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Editorial

I am delighted to bring to you the latest issue of India Spectrum.

India is slowly but surely getting on to a high-growth trajectory and has successfully gained the confidence of investors, evidenced by record Foreign Portfolio Investment inflows. The Finance Minister has promised a reasonable and rational tax policy that would not be “ultra-aggressive”, and the CBDT has recently issued instructions to promote a non-adversarial culture within the Department. Among other things, it laid emphasis on cleanliness in the office, punctuality, promptness in appointments and avoiding unnecessary adjournments. The instructions also touched upon other administrative areas such as scrutiny, refund, high-pitched assessments, recovery/ stay of demand, frivolous filing of appeals in the High Courts (HCs) and Income-tax Appellate Tribunals (Tribunal) and effective grievance redressal system. This can only help further improve investor sentiment. The Attorney General of India has advised the Government not to appeal the Bombay HC decision in the case of Vodafone India Services Private Limited in relation of under-pricing of shares in a rights issue to the parent firm, as it would send out a clear signal of its investor-friendly credentials.

The Government is looking to reform the Land Acquisition law and is in an advanced stage of discussions with State Governments on changes to the constitutional amendment bill required for the long-awaited Goods and Services Tax to become a reality. The Government has already embarked on changes in labour policy, fuel price deregulation and auctions of natural resources among others. The Finance Minister has also expressed optimism that the Insurance Bill, seeking to raise the Foreign Direct Investment cap, would be passed in the upcoming winter session of Parliament.

The industrial production growth recovered to a better-than-expected 2.5% in September from less than 0.5% in August. The consumer price index showed retail inflation slowing further to 5.52% in October. Inflation is likely to lower even further, with global crude and commodity prices falling, and the winter vegetable crop likely to push prices down, but growth indicators suggest that consumer demand is still sluggish and the festival season has not provided as much of a boost as expected.

The G20 countries have agreed to start automatic exchange of information relating to tax evaders, in an effort to arrest the quantum of global tax evasion. The International Monetary Fund has estimated measures put in place by the group would result in expansion of the global economy by 1.8%, a bit less than the target of 2%.

Greater flexibility has been provided in issue of equity shares under the Foreign Direct Investment scheme against any sums payable by the investee company, provided the remittance of such funds does not require the prior approval of Government of India or the Reserve Bank of India (RBI). Earlier, an Indian company was permitted to issue shares/ convertible debentures under the automatic route to a person resident outside India only against lump sum technical knowhow fee, royalty, external commercial borrowings (ECBs) (other than import dues deemed as ECB or trade credit as per the RBI guidelines) and import payables of capital goods by units in Special Economic Zones, subject to certain conditions.

The Delhi HC, in the case of Panalfa Autoelektrik Limited, held that in the absence of managerial/ technical/ consultancy services, commission payments to non-residents for procuring export orders would not be in the nature of fees for technical services. In another ruling in the case of Antrax Technologies Private Limited, the Bangalore bench of the Tribunal held that payments for the purchase of service manuals was not in the nature of 'royalty', and hence there was no requirement to withhold tax on the payment made for these purchases.

I hope you enjoy this issue. As always, I look forward to hearing from you.

Shyamal Mukherjee
Leader, Tax and Regulatory Services

Analysing tax issues
Corporate tax

Case law

Withholding tax

Discount allowed to non-resident buyers for advance payment towards export proceeds is interest not subject to withholding tax under section 195

DCIT *v.* Kothari Food & Fragrances [TS-559-ITAT-2014(Lucknow-Tribunal)]

Facts

The taxpayer was an exporter. During the assessment year (AY) 2008-09, the taxpayer allowed a discount on the sale made to non-resident buyers for making advance payment. The tax officer (TO) held that the discounts credited in the non-resident buyer's account in the taxpayer's books of account constituted a 'credit', though not a 'payment', and therefore section 195(1) of the Income-tax Act, 1961 (the Act) would apply. Since the taxpayer had debited an equivalent amount as expenditure, by not withholding tax on such a payment, the TO disallowed the expenditure on account of the discount allowed under section 40(a)(i) of the Act. The Commissioner of Income-tax (Appeals) (CIT(A)) deleted the additions made by the TO.

Held

On perusal of the purchase agreement, it was observed that the seller would cause the issuance of a banker's guarantee or standby letter of credit by the seller's bank for an amount equal to the provisional price, plus interest in the form acceptable to the buyer, which would be informed in a separate message. The Tribunal observed that within two business days from the date when the buyer's bank received the bank guarantee, the buyer would pay the seller the pre-payment amount. Hence, there was no mention of pre-payment discount to be allowed by the taxpayer in the purchase agreement. The payment was to be made by the buyer to the tune of a provisional price, in accordance with the agreement, after the furnishing of bank guarantee by the taxpayer. According to the purchase invoices, the pre-payment discount was allowed by the taxpayer, and the taxpayer asked the buyer to make the payment of the balance amount against the invoiced price after adjusting the advance received by the taxpayer and pre-payment discount. Asking the buyer to pay a lesser amount after adjusting for the discount, or making a payment of discount to the buyer, was equivalent to the buyer receiving a benefit from it. Under section 195 of the Act, the taxpayer was required to withhold tax from any sum paid to a non-resident that was chargeable under the provisions of the Act. It was not necessary that only commission or interest payment was subject to withholding tax. The Tribunal observed that the benefit allowed to the buyers by way of discount was in nature of interest because the same was in consideration of receiving an advance payment. On receiving an advance payment, one may compensate the maker of advance payment by allowing interest, or the same benefit could be provided as a discount, but merely because a different nomenclature had been given, it did not change its character. Accordingly, the Tribunal held that the withholding tax was deductible under section 195 of the Act on the discount allowed to non-resident buyers for making advance payments.

Royalty

Payments for purchase of service manuals not in the nature of 'royalty', hence no requirement to withhold tax

ITO *v.* Antrax Technologies Private Limited [TS-715-ITAT-2013(Bangalore-Tribunal)]

Facts

The taxpayer had paid an amount for the purchase of service manuals to non-resident entities. The payments were made incidental to the import of projectors, LCD cables, etc. for sales made within India. The manuals contained operating and servicing instructions for use of the equipment. The taxpayer submitted that the payments were not in the nature of royalty or fees for technical services (FTS) since the manuals and software were copyrighted products. The payment was made for use and sale of the copyrighted product, and not for acquiring any copyright. The TO rejected the submission of the taxpayer by relying on the Karnataka HC decision in the case of CIT *v.* Samsung Electronics [2011] 16 taxmann.com 141 (Karnataka) and Sonata

Information Technology Limited [ITA No. 3076 of 2005]. According to the TO, the aforementioned decisions were applicable to the facts of the present case, and hence the payment for the purchase of software should have been treated as a royalty on which tax should have been withheld. On the failure to withhold tax, the TO disallowed the payment of sale consideration under section 40(a)(ia) of the Act and added it back to the returned income. The CIT(A) distinguished the Karnataka HC decision as it dealt with shrink-wrapped software which was not applicable to the taxpayer, and therefore concluded that the TO had inappropriately invoked the provisions of section 40(a)(ia) of the Act.

Held

Service manuals were books containing guidance and instructions for the operation, use and after-sale service of equipment, and thus were part of the equipment imported by the taxpayer. While software requires a user license, the manuals were copyrighted products that could be used by any person purchasing the equipment. There is a clear distinction between the copyrighted article and equipment which comes with a copyright or license to use the copyright. Therefore, the Tribunal distinguished the rulings of the Karnataka HC on the premise that the service manuals were not products by themselves, but were only manuals that guided buyers in using the product. Furthermore, the products imported by the taxpayer were not protected by a licence or copyright and could be used by any purchaser without any restriction on the right to transfer or usage. Thus, the Tribunal concluded that the service manuals imported by the taxpayer were different from the equipment that came with the copyright or licence to use the copyright. The Tribunal declined to interfere with the CIT(A)'s order, holding that the payments for purchase of service manuals would not qualify as royalty.

