i.e., SENSEX over a period of time. ITAT held that longer time frame would neutralize the impact of any abnormalities on the market risk premium. The market risk premium computed by the independent valuers (8.09%) resulted in a discount rate of 18.12% and hence, the fair valuation adopted by the taxpayer will be higher than the value adopted by the TPO.

- Goodwill Adjustment: The TPO made addition to the sale consideration on account of goodwill related to the shares transferred. The ITAT opined that when the fair value is determined in accordance with Discounted Cash Flow (DCF) methodology, all assets of the business are subsumed and accordingly any asset which may have effect on the future operating profits are taken into consideration. Consequently, there cannot be separate addition of the value of goodwill as the same will result into double counting.

[1]CBDT vide Instruction No. 5/2011

- Also, the ITAT highlighted the technical guide on share valuation issued by ICAI which states that goodwill is an integral part of business, even if it is not separately accounted for, and it cannot be separately added to fair value of business determined by DCF methodology.

- Exchange Rate Difference: The ITAT highlighted that the share transfer transaction was done in INR and the TPO has adopted Euros as the basis for objecting for the exchange rate difference adjustment which is hypothetical and does not have grounds to stand on.

- The ITAT, thus directed that the addition made by the AO/TPO to be deleted accordingly.

NANGIA'S TAKE

The recent ruling clarifies the position that incidence of Transfer pricing provisions shall not be defended on grounds of any "non-discrimination clause" of any DTAA with India. Also, the instant case brings to light the responsibility of Revenue to comply with all the pre-requisites of valuation methodology and other factors in order to arrive at a share value. Also, this judgement highlights Discounted Cash Flow (DCF) methodology already subsumes goodwill valuation and that no separate evaluation/ inclusion is to be called.

Source: Technip Italy S.P.A [TS-122-ITAT-2019(DEL)-TP]

11. HC Accepts "headcount method" as a basis for apportionment of un-allocable cost

Outcome – In favour of Assessee
Category – Cost allocation

Facts and Contentions

- Fujitsu India Ltd. ("the taxpayer"), a 100% subsidiary of Fujitsu Ltd., Japan was incorporated with the prime objective of consolidating marketing operations of Fujitsu Group in India.

- During the relevant assessment year 2008-09 ("the year under consideration"), the taxpayer entered into six international transactions, out of which five were accepted at arm's length price ("ALP") by the Transfer Pricing Officer.

- The TPO, while accepted the most appropriate method ("MAM") with respect to transaction pertaining to 'Receipts for services rendered', however, proceeded with the following adjustments :

  a) Re-determination of the mechanism used for computing the taxpayer's Profit Level Indicator ("PLI"), i.e. OP/TC;

  b) Changes in the comparable set used by the taxpayer;

  c) Re-computation of the working capital adjustment

- In relation to the above, the TPO made an upward adjustment of INR 2.63 cr. Aggrieved by the same, the taxpayer filed an appeal before Dispute Resolution Panel ("DRP"). The DRP reduced the TP adjustment to INR 2.39 on account of re-calculation of working capital adjustment.

- Consequently, the taxpayer filed an appeal before the Income Tax Appellate Tribunal ("ITAT")

Proceedings before ITAT ("the Tribunal")

ITAT made the following observations:

- Re-determination of mechanism used for computing PLI – Apportionment of Unallocable costs & Working Capital Adjustment

- The tribunal noted that the TPO considered ratio of gross revenue from the three segments for apportioning combined 'Unallocable costs' as against the 'headcount' basis used by the taxpayer for such apportionment; the taxpayer contested the same

- In view of the above, at the outset, the ITAT rejected both the methods of apportionments used by the taxpayer as well the TPO and held that such apportionment on both the aforesaid basis would give distorted results;

- Further, in this regard, the ITAT whilst giving the reasoning for rejection of basis, held that while apportioning on the basis of headcount, a lower salaried person cannot be compared with a higher one. With respect to apportioning on the basis of gross revenue, trading segment will naturally have more gross revenue than service segment

- Consequently, the tribunal opined a more logical way of the apportionment of the cost which it stated to be on the basis of gross margins earned by the taxpayer from the respective segments.