Fees for technical services

In absence of managerial/ technical/ consultation services, commission payments to non-resident for procuring export orders are not FTS in nature

DIT *v.* Panalfa Autoelektrik Limited [TS-587-HC-2014(Delhi)]

Facts

The taxpayer had paid commission to a non-resident company registered in Liechtenstein (with whom India had no tax treaty signed) for procuring export orders. It made an application under section 195(2) of the Act for authorisation to remit in Euro commission to the non-resident for arranging export sales and realising payments. The TO relied on Wallace Pharmaceuticals Private Limited, *In re* [2005] 278 ITR 97 (AAR) to hold that the commission paid to the non-resident was taxable as FTS under section 9(1)(vii)(b) of the Act. Consequently, the TO initially directed that tax should be withheld at 20%; but subsequently modified its order and reduced it to 10%. The CIT(A) reversed the TO's order and distinguished the ruling by the Authority for Advance Ruling.

Held

The HC perused sections 5(2), 9(1)(i) and 9(1)(vii) of the Act and ruled out the applicability of section 9(1)(i) of the Act to the present case, since the taxpayer did not conduct any operation/ business in India. Explanation 2 to section 9(1)(vii) of the Act did not define the terms, 'managerial', 'technical' and 'consultancy'. The HC observed that the non-resident was not acting as a manager, dealing with administration, controlling the policies or scrutinising the effectiveness of the policies. It did not perform as a primary executor, or have any supervisory function whatsoever. On perusal of the CIT(A)'s order and the agreement with the taxpayer, the HC held that the service rendered included procurement of export orders etc., which could not be treated as management services provided by the non-resident to the taxpayer. Furthermore, the non-resident had not undertaken or performed 'technical services', where special skills or knowledge relating to a technical field were required.

With regard to 'consultancy services', the HC held that the non-resident procured orders on the basis of the said knowledge, information and expertise to secure their commission. It was a case of self-use and benefit, not giving advice or consultation to the taxpayer on any field. The taxpayer, on receipt of the export orders, manufactured the required articles/ goods and then the goods procured were exported. There was no element of consultation or advice rendered by the non-resident to the taxpayer. Agreeing with the OECD classifications, the HC observed that for selling agents, a note of caution was added that taxability would depend on the nature of the character of services rendered. Thus, the HC concluded that technical, managerial and consultancy services could overlap, and it would not be proper to view them in watertight compartments. However, in the present case, this issue or differentiation was not relevant. Therefore, the HC held that the commission payments to non-resident for procuring export orders was not FTS in the absence of the services being managerial/ technical/ consultancy in nature.

Market survey fees not taxable in absence of FTS article under the India-UAE Double Taxation Avoidance Agreement

JCIT *v.* Wifi Networks Private Limited [TS-719-ITAT-2013(Bangalore-Tribunal)]

Facts

The taxpayer was engaged in the business of software development and implementation. For AY 2007-08, the taxpayer submitted a revised return declaring a loss. On assessment, the TO made various disallowances under section 40(a)(ia) of the Act for non withholding of tax on account of software payments to parties outside India, market surveys and knowhow fees. The CIT(A) granted partial relief to the taxpayer. However, he confirmed the disallowance in respect of software payments and market survey fees.

Held

With regard to disallowance under section 40(a)(ia) of the Act, the Tribunal observed that depreciation on knowhow fees was disallowed. The said payment was capitalised and was not charged to a profit and loss account. The Tribunal concluded that the CIT(A) was justified in deleting the disallowance of depreciation on technical knowhow fees. For disallowance on software payments, the Tribunal directed the TO to verify whether the said payment had been capitalised or charged to revenue and hence, remitted the matter back to the TO.

The non-resident payee was conducting business in UAE in the field of market surveys, and the taxpayer had availed its services for a consideration.

The Tribunal relied on certain decisions to hold that the tax treaty between India and UAE did not contain an article in respect of FTS, and the payment of market survey fees would have to be regarded as 'business profit' in accordance with Article 7 of the tax treaty. The Tribunal also agreed with the view of the CIT(A) that the agreement with the non-resident was entered into by the taxpayer in the course of the business conducted by the non-resident. The Tribunal observed that the revenue had not established that the non-resident to whom the taxpayer had made payment for market surveys had a permanent establishment (PE) in India. The Tribunal held that in absence of a PE in India, the business profit of the non-resident was not taxable in India. Furthermore, the Tribunal observed that even if it was considered that the payments made to the non-resident were covered under Article 22 of the tax treaty, *viz.*, other income, the payments would not be taxable in India since, as per Article 22 of the tax treaty, the income of a resident should be taxable only in the contracting state, i.e. UAE, and not in India. Therefore, the Tribunal concluded that the payment made to the non-resident was not chargeable to tax in India, and hence there was no liability to withhold tax under section 195 of the Act. The Tribunal therefore deleted the disallowance of market survey fees under section 40(a)(ia) of the Act.

Permanent Establishment

Indian branch office rendering preparatory/ auxiliary services that formed the main function of non-resident head office constitutes a PE

Consulting Engineering Corporation *v.* JCIT [TS-660-ITAT-2014(Delhi-Tribunal)]

Facts

The taxpayer was a non-resident based in United States (US) and had a branch office in India. The branch office was engaged in preparatory and auxiliary activities for its head office (HO). The costs of the taxpayer were reimbursed by the HO and hence, there was no income accrued. In absence of any income embedded in the amount reimbursed by the HO to its branch that acted as a cost center, the taxpayer argued that the assessment made was bad in law. The taxpayer also raised an additional ground before the CIT(A) alleging that there was no PE in India in terms of the tax treaty with the US, and no business profit could be said to have accrued in India. Accordingly, the taxpayer was not liable to be taxed in India. It placed reliance on the case of DIT *v.* Morgan Stanley and Co. Inc. [2007] 292 ITR 416 (SC) to contend that (a) its branch was engaged in back office support services; (b) the activities conducted were in aid or support of the main activities of the HO; and (c) income offered by the taxpayer in its return was under some misconception of law. Furthermore, the taxpayer denied its liability to be assessed to tax in India, as all sums received by it were on account of reimbursement of expenses only and did not bear the character of income. According to the revenue in the present case, the main business was being conducted in India, and it had not been compensated at all other than for meeting the expenses.

Held

On perusal of the provisions of the India-US tax treaty, especially Article 5(3) read with Article 7 of the tax treaty, the Tribunal gathered that the income attributable to the operation conducted by the PE would be taxable in India. The Tribunal referred to a letter from the taxpayer to the CIT(A) that explained the details of its role and distribution of its work profile with the HO. The letter clarified that the role of the branch office was mainly towards back-end engineering calculation and drafting according to the direction, instruction and guidelines provided by the HO. The branch office was also exclusively doing research and development work for the HO, and it was being done exclusively by the Indian branch, which was the taxpayer's core business. The Tribunal declined to accept that such work was preparatory or auxiliary in character within the ambit of Article 5(3)(e) of the India-US tax treaty. The Tribunal concluded that the important work assigned to the Indian branch office by the HO was to minimise their service costs and other expenses by assigning and appointing highly technical and materially skilled professionals to discharge the main function of the HO in India at a low cost. In the case of Morgan Stanley (*supra*), the SC had held that employees who were highly experienced in their specialised fields had lent their expertise to the Indian entity, and in that sense there was a service PE under Article 5(2)(1) of the India-US tax treaty. Therefore, the case law relied on by the taxpayer was distinguishable from the facts and circumstances of the present case. The Tribunal concluded that the taxpayer was a PE in India as per provisions of Article 5(2)(b) and (c) of the India-US tax treaty.

Consent fee paid to the SEBI not be equated with a "penalty", allowable as business expenditure under section 37

ITO *v.* Reliance Share & Stock Brokers Pvt. Ltd. [2014] 51 taxmann.com 215 (Mumbai - Tribunal)

When the Securities and Exchange Board of India (SEBI) accepted the consent application without admitting or denying guilt by the taxpayer-stock-broker, the resultant consent fee paid to the SEBI were mere technical violations, not to be related as "penalty". The fee was paid for the purpose of business, to settle a dispute with SEBI and to be able to conduct business without interruption. Thus, the consent fee was allowable as business expenditure under section 37 of the Act.

Facts

Reliance Share & Stock Brokers Pvt. Ltd. was a company engaged in stock-broking business. The SEBI had recommended suspension of the Certificate of Registration of the taxpayer as a stock-broker for a period of nine months for violating the various regulations framed by it, which was ultimately reduced to four months. The taxpayer challenged the said order by filing an appeal before the Securities Appellate Tribunal. While the said appeal was pending, the SEBI issued a circular whereby it agreed to settle the disputes in consideration of a 'consent application' submitted by the taxpayer on payment of a consent fee. Accordingly, the taxpayer filed a consent application with the SEBI wherein it agreed to pay a sum of INR 5 million, without admitting or denying the guilt alleged by the SEBI, as an amount towards settlement charges, legal expenses and administrative expenses.

The TO, during the course of assessment, considered the said amount as a compounding fee paid for offences committed under the SEBI (Stock-Brokers and Sub-Brokers) Regulations, 1992. Accordingly, the TO held that it was a penalty paid for infraction of law and, hence, disallowed the said claim. On appeal, the CIT(A) deleted the disallowance made by the TO. Aggrieved by the order, the Revenue filed an appeal with the Tribunal.

Held

The Tribunal observed that that it was apparent from the circular issued by the SEBI that instances of administrative/civil actions which included, among other things, orders of suspension from trading, etc., were different from criminal actions. Furthermore, it was apparent from the order of SEBI that the irregularities alleged against the taxpayer were 'technical violations' and had not been awarded any monetary fines. Also, the SEBI had accepted the consent application without admitting or denying the guilt. Therefore, the Tribunal opined that the fee paid could not be equated with a "penalty" which had necessarily to be a punishment for infraction of a law or a regulation having statutory force. On the contrary, the fee was claimed to have been paid for the purposes of business to settle a dispute with the SEBI and to be able to conduct its business without interruption. Thus, if the concerned impost was purely compensatory in nature, this was an allowable expense under section 37 of the Act. Accordingly, the Tribunal held that the fee could not be equated with a penalty and is a payment to enable the taxpayer to carry out its business in the normal course, and thus was an allowable expense.

Editor's note

Before any amount is considered as penalty or akin to penalty, one needs to examine the nature of expense and if this is compensatory in nature, it should be allowed as a deduction.

Share-trading loss to be set-off against derivative profits before applying Explanation to section 73 of the Act

DCIT *v.* Baljit Securities Pvt. Ltd. [TS-651-ITAT-2014(Kolkata - Tribunal)]

Since both delivery-based transactions and derivative transactions are non-speculative as far as section 43(5) of the Act is concerned, both will have the same treatment as far as application of the Explanation to section 73 of the Act is concerned. Therefore, aggregation of the share trading loss and profit from derivative transactions should be done before the Explanation to section 73 of the Act is applied.

Facts

The taxpayer was engaged in the business of stock broking, purchase and sale of delivery-based shares and derivative trading. The taxpayer incurred loss on delivery-based trading of shares which was set off against profit on trading in derivatives. The TO during the course of assessment proceedings divided the business of purchase and sale of shares into two separate headings, namely trading in shares and trading in derivatives. The TO, thereafter, applied the Explanation of section 73 of the Act and denied the claim of set-off of loss from dealing of shares against profit from derivative transactions.

The taxpayer appealed to the CIT(A) who allowed the claim of the taxpayer by holding that share-trading loss is to be allowed to be set off against the profits earned in derivative transactions before applying the Explanation of section 73 of the Act. Aggrieved by the order of the CIT(A), the Revenue filed an appeal with the Tribunal.

Held

Section 43(5) of the Act, which contains the definition of 'speculative transaction', applies only for purposes of section 28 of the Act i.e. it does not apply to the

other sections of the Act. On the contrary, Explanation to section 73 of the Act creates a deeming fiction that if certain companies suffer loss on trading in shares, such loss should be treated to be speculative loss within the meaning of section 73 of the Act, notwithstanding the fact that the transaction is not of speculative nature as defined in section 43(5) of the Act.

Under the definition of section 43(5) of the Act, trading of shares which is done by taking delivery does not come under the purview of the said Section. Similarly, under clause (d) of section 43(5), a derivative transaction is also not a speculation transaction. Therefore, profit /loss from both share-delivery transactions and derivative transactions has the same meaning, so far as section 43(5) of the Act is concerned. Therefore, it follows that both will have the same treatment as far as application of the Explanation to section 73 of the Act is concerned. Therefore aggregation of the share-trading loss and profit from derivative transactions should be done before the Explanation to section 73 of the Act is applied.

Editor's note

Certain entities such as stock-brokers engaged in proprietary trading could be subject to additional tax in case loss from trading in shares is not allowed to be set off against income from trading in derivatives. This decision provides relief to such entities and is in line with the decision of the Special Bench of the Mumbai Tribunal in the case of CIT v. Concord Commercial Pvt. Ltd. [2005] 95 ITD 117 (SB).

Case Law

Tax withholding

The Tribunal holds the taxpayer liable for tax withholding under section 195 on non-resident seller's proportionate sale consideration

Shri R. Prakash *v.* ITO [TS-605-ITAT-2014 (Bangalore - Tribunal)]

The Tribunal held the taxpayer was in default for non-withholding of tax under section 195 of the Act while making payment to a non-resident on purchased property. The Tribunal, in its order, also rejected the claim of the Revenue of withholding tax on the entire amount of sale consideration paid by the taxpayer, in the case of joint owned property.

Facts

R. Prakash (the taxpayer) purchased a residential house property in Bangalore for INR 12 million during financial year (FY) 2008-09. The property belonged to Mrs. Shyamala Vijai and her daughter Mrs. Poornima Shivaram (non-resident), both 50% co-owners of the property. Mrs. Shivaram had given a General Power of Attorney (GPA) to her mother, who executed the sale deed in favour of the taxpayer for her daughter and herself. The TO held the taxpayer to be in default under the provisions of section 201(1) of the Act on account of failure to withhold tax at source as required under section 195 of the Act at the time of paying sale consideration to the non-resident seller and raised a tax demand under section 201(1) of the Act.

Aggrieved by the order of the TO, the taxpayer filed an appeal before the CIT(A). The taxpayer contended that Mrs. Vijai was the absolute owner of the property and her daughter was shown as a joint owner only by way of abundant caution. Also, Mrs. Vijai had invested the entire capital gain for purchase of a new property and was entitled to claim exemption under section 54F of the Act and therefore, no capital gain was chargeable to tax in the hands of Mrs. Vijai. Hence, there was no requirement on the part of the taxpayer to withhold taxes under section 195 of the Act. The CIT(A), however, rejected the taxpayer's contention, observing that the sale deed in respect of the property indicated that Mrs. Vijai (resident) and Mrs. Shivaram (non-resident) were the joint owners of the property. Also, the Sale Deed was signed by Mrs. Vijai in two capacities i.e. once for herself and again as the GPA holder of her daughter. The CIT(A) upheld the order of the TO and accordingly dismissed the appeal of the taxpayer. Aggrieved by the order of the CIT(A), the taxpayer filed an appeal before the Bangalore Tribunal.