- Furthermore, the ITAT noted that the taxpayer wants to exclude cost incurred on outsourced maintenance services considering them as 'pass through cost';

- In view of the above, the Tribunal held that pass through cost pre-supposes its specific and identifiable recovery without adding any element of profit. Accordingly, in the instant case the ITAT the aforesaid cost were not recovered by the taxpayer from its AE and therefore, cannot be in the nature of pass through cost. Consequently, rejected the taxpayer's contention.

- Thus, the Tribunal remitted the said matter and the issue revolving working capital adjustment back to the AO/ TPO for fresh assessment.

Selection of Comparables

- The ITAT, at first, noted that the taxpayer did not enter into an inter-company Agreement, in the absence of which nature of work, responsibilities, obligations are not clearly identifiable;

- Basis the above, the ITAT held that the taxpayer was not rendering technical support services, rather was engaged in providing marketing support services and accordingly excluded and included certain comparables on the basis of parameters like functional dissimilarity, absence of segmental details, working capital adjustments etc.

- Accordingly, the ITAT set aside the impugned order and remitted the matter back to AO/TPO for fresh determination of ALP. Further, aggrieved by the judgment of the ITAT, the taxpayer filed an appeal before High Court of Delhi ("The HC")

High Court Ruling

- The HC relied upon the co-ordinate bench ruling pronounced in the case of ***Commissioner of Income Tax vs. EHTP India Pvt. Ltd.*** which accepted the 'headcount' as an appropriate basis of allocation of costs;

- Further, the HC is in the opinion that the taxpayer had two possible choices for the apportionment of un-allocable cost between different segments i.e. turnover method as well as headcount method. Therefore, choosing of headcount principle by the taxpayer could not be reject.

- Accordingly, HC accepted 'headcount principle' based cost allocation mechanism undertaken by the taxpayer.

NANGIA'S TAKE

The instant case focuses on the basis of allocation of un-allocable expenses in case of segmental accounts. In this regard, it is observed that in recent times, the said issue has been one of the most contentious issues in the battleground of TP litigation. One of the major reasons for increased litigation and deliberateness on this issue is owing to the limited guidance on this subject in the Indian TP Regulations and un-appropriation of cost allocation between the segments could lead to an adverse effect on PLI.

Further, OECD guidelines has emphasized that it is necessary to adopt appropriate allocation keys which are rational and quantifiable, for allocating costs in order to derive its correct profitability.
In view of the above, the instant ruling has provide clarification to the taxpayers regarding the selection of mechanism for allocation of cost by identifying appropriate allocation keys.

Source: Fujitsu India Pvt. Ltd. [TS-108-HC-2019(DEL)-TP]

12. Company cannot be rejected as a comparable merely on following different-FY wherein the data can be collated from the public domain relating to the year under consideration

Outcome: - Partially allowed
Category: - Comparability of specific companies, royalty

Facts of the Case

- Greaves Cotton Limited ("the taxpayer") is engaged in the business of manufacturing marine and industrial gearboxes, diesel engines and generating sets etc.

- During the assessment year ("AY") 2005-06 ("year under consideration"), the taxpayer imported kits and spares from two of its Associated Enterprises ("AEs") and also paid royalty to two of its AEs. Further, the taxpayer adopted Re-sale Price Method ("RPM") as the most appropriate method for benchmarking the import transaction.

- However, during the course of assessment proceeding, the Transfer Pricing Officer ("TPO") adopted the Transactional Net Margin Method ("TNMM") and accordingly probed the taxpayer to furnish the comparables. The TPO accepted two of the comparables out of three comparables submitted by the taxpayer i.e. rejected the third comparable viz. M/s. Escorts Ltd. owing to absence of data for the relevant period as the aforesaid comparable followed a different financial year. In view of the above, the TPO made an upward Transfer Pricing ("TP") adjustment.

- Additionally, in regard to the TP adjustment made by the TPO in respect of payment of royalty to its AEs, no separate addition was made by the Assessing Officer ("AO") as the taxpayer itself disallowed the same under section 40(a)(ia) of Income Tax Act, 1961 ("the Act") on account of non-deduction of tax at source.

- Aggrieved by the order of AO/TPO, the taxpayer filed an appeal before the Commissioner of Income Tax (Appeals) ["CIT(A)"].

Proceeding before CIT(A)

- The taxpayer submitted that it has created provision for payment of royalty as per the Mercantile System Accounting on estimated basis and for the reason that it did not deduct any tax at source, it disallowed the same under section 40(a)(ia) of the Act. However, after obtaining an opinion of a Chartered Accountant, the taxpayer pleaded before CIT(A) to delete the suo motto disallowance made by him.