Held

The Tribunal noted that Mrs. Vijai and Mrs. Shivaram are entitled to equal share over the property. The share of each of the owners in the sale consideration would be INR 6 million. Mrs. Shivaram is, admittedly a non-resident and to the extent of INR 6 million paid to Mrs. Vijai (on behalf of her daughter), the provisions of section 195 of the Act are attracted and the taxpayer should have withheld tax at source while making payments to the non-resident through Mrs. Vijai.

The Tribunal referred to the case of Syed Aslam Hashmi *v.* ITO [ITA No. 1313/Bang/2010 & 1076/Bang/2012], wherein it was held that under section 195 of the Act, tax had to be withheld on the entire sale consideration instead of the capital gain arising out of the transfer of a capital asset. The Tribunal distinguished the above case on the fact that in the above case the payment of the entire sale consideration was made to a non-resident while in the present case, the non-resident was entitled only to half of the sale consideration. The Tribunal held that *"the taxpayer can be considered as an 'taxpayer in default' only to the extent of INR 6 million paid to the non-resident. Levy of consequential interest under section 201(1A) should be modified accordingly."*

TDS Credit

Tax cannot be demanded from deductee for deductor's failure to issue tax withholding certificate

Executors of the Estate of S. Shanmuga Mudalidar *v.* ACIT [TS-571-HC-2014(Madras)]

The taxpayer shall not be called upon to pay the tax himself to the extent to which the tax has already been withheld from the income. The only course open to the Revenue is to recover the amount from the very person who has withheld it.

Facts

The taxpayer, a landlord, had rented out a building to Union Motors Services Limited (tenant).The tenant had withheld tax while paying the rent to the taxpayer, but failed to issue the TDS certificate and to credit the amount during AY 2001-02. The taxpayer, while filing the tax return, submitted that though the tenant had not furnished the TDS certificate according to the requirements of the Act, the taxpayer was nonetheless entitled to tax credit as INR 0.275 million had already been withheld. The TO did not give the credit of taxes withheld at source by the tenant as the appellant could not furnish the TDS certificate for this amount. The taxpayer filed an appeal against the assessment order before the CIT(A). The CIT(A) also confirmed the order passed by the TO. The taxpayer filed an appeal before the Tribunal and the Tribunal confirmed the CIT(A)'s order. However, the Tribunal modified the order to allow the taxpayer to approach the TO and file all necessary evidence to show that the tax has already been withheld at source.

Held

Once the tax had been withheld from the income, the bar under section 205 of the Act came into operation and it was immaterial as to whether the tax withheld at source had been paid to the credit of the Central Government or not, because elaborate provisions were made under the Act for recovery of tax withheld at source from the person who had withheld such tax. The HC, relying on Smt. Ansuya Alva *v.* DCIT [2005] 278 ITR 206 (Karnataka), held that the provision is to provide a protection to the taxpayer and to prevent the revenue from embarking on recovery proceedings in respect of such an amount. It is not possible to understand the word 'deduct' occurring in section 205 of the Act as 'deducted and remitted'. The Act prevents the Revenue from demanding the tax withheld at source from the taxpayer who has suffered a deduction. The Revenue is at liberty to proceed against the tenant (in the hands of the official liquidator of Union Motors Services Ltd) with respect to the tax withheld in question.

Case law

Non-compete fee paid by the firm to one of its partners held as capital expenditure

DCIT *v.* ATW Technologies Pvt. Ltd. [TS-565-ITAT-2014 (Bangalore - Tribunal)]

Facts

Mr. X, along with another partner, constituted a partnership firm on 16 March 2000. Subsequently, on 16 March 2001, a company (the taxpayer) was formed where both the partners were directors.

On 1 April 2001, Mr. X entered into a non-compete agreement with the firm for not entering into any business carried out by the firm during the period of the relationship and three months thereafter, for which he received a payment of INR 9.9 million.

On 1 April 2002, the firm was taken over by the taxpayer along with its assets and liabilities. Subsequently, the taxpayer filed the return of income for AY 2003-04 claiming deduction of INR 9.9 million as revenue expenditure for discharging the liability of the firm which was taken over by the taxpayer. The TO disallowed the claim of the taxpayer, treating this as capital expenditure. The CIT(A) deleted the disallowance on the basis that the payment was made to get the expertise and non-competition from Mr. X, and not for acquiring any source of income.

Held

On appeal against the the CIT(A)'s order by the revenue, the Tribunal observed that Mr. X had already undertaken a job in the capacity of a director similar to that of the firm before execution of the agreement, and this created suspicion about the agreement being *bona fide*.

The liability ought to have been discharged by the firm for the accounting period ending March 2002, and not by the company in the subsequent year, and hence, the taxpayer cannot claim it in AY 2003-04.

The Tribunal also held that the payment to Mr. X was not related to his expertise but was related to restraining him from doing the same business, and was of an enduring nature and therefore, capital expenditure.

Editor's note

This judgement of the Tribunal is one of many judgements on the much debated position of the nature of non-compete fees. The decision relies heavily on the Delhi HC judgement in the case of Sharp Business System v. CIT [2012] 27 taxmann.com 50 (Delhi). The Tribunal has concurred with the Delhi HC that the Courts need to take a fact-based approach to decide whether the non-compete fee falls within the purview of revenue expenditure or capital expenditure. But the broader test is that if expenditure is incurred for creating a source of income which will give enduring benefit, then the expenditure is capital in nature.

Capital loss on redemption of preference shares allowed

Consolidated Finvest & Holdings Ltd. *v.* ACIT [TS-576-ITAT-2014 (Delhi - Tribunal)]

Facts

The taxpayer company advanced sums from time to time to a group company. The loan was structured as 0% Optionally Convertible Preference Shares (OCPS), issued at a premium.

During the FY 2001-02, the taxpayer sold a part of the OCPS and claimed capital loss, which was accepted by the tax authorities. Subsequently, due to a change in the SEBI guidelines, the group company (being a listed company) converted the balance of OCPS into 2% Redeemable Cumulative Preference Shares (RCPS), which were redeemed by the group company during the FY 2006-07. The taxpayer company claimed long-term capital loss on redemption of RCPS.

The TO, relying on the ratio laid by the SC in the landmark judgement of McDowell and Co. Ltd [1985] 154 ITR 148 (SC), disallowed the capital loss alleging that the whole transaction was a sham, entered with the sole purpose of transferring funds from one company to another and in the process generating long-term capital loss. The CIT(A) upheld the order of the TO.

Held

The Tribunal allowed the taxpayer company's claim of capital loss stating that a transaction between two group companies could not be presumed to be a sham or bogus merely because it had resulted in a long-term capital loss. It further held that even when transactions were preplanned, if there was nothing to impeach the genuineness of the transactions, the rule of tax avoidance in the McDowell and Co. Ltd. case *(supra)* would not be applicable because every citizen was free to carry out his business within the four corners of the law. Since all the earlier transactions were accepted by the Revenue, the present transaction could not be declared as a sham transaction.

Editor's note

Time and again various Indian courts and judicial authorities have upheld that any transaction cannot be regarded as a sham transaction merely because it has resulted in a benefit to the taxpayer, if it has been carried out within the four corners of the law and without defeating the intent of the legislation, and this case reinforces this.

Depreciation on goodwill allowed as a result of amalgamation

DCIT *v.* Toyo Engineering India Ltd [TS-655-ITAT-2014 (Mumbai - Tribunal)]

Facts

Pursuant to the scheme of amalgamation approved by the Bombay HC, Casablancas Gannon Engineering Limited (the transferor company) merged with the taxpayer company, Toyo Engineering India Limited (the transferee company). The taxpayer company held entire share capital of the transferor company. Per the order of the HC, the difference between the book values of assets and liabilities of the transferor company taken over by the taxpayer company and the book value of investments in the books of taxpayer company was to be recorded as 'goodwill'.

Accordingly, the taxpayer company claimed depreciation on such goodwill under section 32 of the Act. However, the TO disallowed the claim of the taxpayer. On appeal, the CIT(A) ruled in favour of the taxpayer and allowed depreciation on goodwill arising on amalgamation. Aggrieved by the order, the revenue filed an appeal before the Tribunal. The revenue's appeal on the above basis was allowed by the Tribunal, and it upheld the TO's order. On appeal, the Bombay HC restored the matter to the Tribunal for fresh adjudication in light of the recent judgement of the SC in the case of Smifs Securities Limited [2012] 348 ITR 302 (SC).

Held

There was no dispute with respect to either the nature or quantity of goodwill. It was a settled issue that goodwill arising on amalgamation was eligible for depreciation under the Act in view of the judgement of the SC in the case of Smifs Securities Limited (*supra*).

Editor's note

This ruling is in conformity with the decision pronounced by the SC in the case of Smifs Securities Ltd. (supra) allowing depreciation on goodwill recognised in the books of the transferee company consequent to amalgamation. There has, however, been no discussion in these decisions on whether Explanation 7 to section 43 of the Act, which states that the cost of the transferred asset in the hands of the amalgamating company shall be considered as the cost in the hands of amalgamated company, needs to be considered while determining this issue.

Stamp duty

Incidence of stamp duty on merger where transferor company has only investments as assets

Holcim (India) Pvt. Ltd. Order dated 07 August 2014 by Collector of Stamps, Delhi

Pursuant to the scheme of amalgamation, no movable or immovable properties were transferred from the transferor company to the transferee company except investments in shares in other companies (which were held in dematerialised form). The stamp duty authorities held that the stamp duty is payable on the order of the HC for merger irrespective of the transfer of underlying assets. Decision in the matter of Delhi Towers Ltd. v. GNCT [CA No. 466/2008 in Company Petition No. 50/2003], Delhi HC has stayed the said order.

Facts

Pursuant to the scheme of amalgamation approved by the Delhi HC *vide* order dated 14 November 2011, Ambuja Cements (India) Private Limited (the transferor company) merged with Holcim (India) Pvt. Ltd. (the transferee company). Consideration was discharged by the transferee company to the shareholders of the transferor company in the form of issue of equity shares.

The transferor company did not possess any movable or immovable assets except investment in shares of other companies, which were held in dematerialised form. Since transfer of shares held in dematerialised form is specifically exempt under section 8A of the Indian Stamp Act, 1899, no stamp duty was paid by the transferee company on amalgamation.

Held

The stamp duty authorities, relying on the ratio laid down in the case of Delhi Towers (*supra*), held that

the amalgamation scheme sanctioned by the HC and the order was an 'instrument' within the meaning provided under section 2(i) of the Indian Stamp Act, 1899 and stamp duty was leviable on such instrument. In the present case, shares held by the transferor company in other companies were mere assets which were not transferred individually, but all the assets and liabilities constituting an undertaking were transferred by the transferor company to the transferee company as a 'going concern' in a scheme of amalgamation. Hence, stamp duty was payable on the 'instrument' of transfer (as 'conveyance' under Entry No. 23 of Schedule I-A of the Indian Stamp Act, 1899) at 3% of the amount of consideration.

On appeal by the transferee company, the Delhi HC stayed the demand and ordered the stamp duty authorities to file a counter affidavit *vide* its order dated 29 August 2014. *Prima facie* the HC, assenting with the view of the transferee company, stated that an instrument for transfer of an asset, which is otherwise exempt under the Act, would not attract stamp duty simply because the transfer is affected by virtue of a judicial order.

Editor's note

The matter is currently pending disposal by the HC. Since presently, there is no specific entry for levy of stamp duty on merger in Delhi, it is interesting to see if the HC will bring more clarity on the application and levy of stamp duty on mergers in Delhi, which is a subject matter of dispute in many cases.

Pricing appropriately
Transfer Pricing

Prelude

The Shell shock is over! The latest verdict of the Hon'ble HC on the multi-million dollar tax dispute (the dispute pertained to alleged undervaluation of shares issued by their domestic subsidiaries to the parent companies abroad) in the case of Shell and Vodafone have brought in much needed relief to global investors. The decision is not just for Vodafone or Shell but for all investors who have faced adjustments on issuance of shares. The Hon'ble HC decision is a significant development, and it follows the judgement in the Vodafone case wherein it was ruled that Indian transfer pricing provisions would not apply to a transaction involving issuance of shares by an Indian company to its foreign parent as there is no income arising therefrom. The announcement that the Government would not contest the Vodafone decision (*infra*) means that the Government has accepted the HC's decision - another positive signal to global investors. The decision is also timely in view of our Prime Minister's invitation to the world to manufacture and invest in India. This will certainly help in boosting the "Make in India" campaign and the overall investment climate of the country. This decision of the HC endorses a new regime for transfer pricing that holds promise of certainty and realism in the years to come.

On the global front, September has been an important month in the field of transfer pricing as some of the deliverables of the Base Erosion and Profit Shifting (BEPS) action plan were agreed in consensus by the OECD and G20 countries. This is also summarised in this communique.

Case law

Issue of shares at a premium does not give rise to any "income" from an international transaction; transfer pricing provisions cannot be invoked

Vodafone India Services Pvt. Ltd. *v.* UOI [2014] 50 taxmann.com 300 (Bombay-HC)

The taxpayer had issued equity shares of the face value at a premium to its associated enterprises (AEs). During the assessment proceedings, the transfer pricing officer (TPO) alleged that the shares were undervalued and concluded that the difference in the value of the shares multiplied by the number of shares issued was an income chargeable to tax. The TPO also deemed the shortfall as a loan provided by the taxpayer to the holding company and imputed notional interest on it.

The taxpayer, in the first writ petition, challenged these adjustments as being illegal and without jurisdiction. This was on the ground that the purported undervaluation could never have been brought under the ambit of taxation by taking course to transfer pricing (TP), as the same was on capital account. The HC directed the Dispute Resolution Panel (DRP) to decide the taxpayer's preliminary issue of jurisdiction. However, the DRP held the undervaluation of shares as income chargeable to tax. Furthermore, it imputed notional interest on the alleged undervaluation by treating it as deemed loan. Against the said order of the DRP, the taxpayer filed a second writ petition before the HC.

In the second writ proceeding, the HC categorically held:

- "Income" arising from an international transaction was a condition precedent for application of Chapter X of the Act. The objective of the legislation was certainly not to punish MNEs and/ or AEs for doing business *inter se*;
- Parliament had consciously not brought to tax amounts received from a non-resident for issue of shares as it would discourage capital inflow from abroad;
- Arm's length price (ALP) was a recomputation exercise to be carried out only when income arose in an international transaction between AEs. It did not warrant the recomputation of a consideration received/ given on capital account;
- The issue of shares at a premium was a capital account transaction and not income. The amount received on issue of shares was admittedly a capital account transaction not separately brought within the definition of income, except in a few cases specifically covered by the Act. Therefore, absent express legislation, any amount received, accrued, or arising on capital account transaction could not be subject to tax as income.

The HC allowed the petition in terms of the findings stated above and set aside the orders as being without jurisdiction, and null and void.

Editor's note:

The judgement delivered by the Hon'ble Bombay HC in favour of the taxpayer is a welcome judgement as the transaction of issue of shares was nothing but a capital account transaction, and consequently the share premium, if any, ought to be a capital receipt. The judgement will not only serve as a precedent in the legal arena but will also lend a much needed boost to foreign investors.