- The CIT(A) confirmed the adjustment made by the TPO and restored the issue relating to adjustment made in respect of royalty payment back to the file of AO, as the AO didn't examine this issue at all in the assessment order.

Proceedings before ITAT ("the tribunal")

ITAT made the following observations:

- ITAT noted that M/s Escorts Ltd. was a listed company and hence its quarterly results were available in public domain and therefore, it was possible to collate the figures relating to the financial year under consideration.

- The Tribunal relied on co-ordinate bench ruling in taxpayer's own case for AY 2004-05, wherein the aforesaid comparable company was accepted as a comparable and the matter was restored back to AO/TPO.

- Further, it was submitted by the authorized representative of the taxpayer that the issue relating to disallowance under section 40(a)(ia) was restored back to the AO and if the AO deletes the disallowance in the restored proceedings than the TP adjustment for royalty payment would become relevant.

- In view of the above, ITAT remitted the issue back to the file of AO on the ground that the co-ordinate bench has restored the identical issue back to the file of AO in the taxpayer's own case for the earlier assessment year.

NANGIA'S TAKE

The instant case echoes the fact that the tax authorities must provide cogent reasons for rejecting the comparables. Therefore, where the company is functionally comparable and there is availability of financial data in the public domain in relation to relevant year under consideration, then the same cannot be rejected merely for following different financial year.

Furthermore, this case also provides clarity on the fact that for the same transaction the taxpayer cannot be penalised twice under the relevant provisions of the Act.

The aforesaid ruling also provides that RPM is applicable where the taxpayer is a distributor/trader. Thus the ruling reiterates important principle that most appropriate method is to selected based on multiple factors such as business profile of taxpayer, nature in international transaction, availability of data etc. for the purpose of benchmarking an international transaction under review.

Source: Greaves Cotton Limited ***[TS-153-ITAT-2019(Mum)-TP]***

13. Recent amendment in Companies (Incorporation) Rules

The Ministry of Corporate Affairs ('MCA') has recently made amendments to the Companies (Incorporation) Rules, 2014 through Companies (Incorporation) 2nd Amendment Rules, 2019 notified on 6 March, 2019 and vide the Companies (Incorporation) 3rd Amendment Rules, 2019 notified on March 29, 2019.

The key amendments which have been notified are set out below:

a) **No Statutory fee (other than stamp duty) payable on Incorporation of a Company for Nominal (Authorised) Capital upto INR 15 lakhs -** Companies (Incorporation) Second Amendment Rules, 2019

b) Introduction of **AGILE** (**A**pplication for **G**oods and Services Tax Identification ('GST') Number, Employees State **I**nsurance Corporation ('ESIC') Registration p**L**us **E**mployees Provident Fund ('EPF') Organisation Registration) Form to be mandatorily filed along with SPICE Form at the time of incorporation - Companies (Incorporation) Third Amendment Rules, 2019.

Details relating to the amendments are further enumerated below:

1. **No Statutory fee (other than stamp duty) payable on Incorporation of a company for Nominal (authorized) capital upto INR 15 lakhs**

   - MCA had earlier in January, 2018 introduced the SPICE form for Incorporation of Companies wherein it had waived off the Statutory Filing fee on such form (SPICE) for companies being registered with a nominal capital of less than or equal to INR 10 lakhs.
   - Through the Companies (Incorporation) Second Amendment Rules, 2019, MCA has merely increased this limit of nominal capital from INR 10 lakhs to INR 15 lakhs.
   - Accordingly, Companies proposed to be set up with a nominal capital of less than or equal to INR 15 lakhs may henceforth be incorporated without payment of the Statutory filing fee.

2. **Introduction of AGILE Form**

   - MCA has introduced a new Form AGILE mandatorily required to be submitted along with form SPICE at the time of Incorporation of a Company. AGILE Form allows stakeholders to make application for GST, ESIC and EPF registration right at the stage of Incorporation itself. This service is available only for incorporation of Companies and is an added initiative to the earlier steps taken by MCA for applying for PAN, TAN registrations during the incorporation stage.