In the case of the "soga shosha" business model (high volume, low risk, trading of goods), the "Berry ratio" is an appropriate profit level indicator

Mitsubishi Corporation India Pvt. Ltd. *v.* DCIT [TS-330-ITAT-2014(Delhi – Tribunal)]

The taxpayer, a wholly owned subsidiary of a Japanese company, one of the Japan's leading sogo shosha (Sogo Shosha or general trading companies are Japanese trading conglomerates, engaged in general trading or diversified range of products in every major market of the world, playing the role of trade intermediaries) or general trading companies. The taxpayer was engaged in two segments, namely, the trading segment i.e. import of goods from its AE for resale and service fees/commission income segment pertaining to sales and marketing services to the AE. The taxpayer had selected the transactional net margin method (TNMM) as the most appropriate method with the Berry ratio (gross profit/operating expenses) as the profit level indicator (PLI). The taxpayer mentioned in its functional, risk and assets (FAR) analysis that it was essentially in the business of providing sales support and coordination activities in relation to international transactions, and therefore was akin to a service provider rather than a trader. During the assessment proceedings the TPO and DRP rejected the PLI adopted by the taxpayer and were of the view that the transactions in question were trading transactions. Accordingly, an adjustment was proposed to the transfer price of the taxpayer.

On appeal, the Tribunal laid down the following observations:

Functional differences:

- It was the level of inventory which was the crucial factor in determining the kind of trading activity a taxpayer had carried out.
- In this regard, the Tribunal referred to the CBDT notification defining a wholesale trader with reference to, *inter alia*, its monthly inventory level being less than 10% and prescribing a lower tolerance range at one-third the level of the normal tolerance range.

Berry ratio:

- The Berry ratio (defined as ratio of gross profit to operating expenses) is used for distributor functions and its application could also be related to service providers with limited or no inventory management functions/ risks.
- The basis for the computation of the ALP, as set out in the Indian Regulations was not exhaustive but only illustrative and ended with the expression 'or having regard to any other relevant base' and accordingly does not prohibit the use of the berry ratio as a PLI.

Location savings:

- In any event, locational savings in the procurement of goods, even if any, will arise to the party actually buying the goods and not the party assisting such buying by way of acting as an intermediary.
- In the case of the taxpayer, it was not established by the revenue authorities that there existed a location saving.

Others:

- Zero inventory level, or even a low inventory level, is a significant factor in TP analysis and the methodology adopted for appropriate comparison must also factor for this peculiarity in a business situation.
- In respect of the re-characterisation of commission agent activity into trading activity, it was observed that was not open to the revenue authorities to reconstruct the financial statements of the taxpayer.

Based on the above observations, the Tribunal set aside the matter to the TPO's file for fresh consideration.

Editor's note:

The above judgement delivered by the Hon'ble Delhi Tribunal has helped the concept of the Berry ratio to blossom into a full blown flower from the initial seeds that were sown by the Tribunal itself in the case of GAP International Sourcing India Pvt. Ltd. v. ACIT [2012] 149 TTJ 437 (Delhi). The judgement has a direct impact on business models, and sends a message to the international investor community that Indian courts will not shy away from appreciating global business models, and Indian regulations are to be interpreted in a manner that is harmonious with business reality.

International developments

OECD guidance on transfer pricing aspects of intangibles – Revised Chapters I, II and VI

Organisation for Economic Cooperation and Development

In September, the OECD finalised its guidance on the TP aspects of intangibles. The revisions to the OECD guidelines clarify the definition of intangibles, provide guidance on identifying transactions involving intangibles, the treatment of local market features and corporate synergies as summarised below:

- Legal ownership by itself does not confer any right to retain residual returns derived by an Multinational Enterprise (MNE) group from exploiting the intangible. Legal ownership merely serves as a reference point for identifying and analysing controlled transactions relating to the intangible. Functional value creation remains at the forefront of revised guidance.
- New guidance is provided on how an MNE group member that merely provides funding without performing/managing the important functions and risks associated with development, enhancement, maintenance, protection and exploitation of intangibles would be entitled to a risk adjusted rate of anticipated return on its investment alone.
- Expanded guidance on the categorisation of intangibles which continue to be broadly split into "marketing intangibles" and "trade intangibles". Also, a definition of "unique and valuable intangibles" has been incorporated.
- Recognises the importance of distinguishing intangibles from market conditions or local market circumstances which are not capable of being owned or controlled.
- A brand is not the same as a trademark, as a brand can represent a combination of intangibles and/or other items including trademarks, reputational characteristics and goodwill. If features of a business allow a company to charge higher prices, such a contribution should be compensable, regardless of the terminology used.
- The use of valuation techniques as part of the five OECD transfer pricing methods is discussed along with examples to illustrate the updated guidance.

The key sections of guidance on the transfer pricing aspects of intangibles are yet to be finalised. As the OECD is trying to focus on the alignment of ownership and functions performed, global businesses will want to continue to monitor developments with respect to this Action 8 and will want to review their TP policy in view of these developments.

Transfer pricing documentation and country-by-country reporting

Organisation for Economic Cooperation and Development

In the month of September, the OECD also finalised its guidance in relation to transfer pricing documentation and country-by-country (CbC) reporting. The guidance from this report will replace the transfer pricing documentation guidance contained in Chapter V of the OECD Guidelines. Under the OECD's new guidance, MNEs are recommended to consider the following 3-tiered approach:

- ***Tier 1:*** a master file, containing specific information, relevant for all MNE group members – While the approach recommended in the OECD's guidance document is similar to the discussion draft, the guidance document is less prescriptive, and excludes one of the most controversial aspects of the discussion draft, which was the title and country of the principal office of each of the 25 most highly compensated employees. It also took back some of the other requirements in the discussion draft, including details of any transfer pricing matters under a tax treaty's mutual agreement procedure.
- ***Tier 2:*** a local file referring specifically to material transactions of the local taxpayer - The requirements in the local file appear to be more detailed and onerous than the discussion draft, particularly the new requirement to attach copies of any APAs and other tax rulings to which the local jurisdiction is not a party, but that are 'related to' the controlled transactions.
- ***Tier 3:*** a CbC report, containing high-level data with respect to the global allocation of the MNEs income and taxes and the certain measures of economic activity - The simplification of the CbC template is a welcome change for the business community. Proposals under the discussion draft which included detailed information on royalties, interest and service fees on an entity-by-entity basis and would have significantly

increased compliance costs for most companies, have been deleted in the final report.

In addition, while the OECD has stated that the reporting on the CbC template should not be used by tax administrations to propose transfer pricing adjustments based on a global formulary apportionment of income, it will undoubtedly have an effect on risk assessments and the direction of audits. For many MNEs, there will be challenges in extracting the information required to complete the report from their existing systems. Addressing this will add to the compliance burden.

In summary, this guidance seeks to provide a coherent and consistent framework under which MNEs should prepare global transfer pricing documentation, while simultaneously improving the ability of tax authorities to make better informed transfer pricing risk assessments. With the amount of extra information and disclosures required adding to the compliance burden of MNEs, the guidance is heavily skewed towards tax authorities. In September, the United Kingdom became the first country to formally commit to implementing the CbC report.

Taxing of goods and services
Indirect taxes

Case law

VAT/sales tax/entry tax/ professional tax

Full input tax deduction allowed to the taxpayer on the sale of taxable final product and exempt byproducts

State of Karnataka *v.* MK Agro Tech Pvt. Ltd. (2014-TIOL-1624-HC-KAR-VAT)

The Karnataka HC held that sale of taxable final product and exempt byproducts did not attract provisions of partial rebate claim, and the taxpayer was allowed the benefit of full input tax deduction.

Taxable event in the event of transfer of goods on right to use basis is the grant of right, and not the receipt of periodical lease rentals

State of Karnataka *v.* Lease Plan India Ltd. (2014-VIL-249-KAR)

The Karnataka HC held that the taxable event, in the event of the right to use goods, occurred when the goods were transferred from the lessor to the lessee on a right to use basis, and not upon receipt of periodical lease rentals. Accordingly, no VAT was payable on lease rentals received after the introduction of the KVAT Act in respect of the transfer of rights to use cars during the erstwhile Karnataka Sales tax Act regime.

CENVAT

Retention of 50% of the sales tax amount under the State Tax Concession Scheme treated as additional consideration for the levy of excise duty

CCE *v.* Maruti Suzuki India Ltd. (2014 (307) ELT 625)

The SC held that the retention of 50% of the sales tax amount under the tax concession granted by the State had to be treated as an additional consideration subject to central excise duty, since the deduction of sales tax was available only when the tax was actually paid to the Sales Tax department.

CENVAT credit cannot be denied merely because the original manufacturer was not traceable

Premraj Dyg & Ptg Mills Pvt. Ltd. *v.* CCE (2014 (306) ELT 145)

The Gujarat HC held that CENVAT credit used on an invoice issued by a registered manufacturer could not be denied merely because the original manufacturer was not traceable, if the appellant had taken reasonable steps as provided under rules.

Service tax

Technical support, including the marketing of products in India for a foreign holding company, qualifies as export

Microsoft Corporation (I) Pvt. Ltd. *v.* CST (2014-TIOL-1964-CESTAT-DEL)

The Delhi Tribunal held by majority that the business auxiliary services in the nature of technical support rendered by the Indian subsidiary for the foreign holding company, including the marketing of products in India, qualified as export of services as per erstwhile provisions of the Export of Services Rules, 2005 and would not be liable to tax.

Substantial benefit cannot be denied on a mere procedural lapse

BSNL *v.* CCE (2014-TIOL-1684-CESTAT-DEL)

The Delhi Tribunal held that the substantial benefit available to a service provider, of adjusting excess service tax paid against the subsequent liability, could not be denied merely due to a procedural failure on the part of the service provider.

Customs / foreign trade policy (FTP)

Customs duty leviable on the date of expiry of the warehousing period

Allied Fibres Ltd. *v.* CC (2014-TIOL-1783-CESTAT-MUM)

The Mumbai Tribunal held that customs duty was leviable on the date of expiry of the warehousing period, as the goods were deemed to be improperly removed from the warehouse even if the importer wanted to relinquish the title of the goods.

Refund of safeguard duty cannot be denied on bar of unjust enrichment

Bilcare Ltd. *v.* CC (2014 (308) ELT 166)

The Mumbai Tribunal held that the refund of safeguard duty could not be denied on bar of unjust enrichment when the importer had submitted a Chartered Accountant's Certificate showing that the amount of excess safeguard duty did not form part of the selling price, and the duty had not been passed on to the buyer.

EOU could not claim rebate on export of manufactured goods since goods cleared for export were exempt unconditionally

Positive Packaging Industries Ltd. (2014 (307) ELT 822)

In a revision application filed before the Department of Revenue, it was held that an Export Oriented Unit (EOU) could not claim a rebate on the export of manufactured goods, since goods cleared for export were exempt unconditionally, and there was no option to pay duty on those goods.

Notifications/ circulars

VAT/sales tax/entry tax/ professional tax

VAT exemption on sale of LPG for domestic use withdrawn in Gujarat

Notification No. (GHN-15) VAT-2014-S.51 (2) (41)-TH dated 23 September 2014

Effective 1 October 2014, the exemption from the levy of VAT on sale of Liquified Petroleum Gas (LPG) for domestic use has been withdrawn.

Service tax

No service tax is payable on the amount of foreign currency remitted to India from overseas by a foreign MTSO

Circular No. 180/6/2014-Service Tax, dated 14 October 2014

The CBEC has clarified that no service tax would be payable on the amount of foreign currency remitted to India from overseas by foreign money transfer service operators (MTSO). However, the following services would be liable to tax in this regard:

- Representation services or services rendered in the capacity of an agent by India bank/entity to MTSO;
- Services rendered by the bank/agent/sub-agent to an ultimate beneficiary or bank in India, for which a separate consideration has been charged.

Services rendered by a JV to its members and vice-versa would be liable to tax

Circular No. 179/5/2014-Service Tax, dated 24 September 2014

The Central Government has clarified that:

- taxable services provided for consideration by the Joint Venture (JV) to its members or vice versa, and between the members of the JV, were liable to tax;
- if the cash calls/ capital contributions by members of JV, were merely transactions in money, they would not be liable to tax.

Customs / foreign trade policy (FTP)

The Central Government has exempted specified goods required for the Airborne Early Warning and Control System Programme of Ministry of Defence

Notification No. 27/2014-Cus dated 18 September 2014

The Central Government has exempted specified goods required for the Airborne Early Warning and Control System Programme of Ministry of Defence from customs duties upon fulfilment of specified conditions.

Following the rulebook
Regulatory developments

FEMA

Foreign Direct Investment (FDI)

Hedging facilities for Foreign Portfolio Investors (FPIs)

A.P. (DIR Series) Circular No. 28 dated 8 September 2014

Presently, FPIs are allowed to hedge their currency risk on the market value of their entire investment in equity and/or debt in India through any Authorised Dealer (AD) bankers, subject to certain specified conditions.

With a view to enhance hedging facilities for FPIs holding securities under the Portfolio Investment Scheme (PIS), the RBI has permitted FPIs to hedge the coupon receipts arising out of their investments in debt securities in India falling due during the following twelve months. This facility is subject to the condition that the hedge contracts shall not be eligible for rebooking on cancellation. The contracts can, however, be rolled over on maturity, provided the relative coupon amount is yet to be received.

Hedging under the Past Performance Route

A.P. (DIR Series) Circular No. 34 dated 30 September 2014

The eligible limit for importers to contract on the hedging of the currency risk of probable exposures has been increased to 100% from the limit of 50%. Contracts already booked within the previous limit of 50% in the current FY shall be eligible for the difference arising out of the enhanced limits.

Issue of equity shares under the FDI scheme against legitimate dues

A.P. (DIR Series) Circular No. 31 dated 17 September 2014

Earlier, an Indian company was permitted to issue shares/convertible debentures under the automatic route to a person resident outside India against lump-sum technical know-how fee, royalty, ECBs (other than import dues deemed as ECB or Trade Credit as per the RBI guidelines) and import payables of capital goods by units in Special Economic Zones, subject to certain conditions.

With a view to provide greater flexibility, RBI has now permitted the issue of equity shares under the FDI scheme against any other funds payable by the investee company, provided remittance of such funds does not require the prior approval of Government of India or the RBI. However, this is subject to the following conditions:

- The equity shares shall be issued in accordance with the extant FDI guidelines on sectoral caps, pricing guidelines etc.;
- The issue of equity shares under this provision shall be subject to tax laws as applicable to the funds payable, and the conversion to equity should be net of applicable taxes.

Financial Services

Rating of fixed deposits of NBFCs- Eligible Credit Rating Agencies- SME Rating Agency of India Ltd. (SMERA)

RBI/2014-15/243, DNBS (PD).CC. No.410/03.10.001/2014-15, 25 September 2014

RBI has approved the SME Rating Agency of India (SMERA) as an 'approved credit rating agency). NBFCs may now use the ratings of SMERA for the purpose of rating their fixed deposits. The minimum investment grade rating for fixed deposits is "SMERAA".