NANGIA'S TAKE

Ministry of Corporate Affairs is further gearing up to simplify the multiple registration requirements for newly setup Indian Companies by introduction of a single form for obtaining three different statutory registrations. At the same time, it has further increased ambit of companies not required to pay statutory RoC fee at the incorporation stage. Both initiatives are in line with "ease of doing business in India" initiative of the Government of India and sets the path for similar mandatory requirements to be simplified and combined within this initiative sooner or later.

14. Issue of Master Direction on External Commercial Borrowings and Trade Credits by RBI

RBI has recently issued Master Directions on **External Commercial Borrowings, Trade Credits and Structured Obligations** on March 26, 2019 in supersession of earlier **Master Direction on External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers dated January 1, 2016**. Master Direction is a compilation of the following circulars issued by the Reserve Bank of India during the year viz.,

1. A.P. (DIR Series) Circular No. 17 on '**ECB Policy- New ECB Framework**' issued on January 16, 2019;

2. A.P. (DIR Series) Circular No. 18 on '**ECB Policy- ECB facility for Resolution Applicants under Corporate Insolvency Resolution Process**' issued on February 07, 2019;

3. A.P. (DIR Series) Circular No. 23 on '**Trade Credit Policy- Revised Framework**' issued on March 13, 2019;

and, **Foreign Exchange Management (Borrowing and Lending) Regulations, 2018** issued on **December 17, 2018**.

Key Features:

Revised ECB guidelines have eased the borrowing regime by broadening the scope of eligible borrowers and lenders and by further simplifying the ECB norms.

The major changes as below:

Currency and Forms of ECB	**The different tracks provided earlier have now been deleted and the entire set of guidelines is now structured vis a vis the denomination currency in which ECB is sought i.e., FCY denominated ECBs and INR denominated ECBs**
Eligible Borrowers	Expanded to include all entities eligible to receive FDI. Additionally, Port Trusts, Units in SEZ, SIDBI, EXIM Bank, registered entities engaged in micro-finance activities, viz., registered not for profit companies, registered societies, trusts, cooperatives and non-government organisations can also borrow under the new ECB Framework
Recognized Lenders	Again, the detailed list of recognized lenders under three different tracks has been replaced with the following categories of recognized lenders: 1. Lenders (including body corporates) which are resident of FATF or IOSCO compliant country; 2. Multilateral and Regional Financial Institutions where India is a member country; 3. Individuals if they are foreign equity holders; 4. Foreign branches/ subsidiaries of Indian banks only for FCY ECB (except FCCBs and FCEBs).
Minimum Average Maturity Period	RBI has set out minimum average maturity period of 3 years for all kinds of ECBs. However, the minimum average maturity period for ECBs raised from foreign equity holders for working capital and general corporate purposes is 5 years. The minimum average maturity period for manufacturing companies raising ECBs up to USD 50 million remains the same as 1 year.
ECB Limits	RBI has fixed a common borrowing limit of USD 750 million per financial year under automatic route for all eligible borrowers
ECB for corporates under restructuring/ corporate insolvency process	Such entities which are under restructuring scheme/ corporate insolvency resolution process can raise ECB if specifically permitted under the resolution plan. No such provision was available in the erstwhile ECB guidelines

Likewise, RBI has made amendments to the Trade Credit guidelines as well, the major highlights of which are as below:

Trade Credit Limits	**The trade credit limits have been increased p to USD 150 million or equivalent per import transaction for oil/gas refining & marketing, airline and shipping companies. For others, it is up to USD 50 million or equivalent per import transaction. Earlier, trade credits up to USD 20 million (for capital and non-capital goods) only per import transaction were allowed.**
Period of Trade Credit	The period of trade credit for capital goods has been reduced from 5 years to 3 years from the date of shipment. For non-capital goods, it remains the same as 1 year or the operating cycle whichever is less.
All in cost ceiling per annum	The all in cost ceiling has been reduced from 350 bps spread to 250 bps spread

NANGIA'S TAKE:

Master Direction on ECBs, Trade Credit, Borrowing and Structured Obligations issued on March 28, 2019 ('ECB Master Directions'), have been issued to provide clarity on various regulations/ notifications/ circulars recently issued by the RBI and to bring together through a single Master Direction all such changes made during the year. Recent liberalization measures such as widening the eligible borrowers to include all entities eligible to receive FDI is aimed as a measure of the Government of India to promote ease of doing business.

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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