Usage of ATMs – rationalisation of the number of free transactions – clarifications

RBI/2014-15/260, DPSS.CO.PD. No.659/02.10.002/2014-2015, 10 October 2014

- RBI has clarified that the number of mandatory free ATM transactions (inclusive of both financial and non-financial transactions) for savings bank account customers at other banks' ATMs has been reduced from the present five to three transactions per month for transactions carried out at the ATMs located in six metro centres, *viz*. Mumbai, New Delhi, Chennai, Kolkata, Bengaluru and Hyderabad.
- It is clarified that the overall cap remains unchanged, i.e. if transactions are carried out at both the six

metro centres and other locations, the total number of transactions (inclusive of both financial and non-financial) free of charge at other bank ATMs would continue to remain at five.

- Banks are free to offer more free transactions per month at other bank ATMs as well as at their own ATMs in any geographical location. Banks are also free to decide on the combination (for metro and non-metro locations) of free transactions while adhering to the minimum requirements.
- It is clarified that the applicability of free transactions (inclusive of both financial and non-financial) at other bank ATMs to small / no frills / basic savings deposit account holders as indicated in circular dated August 14, 2014 is subject to the provisions indicated in the respective Master Circular.

Revisions to Basel II- advanced approaches of operational risk - The Standardised Approach and Advanced Measurement Approach

RBI/2014-15/265, DBOD.No.BP. BC.43/21.06.017/2014-15, 16 October 2014

A comparison of the Reserve Bank guidelines on operational risk with the Basel Guidelines was made by RBI recently, based on which, revisions/additions to the guidelines have been made as described below:

- A parallel run is added as follows:
  - RBI would initially accord a provisional approval to the bank to migrate to The Standardised Approach (TSA), and the bank having such an approval will be required to perform calculation of capital as per Basic Indicator Approach (BIA) in addition to calculations as per TSA.
  - During the parallel run, RBI will continue to evaluate the readiness of the bank to adopt the TSA in order to reach a decision on whether to grant or withhold the final approval for the bank to adopt the TSA. RBI may withhold such approval if, during the parallel run, it becomes aware of information that materially affects its assessment of the readiness of the bank, or if any outstanding issue identified prior to the start of the parallel run has not been addressed.
  - RBI will recognise a parallel run only if it is based on an operational risk management framework assessed by RBI to be sufficiently satisfactory for the parallel run.
- Under the Alternative Standardised Approach (ASA), banks may aggregate retail and commercial banking (if they wish to) using a beta of 15%. Similarly, those banks that are unable to disaggregate their gross income into the other six business lines can aggregate the total gross income for these six business lines using a beta of 18%. As under the TSA, the total capital charge for the ASA is calculated as the simple summation of the regulatory capital charges across each of the eight business lines, *with negative gross income treated as described in paragraph 1.3 of the Guidelines.*
- The guidelines pertaining to the parallel run of TSA banks as explained in Para 1.6 of these Guidelines will apply *mutatis mutandis* to ASA banks.
- Banks with overseas branches and internationally active subsidiaries intending to implement Advanced Measurement Approach (AMA) should have the capability to calculate capital under the AMA on a global basis, even if the local regulators do not require the overseas branches to adopt AMA.
- The board of directors and senior management of each subsidiary/ overseas branch should be responsible for conducting their own assessment of the subsidiary's/overseas branch's operational risks and controls, and for ensuring that the subsidiary/overseas branch is adequately capitalised in respect of those risks.
- A bank should have techniques for allocating operational risk capital to business lines, *among various legal entities and across the banking group* for creating incentives to improve the management of operational risk, processes and practices throughout the bank. The bank should be able to demonstrate that the allocation will enhance transparency, risk awareness and operational risk management expertise in the bank.
- The bank should ensure that the bank's approach for weighting the four fundamental elements avoids the double counting of qualitative assessments or risk mitigants already recognised in other elements of the framework.

Framework for revitalising distressed assets in the economy – review of the Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)

RBI/2014-15/271, DBOD.BP.BC. No.45/21.04.132/2014-15, 21 October 2014

The RBI has recently reviewed the framework based on the representations received from banks and the Indian Banks' Association (IBA) on difficulties faced by them in its effective implementation, and has made the following revisions:

- SMA-2 reporting pushed to a weekly basis instead of daily
- Interbank exposures and crop loans exempted from reporting to Central Repository of Information on Large Credits (CRILC)
- Banks to report overseas lending by them to CRILC
- Not mandatory for offshore lenders to form JLF / be part of JLF
- Time limits for evaluation by an independent committee and development of a corrective action plan increased from 30 to 45 days
- Accelerated provisioning requirement to now apply only to banks with the responsibility to form JLF, and not to all consortium members
- Exit option now extended to all banks

Recent alerts

To download the PDFs of any of these alerts, please go to:

http://www.pwc.in/en_IN/in/services/tax/news_alert/2014/pwc-tax-and-regulatory-news-alerts-2014.jhtml

Date	Name	Subject Line
31 Oct 2014	http://pib.nic.in/newsite/erelease.aspx?relid=0	Liberalization of FDI norms in Construction Development Sector
30 Oct 2014	http://epfindia.com/Circulars/Y2014-15/IWU_BankingAgree_IW_19453.pdf	International workers now can receive Indian social security benefits in their overseas bank accounts
21 Oct 2014	Clarification with regard to Trust/ trustee as a partner in the Limited Liability Partnerships, Circular No. 37/ 2014	MCA clarification: Trust/ trustee not barred from being a partner in an Limited Liability Partnership
12 Oct 2014	Vodafone India Services Private Limited v. UOI (WP No. 871 of 2014, Bombay High Court)	Issue of shares - out of TP rigours - Rules Bombay High Court
1 Oct 2014	CBDT Notification No. 45/ 2014, dated 23 September 2014	Ministry of Finance notifies tolerance band for FY 2013-14
27 Sep 2014	Notification Nos. LAD-NRO/GN/2014-15/11/1576 and LAD-NRO/GN/2014-15/10/1577 dated 26 September 2014	REIT and InvIT Regulations - A Synopsis
26 Sep 2014	CIT *v.* Vatika Township Private Limited [TS-573-SC-2014]	Supreme Court provides clarity on prospective versus retrospective operation of tax amendments
17 Sep 2014	DCIT *v.* Winsome Yarns Limited [TS-546-ITAT-2014(Chandigarh)]	Compensation received for a transaction declared void ab initio is a capital receipt not chargeable to tax
12 Sep 2014	Omniglobe Information Tech India Private Limited v. CIT [TS-526-HC-2014(Delhi)]	BPO businesses are set-up upon commencement of training of employees
9 Sep 2014	A. T. Kearney India Private Limited v. ACIT [TS-527-ITAT-2014(Delhi)]	Deduction under section 10A cannot be denied to a taxpayer unless an 'arrangement' as required under section 80-IA(10) is proved
2 Sep 2014	http://epfindia.com/Circulars/Y2014-15/Coord_SchemeAmendment_13637.pdf	Amendments introduced in Indian social security schemes - statutory wage ceiling increased from INR 6,500 to INR 15,000 per month

Glossary

AE	Associated enterprise
ALP	Arm’s length price
AY	Assessment year
CBDT	Central Board of Direct Taxes
CENVAT	Central value added tax
CESTAT	Customs, Excise and Service Tax Appellate Tribunal
CIT(A)	Commissioner of Income-tax (Appeals)
DRP	Dispute Resolution Panel
FTS	Fees for technical services
FY	Financial year
HC	High Court
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
RBI	The Reserve Bank of India
SAD	Special Additional Duty of Customs
SC	Supreme Court
SEBI	The Securities and Exchange Board of India
The Act	The Income-tax Act, 1961
The tax treaty	Double Taxation Avoidance Agreement
The Tribunal	The Income-tax Appellate Tribunal
TO	Tax officer
TPO	Transfer pricing officer
VAT	Value added tax

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